



**DEPARTMENT OF THE TREASURY**  
**WASHINGTON, D.C.**

**SECRETARY OF THE TREASURY**

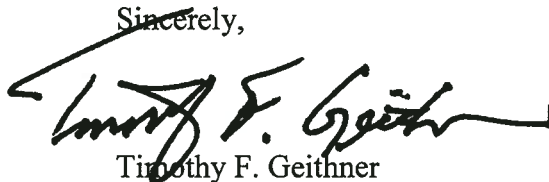
October 5, 2010

Dear Member of Congress:

Please find attached an update on the Troubled Asset Relief Program (TARP), the response to the financial crisis that was enacted by Congress in the fall of 2008 with strong bipartisan support and signed into law by President Bush. Since then, many have lost sight of the pressing need for this initiative at that time and criticized its successful implementation. Yet many nonpartisan researchers credit TARP with helping to avert a potential economic collapse. I hope this report will allow the American people and their representatives in Congress to reassess the initiative and its impact.

TARP undoubtedly helped to stem the financial panic in the fall of 2008 and contributed to the stabilization of the financial system. Congress has now enacted comprehensive financial reform to eliminate the need for future extraordinary government intervention into our financial markets. As these reforms are being implemented, we will also continue our work to give small businesses access to credit, prevent avoidable foreclosures, and reinforce private sector job growth.

Sincerely,



Timothy F. Geithner

Enclosure



UNITED STATES DEPARTMENT OF THE TREASURY  
OFFICE OF FINANCIAL STABILITY

# Troubled Asset Relief Program: Two Year Retrospective



Troubled Asset Relief Program  
Office of Financial Stability

October 2010

*"... if there's one thing that has unified Democrats and Republicans, and everybody in between, it's that we all hated the bank bailout. I hated it. You hated it. It was about as popular as a root canal.*

*But when I ran for President, I promised I wouldn't just do what was popular — I would do what was necessary. And if we had allowed the meltdown of the financial system, unemployment might be double what it is today. More businesses would certainly have closed. More homes would have surely been lost.*

*So I supported the last administration's efforts to create the financial rescue program. And when we took that program over, we made it more transparent and more accountable. And as a result, the markets are now stabilized, and we've recovered most of the money we spent on the banks."*

-- President Obama, January 27, 2010

#### TARP Summary Table:

As of September 30, 2010	Maximum Allocation	Total Spent	Repayments	% Repaid	Income
Bank capital programs	\$ 250	\$ 245	\$ 192	78%	\$ 26.8
Automotive companies	\$ 82	\$ 80	\$ 11	14%	\$ 2.6
AIG	\$ 70	\$ 48			
Credit Markets					
Public Private Investment Program <sup>1</sup>	\$ 22.4 <sup>1</sup>	\$ 14.2	\$ 0.43	3%	\$ 0.2
Term Asset-Backed Loan Facility	\$ 4.3	\$ 0.1			
SBA 7a Securities Purchase Program	\$ 0.4	\$ 0.4			*
Community Development Capital Initiative	\$ 0.8	\$ 0.6			
Treasury housing programs <sup>2</sup>	\$ 45.6 <sup>3</sup>	\$ 0.5 <sup>4</sup>	n/a	n/a	n/a
<b>Totals</b>	<b>\$475</b>	<b>\$388</b>	<b>\$204</b>	<b>53%</b>	<b>\$30</b>

\*Less than \$10 million as of 8/31/2010

1/ Amount was \$30 billion, but was reduced to \$22 billion in July 2010.

2/ Treasury's housing expenditures are not expected to be repaid and Treasury does not receive income or warrants related to these programs.

3/ Amount was \$50 billion, but was reduced to approximately \$46 billion in July 2010.

4/ Expenditures under the housing programs are made incrementally over time.

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## 1. Message from the Acting Assistant Secretary for Financial Stability

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October 5, 2010

Ladies and Gentlemen:

October 3, 2010 marked the second anniversary of the Emergency Economic Stabilization Act that created the Troubled Asset Relief Program (TARP) and the end of the authority to make new financial commitments. Therefore, this is an appropriate time to reflect on what TARP has accomplished.

The TARP was, and is, an enormous commitment of taxpayer money. And TARP has been unpopular for good reason -- no one likes using tax dollars to rescue financial institutions. However, by objective measures, TARP worked. Two years later, our financial system is stable, more than \$204 billion of TARP funds have been repaid, only a quarter of the original \$700 billion authorization remains outstanding, the total estimated cost of TARP has been cut by more than three-fourths, taxpayers have received \$30 billion in income, and the TARP bank programs are on track to make solid returns for taxpayers.

The ultimate cost of TARP and our other financial policies will depend on how financial markets and the economy perform in the future. If financial and economic conditions deteriorate, prospects for TARP investments will also deteriorate. But in light of the recently-announced AIG restructuring and when valued at current market prices, Treasury now estimates that the total cost of TARP will be about \$50 billion. In addition, using the same assumptions, we estimate that the combined cost of TARP programs and other Treasury interests in AIG will be about \$30 billion. The costs are expected to come from losses related to TARP investments in auto companies and initiatives to help responsible homeowners avoid foreclosure.

Going forward, the Department of the Treasury will continue to manage the investments prudently while working with the companies to recover as much of the taxpayers' funds as possible. We will also continue our efforts to help distressed homeowners. And we will take these steps while maintaining comprehensive accountability and transparency for the TARP programs.

This milestone also marked the departure, on September 30, 2010, of Herbert M. Allison, Jr. as the Assistant Secretary for Financial Stability. As Secretary Geithner has said, "the fact that TARP is now regarded by many experts as one of the most effective emergency programs in financial history is a direct result of Herb's leadership."

Sincerely,

Timothy G. Massad  
Acting Assistant Secretary for Financial Stability

## 2. Executive Summary

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October 3, 2010 marked the second anniversary of the Emergency Economic Stabilization Act (EESA) that created the Troubled Asset Relief Program (TARP) and the end of the authority to make new financial commitments.

EESA was an integral part of the government's program to resolve the financial crisis of 2008 and early 2009. Alongside the actions of the Federal Reserve and the FDIC, and the tax cuts and investments set forth in the American Recovery and Reinvestment Act, the financial actions authorized under EESA were critical in preventing a devastating collapse of our financial system and restarting economic growth.

We now have recovered most of the investments we made in the banks. Taxpayers will likely earn a profit on the investments the government made in banks and AIG, with TARP losses limited to investments in the automobile industry and housing programs. And we have already returned hundreds of billions of unused authority to the taxpayer to help reduce our debt and future budget deficits.

TARP, of course, was not the answer to all of America's challenges, and we have many still ahead. The U.S. economy is healing, but at a slower pace than we need. Millions of Americans are still out of work and at risk of losing their homes. Small businesses in many parts of the country still find it very hard to get access to credit. American families are still working to reduce debt and rebuild their savings.

And although the direct fiscal cost of the emergency financial programs will likely be a very small fraction of initial projections and significantly lower than the savings and loan crisis of the 1980s, the overall fiscal and economic costs of this crisis are substantial, and will take significantly more time to address.

The record of the financial programs is defined by the following key accomplishments:

- 1. TARP was remarkably effective in helping to unfreeze the markets for credit and capital, bring down the cost of borrowing, restore confidence in the financial system, and restart economic growth.**

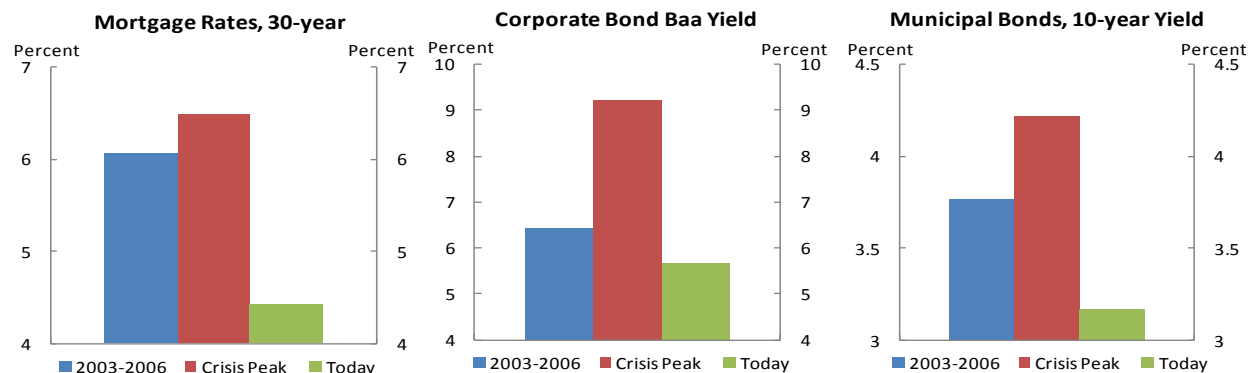
At the peak of the crisis, banks were not making new loans to businesses, or even to one another. Businesses could not get financing in our capital markets. Municipalities and state governments could not issue bonds at reasonable rates. The securitization markets—which provide financing for credit cards, student loans, auto loans and other consumer financing—had basically stopped functioning. The economy was contracting at an accelerating rate, with millions of Americans losing their jobs.

By the middle of 2009, because of the combined impact of the government's financial programs, borrowing rates had fallen sharply for businesses, individuals, and state and local governments. Companies were able to fund themselves in private markets by issuing equity and long-term debt. Housing prices began to stabilize. The value of the savings of American workers had begun to recover. And economic growth turned from negative to positive.

## 2. Executive Summary

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**Figure 2-A:**



### **2. The projected costs of TARP have fallen by about \$300 billion.**

Independent observers, such as the Congressional Budget Office, initially projected that TARP would cost \$350 billion or more. Now, because of the success of the program, TARP will likely cost a fraction of this amount.

We expect that TARP investments in the banks and the credit market programs will be profitable. The recently announced restructuring of AIG will accelerate the government's exit on terms that are likely to lead to an overall profit on the government's support for AIG, including the value of Treasury's interests in AIG held outside of TARP. Most of the cost of TARP is expected to come from two sources: expected losses related to TARP investments in auto companies and initiatives to help responsible homeowners avoid foreclosure.

The ultimate cost of TARP and our other financial policies will depend on how financial markets and the economy perform in the future. If financial and economic conditions deteriorate, prospects for TARP investments will also deteriorate. But in light of the recently-announced AIG restructuring and when valued at current market prices, Treasury now estimates that the total cost of TARP will be about \$50 billion. In addition, using the same assumptions, we estimate that the combined cost of TARP programs and other Treasury interests in AIG will be about \$30 billion.



## 2. Executive Summary

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**Figure 2-B:**

<b>Preliminary Treasury Estimates of the impact of TARP Programs and Other Treasury Investments in AIG on the Federal Budget <sup>1/</sup></b>	
	(\$U.S. billions)
TARP Bank Programs	16 <sup>2/</sup>
AIG (TARP)	-5 <sup>3/</sup>
TARP Credit Market Programs <sup>4/</sup>	1 <sup>2/</sup>
TARP Auto Programs	-17 <sup>2/</sup>
TARP Housing Programs	-46 <sup>2/</sup>
<b>Total TARP Cost</b>	<b>-51</b>
<i>Other Treasury AIG Investments</i>	<i>22 <sup>5/</sup></i>
<b>Total Treasury Cost</b>	<b>-29</b>

<sup>1/</sup> Estimates for AIG reflect the impact of the recently announced restructuring of the government's interests in the firm. Treasury and the Federal Reserve made several investments in AIG. These investments have been restructured over time and are closely intertwined. In particular, Treasury holds investments in AIG in two forms: equity investments made through TARP and equity provided to a trust for Treasury's benefit in connection with the Federal Reserve's creation of a credit facility for AIG.

<sup>2/</sup> Change from previously-published estimate primarily reflects increase in valuation of investments in Ally Financial Inc. (formerly known as GMAC, Inc.) due to improved market conditions.

<sup>3/</sup> After the proposed restructuring of AIG, TARP will hold 1.09 billion shares of AIG common stock, plus preferred equity interests in SPVs of approximately \$22.3 billion, against a cost basis of \$69.8 billion. Valuing the common equity at the market close for October 1 of \$38.86 per share implies a net cost of -\$5.1 billion.

<sup>4/</sup> Includes PPIP, TALF, CDCI and SBA.

<sup>5/</sup> After the proposed restructuring of AIG, Treasury will receive 563 million shares of AIG common in connection with the wind-down of the Federal Reserve credit facility, in addition to the shares noted in footnote 3. Valuing those shares at the market closing price for October 1 of \$38.86 per share implies a profit to the Treasury of \$21.9 billion.

Outside of TARP, we expect to incur substantial losses from Fannie Mae and Freddie Mac (Government Sponsored Enterprises, or GSEs), through capital injections from Treasury to the GSEs through the Preferred Stock Purchase Agreements (PSPAs). These losses stem from poor credit choices and bad risk management decisions before the Federal Housing Finance Agency (FHFA) placed the GSEs in conservatorship in late 2008--not actions taken in 2009 or 2010.

However, a substantial part of the government's projected losses on its support for the GSEs will be offset by revenue from two sources. Under authority provided by the Housing and Economic Recovery Act (HERA), Treasury purchased more than \$200 billion in mortgage-backed securities guaranteed by the GSEs. Those investments are generating notable returns. In addition, as a result of its emergency financial programs, remittances from Federal Reserve operations to the Federal Budget have increased sharply in 2009 and 2010, and they are projected to remain elevated for some time. While considerable uncertainty remains, revenues from these two sources will significantly offset to likely losses elsewhere.

We currently expect that the overall direct fiscal cost of all our financial interventions will be less than one percent of GDP. This result is notable compared past systemic financial crises. An International

## 2. Executive Summary

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Monetary Fund study found that the average net fiscal cost of resolving roughly 40 banking crises since 1970 was 13 percent of GDP. And according to the Government Accountability Office (GAO), the net fiscal cost of cleaning up the U.S. savings and loan crisis was 2.4 percent of GDP.

These estimates provide a meaningful way to compare the direct fiscal cost of resolving financial crises across countries and time. However, our estimates do not reflect the full economic and fiscal costs of this crisis, whether measured in the millions of Americans still searching for work, the lost income for business, or the impact of the recession on Federal and State budgets. But because TARP was so effective at much lower cost than expected, we are in a much stronger position than we would otherwise have been to address the very substantial economic challenges we still face as a country.

### 3. We are moving quickly to recover the government's investments and to withdraw from the financial system.

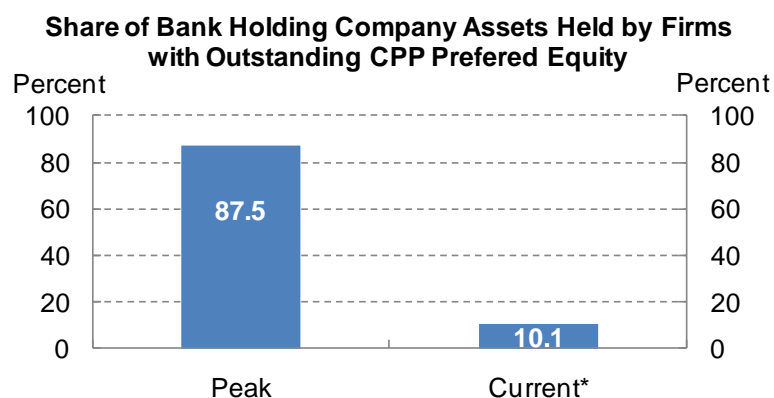
We have already made substantial progress in recovering taxpayer investments, ending emergency government programs, and exiting from the financial system.

In the most acute phase of the crisis at the end of 2008, TARP preferred stock investments were made in financial institutions that held approximately 88 percent of the total assets of our banking system. Today, we hold preferred stock investments in financial institutions that hold approximately 10 percent of the total assets of the system.

In just two years, we have already recovered three-fourths of the TARP funds invested in banks, and we have generated \$27 billion in income from our investments in banks.

We will finish selling our investment in Citigroup early next year. We will also exit from government investments in AIG and the automotive industry much faster than anyone predicted. General Motors is planning an initial public offering for later this year that will allow us to begin to sell down, and AIG has announced a restructuring plan that will accelerate the timeline for repaying the government and put taxpayers in a considerably stronger position to recoup our investment in the company.

**Figure 2-C:**



\* Excludes Citigroup common stock holdings which should be sold by early 2011.

## 2. Executive Summary

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We have closed or are in the process of winding down nearly all other emergency government programs. Treasury terminated the Money Market Fund Guarantee program last year, resulting in a profit to taxpayers. The FDIC's Temporary Liquidity Guarantee Program (TLGP) for debt is closed to new commitments, and the level of participation in the TLGP for transaction accounts has fallen to roughly one quarter of its peak. Nearly all of the Federal Reserve's liquidity programs have been shut down and generated significant revenues.

### **4. Two critical elements of the Obama Administration's strategy were the "stress test" to force banks to raise private capital and a series of innovative programs to jumpstart credit markets and financing for consumers, businesses, and homeowners.**

When President Obama took office many were convinced that the only way to stabilize the banking system was with large additional injections of public capital or nationalization – steps that would have entailed significant risks and costs. The President chose a different path, subjecting major U.S. financial institutions to a "stress test" and forcing them to strengthen capital through private fundraising. Since the results of the tests were released last May, those institutions have raised in the aggregate over \$150 billion in private capital. Only one of the 19 institutions subjected to the tests needed to access TARP after the results were released. And all but six of those institutions have repaid all TARP funds they received—at a profit to taxpayers.

One popular misconception is that Treasury under the Obama Administration injected massive amounts of TARP funds into large banks. In fact, since January 20, 2009, Treasury has provided only \$11 billion to banks under CPP, a large part of which went to over four hundred small and community banks. Meanwhile, the government has gotten out of the business of guaranteeing newly-issued bank debt. Nearly 50 percent of such new issuance was guaranteed by the government in January 2009. The government has not guaranteed one dollar of new issuance in 2010.

When the Administration took office, the credit markets that help provide access to loans to consumers and businesses had frozen. Treasury efforts to unfreeze these markets – including through the Term Asset-Backed Securities Loan Facility (TALF), the Public Private Investment Program (PPIP), and the SBA 7(a) Securities Purchase Program – have helped to make credit more available and are expected to generate revenues—not costs—for taxpayers. Since the government launched TALF in March 2009, prices for securities backed by consumer and business loans have improved significantly and new issuance of such asset-backed securities has averaged \$12 billion per month, compared to less than \$2 billion per month in the six months prior to the program's launch. Similarly, since the announcement of PPIP in March 2009, prices for eligible residential and commercial mortgage-backed securities (i.e., RMBS and CMBS) have increased by as much as 75 percent. As a result, both programs have helped remove significant impediments to new credit for consumers, businesses, and homeowners.

In addition, under TARP, Treasury launched the Making Home Affordable Program (MHA), which includes the Home Affordable Modification Program (HAMP).

After 18 months, HAMP has helped more than 1.3 million homeowners by reducing their mortgage payments to more affordable levels. This includes more than 460,000 homeowners whose mortgage terms have been modified permanently. These homeowners have experienced a 36 percent median reduction in their mortgage payments—more than \$500 per month—amounting to a total, program-wide savings for homeowners of more than \$3.2 billion. MHA has also spurred the mortgage industry to adopt similar programs that have helped millions more at no cost to the taxpayer.

## 2. Executive Summary

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In addition, Treasury launched the Housing Finance Agency (HFA) Innovation Fund for the Hardest Hit Housing Markets (HFA Hardest Hit Fund, or HHF) to help state housing finance agencies provide additional relief to homeowners in the states hit hardest by unemployment and house price declines, and Treasury and the Department of Housing and Urban Development (HUD) enhanced the FHA Short Refinance program to enable more homeowners whose mortgages exceed the value of their homes to refinance into more affordable mortgages if their lenders agree to reduce principal by at least 10%.

### **The U.S. financial system is much stronger today, and in a strong position to support economic recovery.**

The policy response to the crisis has brought about an essential restructuring of the financial system.

The weakest parts of the financial system no longer exist. Of the 20 largest financial institutions in the fall of 2008, four no longer exist as independent entities, five were subject to major interventions by regulators, two agreed to become subject to much greater oversight, and 10 have had significant changes in senior management. The firms that remain had to meet a market test for viability – they had to demonstrate they could raise substantial amounts of private capital.

Today, our financial system has substantially higher levels of capital relative to risk than before the crisis and more capital relative to global competitors. At the same time, we led the effort, working with other countries, to design and impose higher capital requirements internationally so that banks will not become so undercapitalized again.

And the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the Dodd-Frank Act) will significantly reduce the threat of future financial crises. No longer will a major non-bank firm escape comprehensive supervision and capital requirements. No longer will the government be left without the tools it needs to wind down a major firm in the event of a major financial crisis. No longer will derivatives or the shadow banking system be left in the dark. And no longer will consumers be left without adequate protection or the basic information they need to make sound choices.

### **The next stage of financial repair.**

Even though the most dangerous phase of the financial crisis is behind us, we still have substantial work to do to repair the damage.

The Administration will continue to help responsible but at-risk homeowners, while reforming the U.S. housing finance system. In addition to the MHA, the HFA Hardest Hit Fund and FHA Short Refinance programs discussed above, Treasury continues to support new housing credit through the Preferred Stock Purchase Agreements with Fannie Mae and Freddie Mac (the GSEs). Treasury is also working with HUD and other agencies to develop proposals to reform U.S. housing finance and restructure the GSEs. In recent months, we have received input from a variety of stakeholders to inform that process, and have held conferences to hear the views of citizen advocacy groups, economists, investors, market researchers, originators, securitizers, servicers, and private mortgage insurers on reform. We will provide a comprehensive reform proposal to Congress by January 2011 and will work to ensure the new system will deliver a more stable housing market with stronger regulation and a clearer role of government with less risk borne by the American taxpayer. Where guarantees or support is provided, it will be explicit and priced appropriately.

## 2. Executive Summary

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Beyond the measures taken under EESA, we are continuing to provide support for small businesses, many of which are still struggling to access credit, expand and hire new workers. Last week, the President signed into law the Small Business Jobs Act. This legislation establishes two new and separate Treasury lending initiatives: a Small Business Lending Fund that will provide up to \$30 billion in capital to community banks with incentives to increase their small business lending, and a State Small Business Credit Initiative that will spur \$15 billion in private sector lending by strengthening small business programs threatened by state budget cuts. The Small Business Jobs Act also includes enhancements to SBA programs that will help creditworthy small businesses access loans, as well as eight new small business tax cuts that provide incentives for small businesses to invest and expand.

Finally, there is still work to be done in managing our remaining TARP commitments. Foreclosure-mitigation programs will continue to require substantial oversight of mortgage servicers to ensure that these initiatives are effectively implemented. While most of the largest banks have repaid their obligations to TARP, we still have investments in over 600 banks. We will work with these institutions, and their regulators, to accelerate repayment where appropriate. We will also work to ensure that restructuring plans for our investments in AIG and the auto industry are executed successfully. And we will continue to be transparent in all of our efforts.

When TARP was created, the world around us was falling apart. And in that moment, when families and businesses were worried like never before about their basic economic security, leaders from both parties stood up, stood together, and as Americans, did what was best for the country. They did something unpopular, but necessary. And we are much better off as a result.

### 3. TARP Overview

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In this overview, we discuss why TARP was necessary, the results and current status of the actions taken under TARP, its costs, its effect on achieving stabilization of financial markets, and Treasury's plans to wind down the program.

#### **A. The Financial Crisis and the Need for the Troubled Asset Relief Program.**

In September 2008, the nation was in the midst of one of the worst financial crises in our history. The financial institutions and markets that Americans rely upon to protect their savings, help finance their children's education, and help pay their bills, and that businesses rely upon to make payroll, build inventories, fund new investments, and create new jobs, were threatened unlike at any time since the Great Depression. Across the country, people were rapidly losing confidence in our financial system and in the government's ability to safeguard their economic future.

The causes of the crisis will be studied for years, and this report is not meant to provide a comprehensive analysis of why the crisis occurred. But some reasons are clear. Over the two decades preceding the crisis, the financial system had grown rapidly in an environment of economic growth and stability. Risks grew in the system without adequate transparency. Lax regulations and loopholes in supervision let firms become highly leveraged and take on too much risk. Ample credit around the world fueled an unsustainable housing boom in the first half of the last decade. When the housing market inevitably turned down, starting in 2006, the pace of mortgage defaults accelerated at an unprecedented rate. By mid-2007, rising mortgage defaults were undermining the performance of many investments held by major financial institutions.

The crisis began in the summer of 2007 and gradually increased in intensity and momentum over the course of the following year. A series of major financial institutions, including Countrywide Financial, Bear Stearns, and IndyMac, failed; and Fannie Mae and Freddie Mac, the largest purchasers and guarantors of home loans in the mortgage market, came under severe stress.

By September 2008, for the first time in 80 years, the U.S. financial system was at risk of collapse. A growing sense of panic was producing the classic signs of a generalized run on the banks. Peoples' trust and confidence in the stability of major institutions, and the capacity of the government to contain the damage, were vanishing.

Our system of regulation and supervision had failed to constrain the excessive use of leverage and the level of risk in the financial system, and the United States entered this crisis without adequate tools to manage it. The Executive Branch did not have existing options for managing failures of systemically important non-bank financial institutions.

The Treasury Department, the Federal Reserve, the FDIC, and other government bodies undertook an array of emergency actions to prevent a collapse and the dangers posed to consumers, businesses, and the broader economy. However, the severe conditions our nation faced required additional resources and authorities. Therefore, the Bush Administration proposed EESA in late September, and with the support of Democrats and Republicans in Congress, it was enacted into law on October 3, 2008.

#### **B. The Bush Administration's Actions under TARP**

The TARP was originally proposed as a means for the government to buy mortgage loans, mortgage-backed securities and certain other assets from banks. The fact that it was not used for this purpose promptly after passage has led to criticism of the program. However, by early October 2008, lending even between banks had practically stopped, credit markets had shut down, and many financial institutions were facing severe



### 3. TARP Overview

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stress. It was also clear that there was not sufficient time to implement a program to buy mortgage-related assets, given the challenges of valuing troubled assets and quickly building the administrative infrastructure to purchase large volumes of those assets.

In this context, immediate capital injections were needed to stabilize the banks and avert a potential catastrophe. The law provided for this approach, because the authorities had been broadened in the legislative process to cover the purchase of any financial instrument if the Secretary of the Treasury, after consultation with the Chairman of the Federal Reserve, determined this was necessary to promote financial stability. This was also the approach that many other countries took at that time. Therefore, the Bush Administration launched the Capital Purchase Program and later the Targeted Investment Program to provide this support.

Under the Bush Administration, during the fall and winter of 2008, TARP funds were used as follows:

- \$234 billion was invested in banks and thrifts, including \$165 billion in eight of the largest financial institutions in the country, and additional funds were committed to guarantee assets of two of the largest banks;
- \$40 billion was invested in American International Group (AIG), along with additional funds from the Federal Reserve; and
- Approximately \$20 billion in loans was provided to the auto industry.

#### C. The Obama Administration's Actions under TARP

In January 2009, President-elect Obama faced a combination of acute financial and economic challenges. The economy was in a full-fledged recession. The nation had lost over 3.5 million jobs in 2008, and was losing additional jobs at the rate of roughly 750,000 per month in the first quarter of 2009. Businesses around the world were cutting back investments that are essential to growth. Trade among nations had contracted sharply. Home prices were falling, and foreclosures were increasing. Instead of catalyzing recovery, the financial system was working against recovery. The system was still fragile, and the recession was putting even greater pressure on banks. This dangerous dynamic needed to be halted immediately.

Together with the fiscal stimulus enacted under the American Recovery and Reinvestment Act, the Financial Stability Plan announced in February 2009 laid out the Obama Administration's comprehensive, forceful and sustained commitment to ensure the stability of the financial system, assist in the cleanup of legacy assets, jumpstart the provision of new credit for households and businesses, and support distressed housing markets. As part of that plan, the Treasury Department has taken the following actions under TARP over the last 20 months:

##### 1. Recapitalizing the Banking System

Our financial system needed to be recapitalized. But private capital could not be raised until the condition of the major financial institutions was made clear. Treasury worked with the federal banking regulators to develop a comprehensive, forward-looking "stress test" for the nineteen largest bank holding companies to determine which ones would need more capital to remain well-capitalized if economic conditions deteriorated significantly more than expected. The stress test was conducted with unprecedented openness and transparency, which helped restore market confidence in our financial system. Since completion of the stress test, these banks have raised an aggregate of more than \$150 billion in private

### 3. TARP Overview

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capital, and twelve of the stress test banks that had TARP investments have repaid the government in full. Treasury allowed banks needing capital to apply for further assistance from the government, but only one did so.

Treasury estimates that the capital programs developed under TARP to support all banks, taken together, will result in a gain to the taxpayer. See Section 5 – Program Descriptions, pages 22 – 33.

#### **2. Jumpstarting the Credit Markets that are Critical to Providing Financing to Consumers and Businesses**

Because the crisis had frozen credit markets, Treasury launched three programs to help restart them:

- The Term Asset-Backed Securities Loan Facility (TALF), a joint program with the Federal Reserve, helped to restart the asset-backed securitization markets that provide credit to consumers and small businesses;
- The Legacy Securities Public Private Investment Program (PPIP), matched TARP funds with private capital to purchase legacy mortgage-related securities; and
- The SBA 7(a) Securities Purchase Program, in which Treasury committed to help unlock credit for small businesses by providing capital in exchange for securities backed by small business loans.

Treasury estimates that these programs, taken together, will result in minimal or no costs under TARP. See Section 5 – Program Descriptions, pages 34 – 43.

#### **3. Stabilizing the Automotive Industry and AIG**

Treasury provided additional assistance to GM and Chrysler on the condition that those companies fundamentally restructure their businesses. These restructurings involved sacrifices from all stakeholders—shareholders, unions, auto dealers, and creditors—and have enabled the companies to become more competitive. This assistance also helped the many suppliers and ancillary businesses that depend on the automotive industry.

Treasury also took steps to restructure the assistance that had been provided to the American International Group, Inc. (AIG) under the Bush Administration. This involved making an additional commitment of support and working with AIG toward repaying the government by selling non-core businesses and completing other restructuring initiatives.

In Treasury's most recent official estimate, these investments will result in a portion of the costs under TARP. However, the prospects for repayment to the taxpayer are improving as the companies continue to strengthen. See Section 5 – Program Descriptions, pages 44 – 57.

#### **4. Support for Small and Mid-Sized Banks**

While the Obama Administration made no further investments in the nation's largest banks, Treasury invested \$11 billion in more than 400 other banks and thrifts, most of which were small and community banks. In recognition of the fact that they had fewer alternatives to raise capital, the smallest banks were also given additional time to apply for assistance. Because community development financial institutions serve small businesses and consumers in the communities hardest hit by the recession, communities which

### 3. TARP Overview

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are typically underserved by large financial institutions, a special program was established to help these institutions.

See Section 5 – Program Descriptions, page 33.

#### 5. Helping Responsible but Struggling Homeowners

When the Obama Administration took office, the nation's housing market had been in broad decline for 18 months. EESA authorities enabled Treasury to develop a voluntary program that would support servicers' efforts to modify mortgages, consistent with the protection of taxpayers. While the serious effects of the recession and financial crisis on the housing market and foreclosures persist, this Administration has taken aggressive action on many fronts, including under TARP, and has made considerable progress in helping to stabilize the housing market.

- Treasury launched the Making Home Affordable (MHA) program, which includes the Home Affordable Modification Program (HAMP), under TARP. HAMP has helped hundreds of thousands of responsible homeowners reduce their mortgage payments by an average of \$500 per month and avoid foreclosure. MHA has also spurred the mortgage industry to adopt similar programs that have helped millions more at no cost to the taxpayer.

As the housing crisis has evolved, Treasury has responded to the unemployment and negative equity problems by adjusting HAMP and instituting additional programs. For example:

- Treasury launched the Housing Finance Agency (HFA) Hardest Hit Fund to help state housing finance agencies provide additional relief to homeowners in the states hit hardest by unemployment and house price declines.
- Treasury and the Department of Housing and Urban Development (HUD) enhanced the FHA Short Refinance program to enable more homeowners whose mortgages exceed the value of their homes to refinance into more affordable mortgages.

To protect taxpayers, MHA housing initiatives have pay-for-success incentives: funds are spent only when transactions are completed and thereafter only as long as those contracts remain in place. Therefore, funds will be disbursed over many years. The total cost of the housing programs cannot exceed—and may be less than—\$46 billion, which is the amount committed to that purpose.

See Section 6 – Retrospective on the TARP Housing Initiatives, pages 58 – 79.

#### 6. Recovering TARP Funds

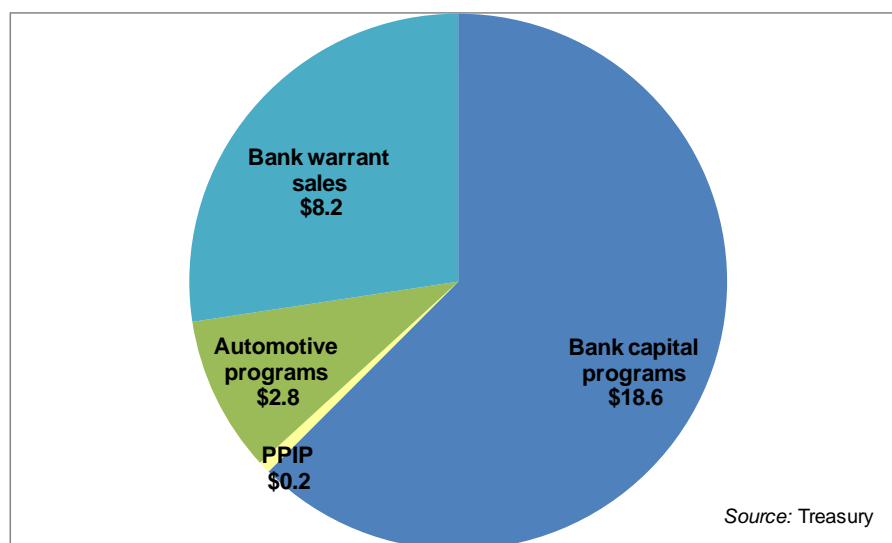
One of Treasury's primary objectives has been to get TARP dollars back. So far, more than \$200 billion has been returned. In addition, TARP investments have generated \$30 billion of proceeds to taxpayers, in the form of dividend and interest payments and sales of warrants.

The sales of warrants have been particularly successful. The law that created TARP requires, in most cases, an institution receiving TARP funds to give Treasury warrants that allow taxpayers to participate in potential additional returns when the institution regains financial stability. By negotiating effectively with banks seeking to repurchase their warrants directly, and by effectively auctioning the warrants of banks that elect not to repurchase, Treasury has received over \$8 billion in additional revenue for taxpayers.

### 3. TARP Overview

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**Figure 3-A: TARP Income as of September 30, 2010**



See Section 5 – Program Descriptions, page 26, for a description of certain institutions in the Capital Purchase Program that represent losses on TARP investments.

#### **7. Implementing Executive Compensation Restrictions**

The law that created TARP (as amended by the American Recovery and Reinvestment Act of 2009 (ARRA)) imposes restrictions on the executive compensation of top management of those institutions that received TARP funds. Treasury implemented regulations to enforce these restrictions, which included creating the Office of the Special Master for Executive Compensation. The Special Master has taken steps to ensure that executive pay at the TARP firms receiving exceptional assistance promotes long-term value creation and financial stability.

#### **8. Comprehensive Accountability and Transparency**

Treasury has operated the TARP programs with comprehensive standards for accountability and transparency. Voluminous data and information have been made public and available to taxpayers, observers and Congress on the websites – [www.FinancialStability.gov](http://www.FinancialStability.gov) and [www.MakingHomeAffordable.gov](http://www.MakingHomeAffordable.gov). This includes all contracts governing any investment or expenditure of TARP funds, and more than 275 reports over two years. Treasury will also publish in November comprehensive audited financial statements for the TARP programs, for the fiscal year ending September 30, 2010, as we did for the previous fiscal year.

#### **D. TARP Will Cost a Fraction of What Was Expected**

It is clear that TARP will cost taxpayers a fraction of the \$700 billion originally authorized. The Treasury Department's efforts have consistently reduced the program's cost. We will not use more than \$475 billion of TARP funds, including amounts already expended and recovered, and we expect to recover most of those funds, other than the funds spent on housing programs, which were not intended to be returned.

### 3. TARP Overview

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- In July 2010, the Obama Administration and Congress capped the amount that could be invested under TARP at \$475 billion, a one-third reduction from the original commitment authorized by Congress.
- More than \$204 billion of TARP funds expended have been repaid — including more than seventy-five percent of the money invested in large banks.
- TARP investments have already generated returns to taxpayers from dividends, interest and sales of warrants and other securities of \$30 billion.
- The pay-for-success features of TARP’s MHA housing programs assure that taxpayer funds are used only to the extent that programs achieve intended results. In addition, the TARP housing programs have also caused mortgage servicers to adopt similar programs that have helped millions more homeowners at no cost to the taxpayer.

The ultimate cost of TARP and our other financial policies will depend on how financial markets and the economy perform in the future. If financial and economic conditions deteriorate prospects for TARP investments will also deteriorate. But the most up-to-date Treasury estimates for TARP programs, including the impact of the AIG restructuring, now suggest that total fiscal impact of TARP will be to increase the Federal deficit by about \$50 billion. Moreover, other Treasury investments in AIG are expected to generate a positive return of about \$20 billion. See Figure 2-B “Preliminary Treasury Estimates of the Impact of TARP Programs and Other Treasury Investments in AIG on the Federal Budget” in Section 2 – Executive Summary, page 4.

#### E. Exit Strategy and Wind Down

Final purchase authority to make commitments under TARP expired on October 3, 2010. This means no new commitments to invest funds can be made. The Department of the Treasury will continue to wind down TARP and manage the remaining TARP investments prudently in order to recover as much of taxpayers’ funds as possible.

##### 1. TARP Investments

As of September 30, 2010, Treasury has approximately \$184 billion in TARP investments and commitments outstanding, in over 600 banks, the automotive industry, AIG, the Public Private Investment Program funds and the purchased SBA 7(a) securities<sup>1</sup>, but exclusive of the housing initiatives. Treasury intends to recover or dispose of these investments as soon as practicable. But generally, Treasury cannot demand repayment, so recovery requires that the institutions replace government support with private capital. This means that the timing of repayments by various institutions will differ, as will the times when the various TARP programs terminate. For example, under the bank capital support programs, some financial institutions are thriving and have the ability to repay Treasury now or in the very near future. Other institutions will need more time to recover and repay Treasury, as expected given the uneven impact of this financial crisis. Exit from the largest remaining investments – which are in the automotive industry and AIG – will also take time in order to protect the returns for the taxpayer.

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<sup>1</sup> The amount outstanding may be adjusted as further repayments are received and committed but undisbursed amounts for investments are made.

### 3. TARP Overview

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In most cases, the TARP investment is in the form of non-voting preferred stock, for which Treasury cannot demand repayment. In certain cases, Treasury owns common stock: in GM (61 percent of the outstanding shares) – for which an initial public offering is expected before year-end; Ally Financial (formerly GMAC, 56 percent); Chrysler (9 percent); and Citigroup (12.4 percent as of September 30, 2010). Upon consummation of the restructuring plan for AIG announced on September 30, 2010, Treasury will be the majority shareholder of AIG.

#### 2. Housing Initiatives

In this next phase of TARP, Treasury will also complete the implementation of the housing initiatives. HAMP, the principal TARP housing program, is designed so that most funds are disbursed over a five year period, on a “pay for success” basis. This ensures that taxpayer dollars are used only as long as mortgage modifications remain in effect and borrowers continue to fulfill their responsibilities.

Servicers that participate in HAMP can continue to make mortgage modifications through the end of 2012. The HFA Hardest Hit Fund permits participating state housing agencies to provide support through their programs until as late as 2017, depending on available funding. And the FHA Short Refinance program is designed to enable homeowners to refinance their mortgage loans and reduce their overall mortgage debt through the end of 2012. In much the same way that HAMP’s first lien modification program has provided a national blueprint for mortgage modifications, these new programs will continue to reshape the mortgage servicing industry and promote industry standardization of short sale, refinance and principal reduction programs. However, their cost cannot exceed—and may be less than—the \$46 billion allocated.

#### F. Financial Regulatory Reform

The actions taken to combat the financial crisis were, in part, the result of a fundamental failure of the structure of financial regulation. Regulators did not have the tools to break apart or wind down a failing financial firm without putting the entire financial system at risk. The FDIC’s resolution authority was limited to insured depository institutions and did not include their holding companies. Without changes to the system, there is a risk that TARP and other government actions had created “moral hazard”. That is, because the federal government stepped in to provide assistance, the private sector may assume federal government support will be there if they again cause a systemic risk to our financial system. Therefore, beginning in 2009, the Obama Administration fought to pass a comprehensive financial reform law to rein in excessive risk in our financial system so that we will not have to again resort to a TARP-like program. In July this year, Congress passed and President Obama signed into law the comprehensive financial reform legislation, the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010. The rules to implement the Dodd-Frank Act are currently being written. Among other things, the legislation will:

- Give the federal government the authority to shut down and break apart large non-bank financial firms whose imminent failure might threaten the broader system;
- Put in place a Consumer Financial Protection Bureau to promote transparency and consumer choice, and to prevent abusive and deceptive practices;
- Give financial regulators the tools they need to collect data and analyze risk in the entire financial system, beyond individual firms and markets, and to identify and curb reckless risk-taking, so that we can help prevent future crises; and
- Create a safer, more transparent derivatives market.



## 4. Stabilization of the Financial Markets

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*“There is broad consensus that the TARP was an important part of a broader government strategy that stabilized the U.S. financial system by renewing the flow of credit and averting a more acute crisis...it eventually proved decisive enough to stop the panic and restore market confidence.”*

- Congressional Oversight Panel, “Taking Stock: What Has the Troubled Asset Relief Program Achieved?”, (December 2009), page 4.

### A. TARP Contributed to Financial Stability

The Troubled Asset Relief Program has succeeded—faster, and at a much lower cost, than expected. TARP has played a critical role in helping to stabilize the financial system and in putting the economy in a better position to confront the challenges that lie ahead. Emergency government programs helped to stabilize financial markets by rebuilding confidence in our financial system, making it possible for U.S. homeowners, consumers, and businesses to borrow at lower costs and the U.S. to recover more rapidly from a severe recession. Financial market data shows that conditions have significantly improved since the fall of 2008.

- Fear that our major financial institutions could fail has receded.
- Credit markets important to consumers and small businesses have reopened.
- Businesses are able to raise record amounts of capital in private markets.
- Mortgage rates have been brought down to historical lows.
- Municipalities are able to borrow at historically low rates.

While substantial progress has been made, our economy still has a long way to go to get back to normal. Unemployment is unacceptably high and the housing market has not yet stabilized. In the banking system, charge-offs for residential, consumer, and commercial loans are still high, and the FDIC projects that the rate of bank failures will remain high for some time. Despite offering relatively low borrowing costs, banks continue to report falling loan balances. This reflects the fact that we have endured a difficult recession and many borrowers and lenders are reducing debt after a period of aggressive growth in leverage. But it means that many responsible consumers and businesses are still finding it difficult to get new credit.

Nevertheless, thanks to the coordinated and forceful actions of Congress, the Obama Administration, the Federal Reserve, the FDIC, and other regulatory agencies, the U.S. financial system is much stronger today than it was in the fall of 2008 and early 2009.

#### **1. TARP restored confidence in the financial system, lowering borrowing costs for businesses, homeowners, and municipalities.**

The primary purpose of TARP was to restore the liquidity and stability of our financial system. That system plays a critical role in our economy, for example, by helping businesses raise funds and pay employees, providing consumers with convenient forms of credit, financing education, and allowing millions of Americans to own homes.

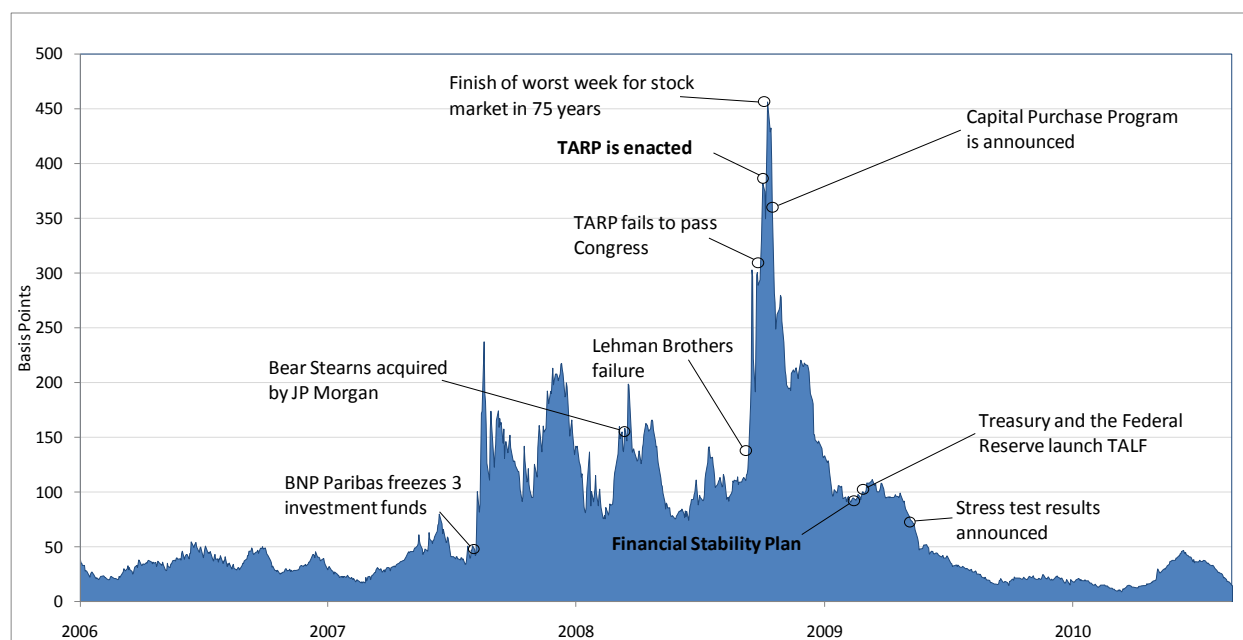
In September 2008, banks were not making new loans to businesses, or even to one another. Businesses could not get financing in our capital markets. Municipalities and state governments could not issue bonds at reasonable rates. The securitization markets—which provide financing for credit cards, student loans, auto loans and other consumer financing—had basically stopped functioning.

## 4. Stabilization of the Financial Markets

TARP provided the buffer that the system needed. In conjunction with the “stress tests” of our major banks, it helped force the system to raise private capital. And more broadly TARP provided a backstop that allowed the credit markets to start working again.

Figure 4-A shows bank borrowing costs relative to Treasury borrowing cost over the course of the crisis. During the financial crisis in 2008, there was a drastic spike in cost of bank borrowing costs, followed by an improved, lower cost of borrowing after implementation of the TARP and the Obama Administration’s Financial Stability Plan.

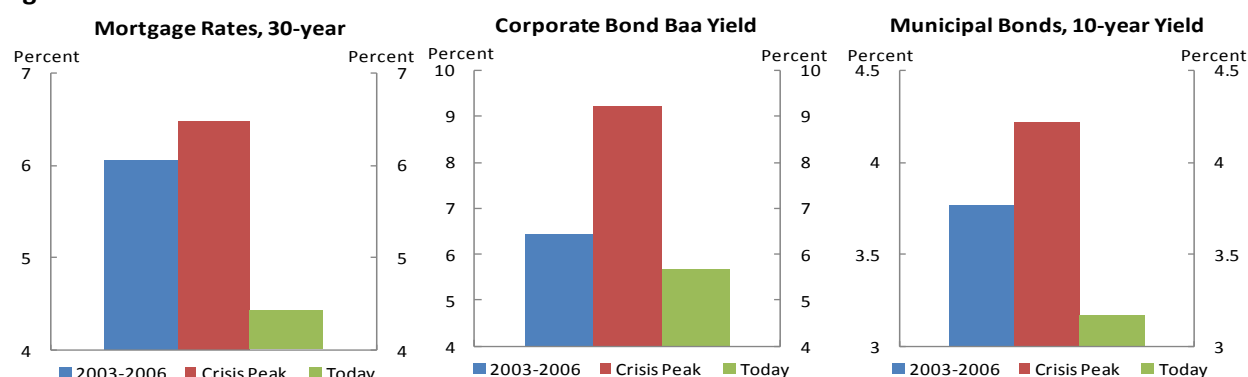
**Figure 4-A: Spread Between Inter-Bank Deposit Rates and Yields on Short-term Treasury Bills**



Following the passage of TARP and the announcement or implementation of TARP programs, borrowing costs declined for many businesses, homeowners, and municipalities. Investment-grade corporate bond spreads fell by almost 70 percent in 2009. Yields on high quality municipal bond rates fell to three percent in 2009, down from five percent in fall 2008. That translated into real savings for Americans and enabled our economy to begin to recover.

## 4. Stabilization of the Financial Markets

Figure 4-B:

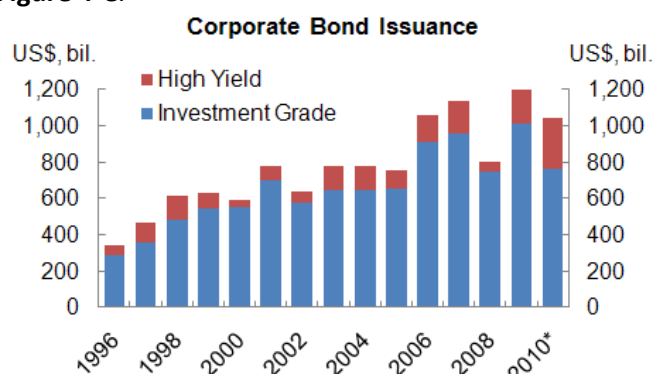


### 2. Lower borrowing costs have allowed businesses to tap private funding sources and major financial institutions to recapitalize with private funds.

As borrowing costs have come down, businesses have raised substantial capital from private sources in 2009 and 2010. Corporations, for example, raised over \$1 trillion in investment-grade debt and over \$180 billion in high-yield debt in 2009. While much of the new issuance in early 2009 was supported by government guarantees, private investors funded most new corporate debt without public support in late 2009 and in 2010. Nearly 50 percent of new issuance was guaranteed by the government in January 2009. No new issuance has been government guaranteed in 2010.

The overall strength in the funding markets has continued into 2010. The pace of high yield issuance so far this year is actually higher than in 2009.

Figure 4-C:



\* Annualized estimate based on data through September 2010.

It is important to note that, banks managed to raise substantial private capital following the release of the results from the federal government “stress test” of major U.S. financial institutions. In the months after the results were released, banks issued over \$100 billion in new common equity. As a result, the U.S. banking system is much better capitalized today

## 4. Stabilization of the Financial Markets

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### 3. Securitization markets have come back to life as a result of TALF and other initiatives.

Securitization markets that provide important channels of credit for consumers and small businesses have also improved, in large part because of programs launched under the TARP. Announcements about the Term Asset-Backed Securities Loan Facility (TALF) helped narrow spreads in these markets even before the program began operating. In 2009, spreads on TALF-eligible asset-backed securities (ABS) fell back to pre-crisis levels and spreads on non-TALF-eligible ABS were down more than 90 percent from their peaks in the fall of 2008. Since the government launched TALF in March 2009, issuance of ABS backed by consumer and business loans have averaged \$12 billion per month, compared to less than \$2 billion per month in the six months prior to the program's launch. And as with corporate bonds, new issuance in the ABS market has shifted from public support to purely private financing.

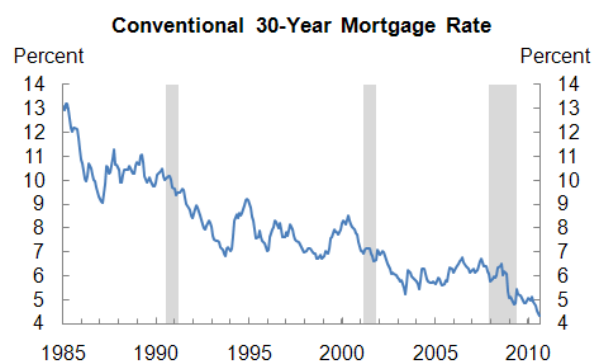
Prices for impaired securities that constrain bank lending also improved significantly starting in 2009. This was due in part to general market improvement and in part to announcements for the Public Private Investment Program, which was designed to remove these securities from banks. Most of the Public Private Investment Funds were formed by the end of 2009 and had started to purchase legacy securities. Since the announcement of PPIP in March 2009, prices of benchmark indices for the non-agency residential mortgage backed securities and commercial mortgage backed securities have appreciated between 60 percent and 100 percent. These positive developments reduced the need for PPIP at the levels originally contemplated.

### 4. Housing markets stabilized to some degree.

Following the implementation of TARP, housing markets began showing some signs of stabilizing and wealth recovery, which should stimulate consumer spending – vital to American economic growth. Thanks in part to federal government financial policies, mortgage rates remain near historic lows. Home prices stabilized in March 2009, following consistent declines since 2006. For example, the S&P/Case-Shiller U.S. 20-City Composite Home Price Index experienced a 3 percent year-to-year increase in July, compared to a 19 percent year-to-year decline in March 2009.

The Obama Administration's housing initiatives under TARP were intended to help prevent avoidable foreclosures and stabilize the housing market. Eighteen months into the HAMP program, over 1.3 million homeowners have seen their monthly mortgage payments reduced to affordable levels, including over 460,000 who are in permanent modifications.

**Figure 4-D:**



Source: Federal Reserve

## 4. Stabilization of the Financial Markets

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The TARP housing initiatives have also spurred mortgage servicers to adopt similar programs, enhancing their capacity to engage with homeowners to modify mortgages and provide additional solutions to avoid foreclosure. This has helped millions more homeowners at no cost to the taxpayer.

### **5. The investments in the Automotive Industry and AIG accomplished their purpose -- they were critical to maintaining financial stability.**

The Bush Administration provided loans to GM and Chrysler in December 2008 to avoid uncontrolled liquidations in the industry that could have resulted in millions of job losses. The Obama Administration provided additional assistance to GM and Chrysler on the condition that those companies would fundamentally restructure their businesses. In the 14 months since GM and Chrysler emerged from bankruptcy, the auto industry has increased employment by 62,100 jobs and is much stronger. Some TARP funds have already been returned, and GM is poised for an initial public offering, which will allow the government to begin selling down its TARP investment.

Before the crisis there was insufficient regulation and oversight of AIG, and none of the government agencies with supervisory authority had a mechanism to provide for the orderly unwinding, dismantling, sale, or liquidation of a global, non-bank financial institution like AIG. But, today, the risks to our economy posed by AIG have been reduced. On September 30, 2010, AIG and the government announced a restructuring plan that will accelerate the government's exit and puts us in a stronger position to recover taxpayers' investments.

### **B. TARP Was Part of the Government's Coordinated Efforts**

As credit conditions have improved, the U.S. economy has stopped contracting and started to grow again. The number of jobs is also growing, although at a slow pace. After four consecutive quarters of negative growth, the economy expanded at an annual rate of 1.6 percent in the third quarter of 2009 and has continued to grow since. The unemployment rate has fallen from a peak of 10.1 percent in October 2009 to 9.6 percent in August.

Economic experts Alan Blinder and Mark Zandi<sup>2</sup> find that TARP has been a substantial success in helping the economy snap back more rapidly than would be expected from early 2009 when the U.S. was suffering a severe economic downturn. Blinder and Zandi estimate that without government intervention U.S. real GDP would have fallen roughly three times what we actually experienced, and the unemployment rate would have peaked at 16.5 percent.

### **C. Challenges Lie Ahead To Achieving a Full Recovery**

The financial and economic recovery still faces significant headwinds. TARP and the broader response to the financial crisis have been successful in critical ways. Those policies have contained the most significant financial crisis our country has faced since the Great Depression. But the economy has a long way to go to recover fully from the deep contraction generated by the crisis.

The contraction in many categories of bank lending reflects a combination of persistent weak demand for credit and tight lending standards at the banks, amidst continued pressure on many bank balance sheets, particularly from commercial mortgage losses. Bank lending continues to contract overall, although the pace of contraction has moderated and some categories of lending are growing again. For

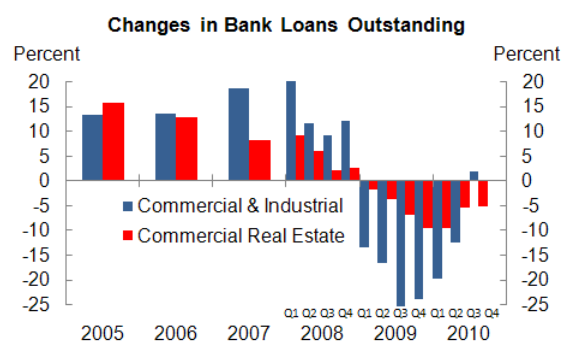
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<sup>2</sup> Blinder and Zandi, "How the Great Recession Was Brought to an End," July 27, 2010.

## 4. Stabilization of the Financial Markets

example, commercial and industrial loans contracted at an annual rate of 27 percent in the third quarter of 2009, but they expanded in the third quarter of 2010. Such loans are particularly important for small businesses, which generally cannot raise money by issuing debt in securities markets.

**Figure 4-E:**



Source: Federal Reserve Assets and Liabilities of Banks (H.8).

Note: Adjusted for merger activity and accounting changes

Although RealtyTrac reports that July 2010 foreclosure activity was 10 percent lower than in July 2009, foreclosures were still up nearly 20 percent since July 2008, and July 2010 marked the seventeenth consecutive month of foreclosure activity exceeding 300,000 filings.



## 5. TARP Investment Program Descriptions

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### A. Capital Purchase Program

EESA was originally proposed as a means to buy mortgage loans, mortgage-backed securities and certain other assets from banks. However, the authorities granted under EESA were broadened in the legislative process to cover any financial instrument whose purchase the Secretary of the Treasury, after consultation with the Chairman of the Federal Reserve, determines necessary to promote financial market stability. Shortly following passage of EESA, lending even between banks had practically stopped, credit markets had shut down, and many financial institutions were facing severe stress. Given the high level of uncertainty in financial markets and the economy, even strong financial institutions began to hoard capital. There was not sufficient time to implement a program to buy mortgage related assets, which posed difficulties related to valuing such assets and getting the holders of such assets to sell them at current prices. Based on market indicators, it became clear that financial institutions needed additional capital to sustain a normal flow of credit to businesses and consumers during the financial turmoil and economic downturn. In this context, immediate capital injections into financial institutions were a necessary step to avert a potential collapse of the system.

As a result, Treasury launched the Capital Purchase Program (CPP), the largest and most significant program under EESA, on October 14, 2008. Treasury initially committed over a third of the total TARP funding, \$250 billion, to the CPP, which was later lowered to \$218 billion in March 2009. At the close of the program, Treasury had invested approximately \$205 billion under the Capital Purchase Program.

#### 1. Program and Goals

The Capital Purchase Program was designed to bolster the capital position of viable institutions of all sizes and, in doing so, to build confidence in these institutions and the financial system as a whole. With the additional capital, CPP participants were better equipped to undertake new lending and continue to provide other services to consumers and businesses, even while absorbing write-downs and charge-offs on loans that were not performing.

Of the \$250 billion in total possible commitments, Treasury invested \$125 billion in eight of the country's largest financial institutions.<sup>3</sup> The remaining \$125 billion was made available to qualifying financial institutions (QFIs) of all sizes and types across the country, including banks, savings and loan associations, bank holding companies and savings and loan holding companies. QFIs interested in participating in the program had to submit an application to their primary federal banking regulator. The minimum subscription amount available to a participating institution was one percent of risk-weighted assets. The maximum subscription amount was the lesser of \$25 billion or three percent of risk-weighted assets.

In the months following announcement of the Capital Purchase Program, Treasury provided \$205 billion in capital to 707 institutions in 48 states, including more than 450 small and community banks and 22 certified community development financial institutions (CDFIs) (see chart 5-A below). The largest investment was \$25 billion and the smallest was \$301,000. The final investment under the CPP was made in December 2009.

The CPP funds were not given as grants. Treasury received preferred stock or debt securities in exchange for these investments. There is no fixed date on which the banks must redeem the preferred stock—or repay Treasury. This is necessary for the investment to qualify as “Tier 1” capital under

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<sup>3</sup> In 2008, these banks represented more than half of all bank assets.

## 5. TARP Investment Program Descriptions

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regulatory requirements. However, there are incentives for the banks to repay.<sup>4</sup> Institutions may repay Treasury after consultation with the appropriate federal regulator. To date, Treasury has received approximately \$152 billion in CPP repayments.

Most banks participating in the Capital Purchase Program pay Treasury a dividend rate of five percent per year, which will increase to nine percent a year after the first five years. In the case of Subchapter S-corporations, Treasury acquires subordinated debentures. The subordinated debenture interest rate is 7.7 percent per year for the first five years and 13.8 percent thereafter; however, the total amount of S-corporation dividends payable per year is less than \$40 million. To date, Treasury has received approximately \$10 billion in CPP dividends and interest and \$3 billion in other income from the sale of Citigroup common stock (in excess of the recovered principal amount).

Treasury also received warrants to purchase common shares or other securities from the banks at the time of the CPP investment. The purpose of the additional securities is to provide opportunities for taxpayers to reap additional returns on their investments as banks recover. To date, Treasury has received more than \$8 billion in proceeds from the sale of CPP and TIP warrants. See page 32 for a description of the warrants and their sale by Treasury.

### ***a. Role of bank regulators***

Many have asked how Treasury decided which banks would receive funds. The program was open to all institutions and a process was established to ensure decisions were made in a fair, impartial and consistent manner. The process also helped ensure that the program fulfilled Treasury's statutory responsibilities to promote financial stability and protect the taxpayer. The process required that a QFI apply to the federal agency that is its primary regulator—the Federal Reserve, the FDIC, the Office of the Comptroller of the Currency or the Office of Thrift Supervision. The application had to receive the positive recommendation of the regulator.

The regulators are most familiar with these institutions because they perform periodic safety and soundness examinations that include detailed analyses of the banks' overall financial conditions and operations, e.g., capital, assets, management, earnings, liquidity, and sensitivity to market risk. Regulators also examine the institutions for compliance with applicable laws and regulations.

Nonetheless, Treasury did not defer entirely to the regulators. Treasury conducted its own review of every application that received a positive funding recommendation from the regulators. Treasury staff reviewed the successful applications and presented them to an internal TARP investment committee, which in turn made recommendations to the Assistant Secretary for Financial Stability for a final decision. This process was critical to ensuring objective decision making. The Special Inspector General for TARP did an extensive review of the process and concluded in its August 2009 report that it was "a mostly clear process enhanced by multiple reviews and control mechanisms".

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<sup>4</sup> The contract terms include a number of incentives to encourage banks to replace TARP investments with private capital. These terms include a provision to increase the dividend rate over time, a restriction on the bank from paying dividends to its common shareholders and a restriction on repurchasing shares until the bank repays the TARP preferred stock.

## 5. TARP Investment Program Descriptions

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### *b. Small institutions*

The Capital Purchase Program is often characterized as a “big bank” program and many people erroneously believe that small institutions did not benefit from this program. In fact, smaller financial institutions make up the vast majority of participants in the CPP. Of the 707 applications approved and funded by Treasury through the Capital Purchase Program by the time it closed on December 31, 2009, 473 or 67 percent were institutions with less than \$1 billion in assets.

Treasury recognized that, to allow small institutions to participate in CPP, the program would need to accommodate more than one corporate structure. To that end, Treasury prepared CPP transactional documents for private institutions, mutual organizations, and S-corporations in addition to the documents for publicly traded institutions. The variety of documents addressed the structural complexity of including large and small institutions.

The rate at which applications were submitted declined rapidly in early 2009 and over 650 banks withdrew new applications. Several reasons have been cited for this. One was that in February 2009, Congress adopted more restrictive executive compensation requirements on all TARP recipients. A second was that many banks felt there was a stigma associated with participation in the program. A third was that the severity of the crisis had lessened somewhat.

In May 2009, after many larger institutions started raising capital from the private debt and equity markets, Treasury re-opened the CPP application window for institutions with less than \$500 million in assets. This initiative gave smaller institutions, which did not have the same access to the capital markets as larger institutions, an opportunity to receive additional CPP investments, and Treasury increased the amount of capital available to smaller institutions under the program. Originally, institutions were eligible for a CPP capital investment that represented up to three percent of risk-weighted assets. Upon re-opening the CPP for smaller institutions, Treasury raised the amount of funds available to five percent of risk-weighted assets, and did not require additional warrants for the incremental investment.

The chart below indicates the asset size of the banks participating in the Capital Purchase Program.

**Figure 5-A:**

CPP Initial Investment Profile (\$ in billions)				
Asset Range*	CPP Participants		Investment	
	Number	Percent	Amount	Percent
<\$1bn	473	66.9%	3.8	1.9%
\$1bn - \$10bn	177	25.0%	10.0	4.9%
>\$10bn	57	8.1%	191.1	93.3%
<b>Total</b>	<b>707</b>	<b>100%</b>	<b>204.9</b>	<b>100%</b>

Source: SNL Financial; Treasury

## 5. TARP Investment Program Descriptions

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### ***c. TARP bank investments were structured as non-voting preferred stock, which provided crucial capital support without creating government control***

As described in Section 3 on page 10, in 2008 Treasury decided that the most effective way to try to stabilize the nation's financial system was to provide capital to banks. The vast majority of TARP investments were made in the form of non-voting preferred stock. In order to achieve the objective of providing capital support, and meet bank regulatory requirements for Tier 1 capital, TARP could not require that a bank repay Treasury at a fixed date, as one would with a loan.

Preferred stock generally is nonvoting (except in limited circumstances), while common stock has full voting rights. Therefore, most TARP investments are nonvoting. The preferred stock does not entitle Treasury to board seats or board observers, except in the event dividends are not paid for six quarters, in which case Treasury has the right to elect two directors to the board.

## **2. Status as of September 2010**

### ***a. Repayments – getting TARP funds back***

Banks may repay Treasury under the conditions established in the purchase agreements as amended by the ARRA. Treasury also has the right to sell the securities. However, Treasury does not have the right to force repayment. The repayment price is equal to what Treasury paid for the shares, plus any unpaid dividends or interest.

As of September 30, 2010, Treasury has received over \$152 billion in CPP repayments. Of that amount, approximately \$13.4 billion of repayments is from the sales of Citigroup common stock through September 30, 2010.

### ***b. Returns for taxpayers***

#### ***1) Dividend and interest payments***

As is typical for a preferred stock investment, banks must decide whether to pay the dividends; they can elect instead to conserve their capital. Treasury received “cumulative” dividends where permitted by applicable regulation. That is, if the dividends are not paid in any quarter, they are added to the liquidation preference, thus increasing the claim of the holder of the preferred. In other cases, the dividends were “noncumulative”. CPP participants are allowed to make dividend payments with the approval of their primary federal regulator. But if a bank fails to pay dividends for six quarterly periods, Treasury has the right to appoint two directors to the bank's board.

As of September 30, 2010, total dividends and interest received from Capital Purchase Program investments is approximately \$10 billion. In addition, the sales of Citigroup common stock through September 30, 2010 have generated \$3 billion of income (in excess of the recovered principal amount of the Citigroup investment referred to above).

#### ***2) Overall returns***

The CPP was a success not only in stabilizing the financial system. It will also generate a positive return to taxpayers, as will the bank support programs (Capital Purchase Program, Targeted Investment Program and Asset Guarantee Program) taken as a whole. Currently, Treasury estimates that the net

## 5. TARP Investment Program Descriptions

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gain for all three programs combined will be \$16 billion. This is only an estimate and it will depend on several factors, including market conditions and performance of individual companies. Some initial observers of the CPP investments were critical, for example, that Treasury overpaid to make the investments in eight of the nation's largest financial institutions and/or that the institutions would not be able to repay. In fact, all of those institutions have repaid the government in full with the exception of Citigroup where part of the investment is in the form of common stock which the government is currently in the process of selling. In that case, the government expects to complete its exit by early next year. For the seven institutions which have fully repaid, our internal rate of return on a combined basis was 11 percent. We have also realized a gain on our Citigroup sales to date and expect to realize a gain overall based on the current market price.

### **3) *Certain institutions; missed payments and appointment of directors***

The returns realized from investments in the Capital Purchase Program will be partially offset by losses on investments in certain institutions. As of September 30, 2010, five institutions have been declared bankrupt or had their banking subsidiary placed in receivership (CIT Group Inc., UCBH Holdings, Inc., Midwest Banc Holdings, Inc., Sonoma Valley Bancorp, and Pacific Coast National Bancorp), which represent a total investment of \$2.73 billion. To date, together with the \$242 million of realized discount on sales, as described later in this report, losses on investments are approximately \$3 billion.

For the quarterly dividend payment due in August 2010, 123 institutions missed payments<sup>5</sup>, consisting of 96 cumulative dividend payments (approximately \$41.5 million), 19 non-cumulative dividend payments (approximately \$1.8 million), and eight S-corporation interest payments (approximately \$1.6 million). To date, 21 banks have missed four payments, 15 banks have missed five, six banks have missed six, and one bank has missed seven.

Treasury has released guidance on the exercise of its contractual right to nominate members to an institution's board of directors. Directors cannot be government employees and by law they must act in the interests of all shareholders, not as Treasury's or the taxpayers' representative. Treasury will prioritize banks in part based on whether its investment exceeds \$25 million. In addition, Treasury will seek a bank's permission to have an observer attend board meetings once an institution misses five dividends. The observers can be government employees. This proactive step will help Treasury determine where the appointment of directors would be most effective. If the right to nominate members to a board of directors of a bank becomes exercisable, Treasury will determine whether to nominate up to two members based on an evaluation of the condition of the institution and the functioning of its board of directors.

### **4) *Exchanges and restructurings – to preserve value and protect taxpayer interests***

In limited cases, in order to protect the taxpayers' interest in the value of a CPP investment and to promote financial stability, Treasury may exchange the CPP preferred stock for other securities. Treasury evaluates whether to participate in an exchange of the CPP preferred stock on the basis of enabling the bank to get new investors to provide additional capital, to conduct a capital restructuring or to strengthen its capital position and financial condition. Exchanges made on this basis may be at a rate less than par, and sales by Treasury to a new investor may be made at a discount. Treasury has

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<sup>5</sup> Data excludes the institutions that have entered bankruptcy or receivership at the time the quarterly payment was due.

## 5. TARP Investment Program Descriptions

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described the considerations for evaluating exchanges and restructurings in the Agency Financial Report for FY2009, page 41.

### ***c. Use of funds by banks participating in the Capital Purchase Program***

Treasury worked with the Office of the Special Inspector General for the Troubled Asset Relief Program (SIGTARP) on a Use of Capital Survey. The scope of the annual Use of Capital Survey covers lending, financial intermediation, and capital building activities of each financial institution after the investment of funds under the CPP from the date the funds were initially received until the end of the fourth quarter 2009. Treasury sent the Use of Capital Survey to CPP participants in March 2010, and received survey responses from the majority of CPP participants. Treasury posted all submitted surveys from individual CPP recipients and published the names of the financial institutions that failed to submit a survey response to Treasury, on the FinancialStability.gov website. Additionally, Treasury posted a summary of quantitative data (summary balance sheet and income statement information from each institution's regulatory filings) for each individual CPP recipient on the FinancialStability.gov website.

### ***d. Comparative lending by CPP banks***

The capital that remains in place at many small and medium-sized banks is facilitating new lending while they absorb losses from legacy assets. Indeed, at banks with less than \$1 billion in assets that received TARP capital, median total loans have grown 3.3 percent since 2008Q3, compared with 1.6 percent for comparably-sized institutions that did not receive TARP funds. The difference is even larger for commercial and industrial loans, and for commercial real estate loans, which are especially important for small businesses.



## 5. TARP Investment Program Descriptions

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### B. Supervisory Capital Assessment Program (“Stress Test”) and Capital Assistance Program

While the investments made under the Capital Purchase Program helped prevent a collapse, Treasury also focused on how to recapitalize the system with private capital, so that government support could be paid back. But in late 2008 and early 2009 confidence in our financial system had been severely eroded; investors questioned whether institutions were healthy enough to survive, and doubted whether many institutions really knew their true condition. Therefore, a critical part of the Financial Stability Plan announced by the Obama Administration was to conduct a “stress test” on the major banks to determine their health, and to do so in an open and transparent manner so that the market would know which banks needed more capital. In conjunction with this forward-looking test, Treasury announced that it would provide capital under TARP through the **Capital Assistance Program (CAP)** to banks that needed additional capital but were unable to raise it through private sources.

#### 1. Program and Goals

In early 2009, Treasury worked with the Federal banking agencies to develop the one-time, forward-looking assessment or “stress test”—known as the **Supervisory Capital Assessment Program (SCAP)**—on the nineteen largest U.S. bank holding companies (BHCs). The design of the tests and their results were made public, a novel step that was taken because of the unprecedented need to restore confidence. By identifying and quantifying potential capital shortfalls and requiring that additional capital be raised to eliminate any deficiencies, the SCAP ensured that these financial institutions would have sufficient capital to sustain their role as intermediaries and continue to provide loans to creditworthy borrowers even if economic conditions suffered a severe and extended deterioration.

The stress test found that nine of the largest bank holding companies had adequate capital to withstand more severe economic conditions. Of the ten bank holding companies that were identified as needing to raise more capital, nine met or exceeded the capital raising requirements through private efforts. Only one institution, Ally Financial (formerly GMAC), required additional funds under TARP to meet its SCAP requirements, which was provided through the Automotive Industry Financing Program, not CAP.

#### 2. Status as of September 2010

Since the results of the SCAP were released in May 2009, in the aggregate, the stress test firms have increased requisite capital by over \$150 billion. Importantly, that capital raising has enabled more than 80 banks to repay the TARP investments made by Treasury.

The Capital Assistance Program was offered to all banks and QFIs, not solely to those banks that underwent the SCAP. Another measure of the effectiveness of SCAP and the CPP, as well as other government efforts, is that Treasury did not receive any applications for CAP which terminated on November 9, 2009.

## 5. TARP Investment Program Descriptions

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### C. Targeted Investment Program

Treasury established the Targeted Investment Program (TIP) in December 2008. The program gave the Treasury the necessary flexibility to provide additional or new funding to financial institutions that were critical to the functioning of the financial system. The TIP was considered “exceptional assistance” for purposes of executive compensation requirements (see Section 7).

#### 1. Program and Goals

Through the Targeted Investment Program, Treasury sought to prevent a loss of confidence in critical financial institutions, which could result in significant financial market disruptions, threaten the financial strength of similarly situated financial institutions, impair broader financial markets, and undermine the overall economy. Eligibility to participate in the TIP was determined on a case-by-case basis, and depended on a number of factors. Treasury considered, among other things:

- 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;
- The number and size of financial institutions that are perceived or known by investors or counterparties as similarly situated to the failing institution, or that would otherwise be likely to experience indirect contagion effects from the failure of the institution;
- 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, or significantly increase uncertainty or loss of confidence, thereby materially weakening overall economic performance; and
- 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.

Treasury invested \$20 billion in each of Bank of America and Citigroup under the Targeted Investment Program, which investments were in addition to those that the banks received under the CPP. Like the Capital Purchase Program, Treasury invested in preferred stock, and received warrants to purchase common stock in the institutions. However, the TIP investments provided for annual dividends of eight percent, which was higher than the CPP rate, and also imposed greater reporting requirements and more onerous terms on the companies than under the CPP terms, including restricting dividends to \$0.01 per share per quarter, restrictions on executive compensation, restrictions on corporate expenses, and other measures.

#### 2. Status as of September 2010

In December 2009, both participating institutions repaid their TIP investments in full, with dividends. Total dividends received from Targeted Investment Program investments was \$3 billion. Treasury also received warrants from each bank which provide the taxpayer with additional gain on the investments. As a consequence, the program is closed and resulted in a positive return for taxpayers.

## 5. TARP Investment Program Descriptions

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### D. Asset Guarantee Program

#### 1. Program and Goals

Under the Asset Guarantee Program (AGP), Treasury acted to support the value of certain assets held by qualifying financial institutions, by agreeing to absorb a portion of the losses on those assets. The program was conducted jointly by Treasury, the Federal Reserve and the FDIC. Like the Targeted Investment Program, it was designed for financial institutions whose failure could harm the financial system and reduce the potential for “spillover” to the broader financial system and economy. More specifically, the Asset Guarantee Program was used to help certain financial institutions facing a potential loss of market confidence due in large part to their holdings of distressed or illiquid assets. By helping to limit the institution’s exposure to losses on illiquid or distressed assets, the Asset Guarantee Program helped the institution maintain the confidence of depositors and other funding sources and continue to meet the credit needs of households and businesses. The AGP was used in a limited fashion to assist Bank of America and Citigroup in conjunction with the Targeted Investment Program investments in those institutions.

##### *a. Bank of America*

In January 2009, Treasury, the Federal Reserve and the FDIC agreed in principle to share potential losses on a \$118 billion pool of financial instruments owned by Bank of America, consisting of securities backed by residential and commercial real estate loans and corporate debt and derivative transactions that reference such securities, loans and associated hedges. If the arrangement had been finalized, Treasury and the FDIC would have received preferred stock and warrants as a premium for the guarantee. The announcement of the transaction (and the Citigroup transaction discussed below) was widely welcomed by the markets and contributed immediately to helping restore investor confidence in the financial institution and the banking system generally. In May 2009, before the transaction was finalized, Bank of America announced its intention to terminate negotiations with respect to the loss-sharing arrangement and in September 2009, the government and Bank of America entered into a termination agreement. Bank of America agreed to pay a termination fee of \$425 million to the government, \$276 million of which went to Treasury. The fee compensated the government for the value that Bank of America had received from the announcement of the government’s willingness to guarantee and share losses on the pool of assets from and after the date of the term sheet. The termination fee was determined by reference to the fees that would have been payable had the guarantee been finalized. No claims for loss payments were made to the government, nor were any TARP or other funds spent. Thus, the fee is a net gain to the taxpayer.

##### *b. Citigroup*

In January 2009, Treasury, the Federal Reserve and the FDIC similarly agreed to share potential losses on a \$301 billion pool of Citigroup’s covered assets. The arrangement was finalized and, as a premium for the guarantee, Treasury and the FDIC received \$7.1 billion of preferred stock, with terms that were similar to those in the TIP investment and more onerous than in the CPP, including a dividend rate of eight percent. Treasury also received warrants to purchase 66.5 million shares of common stock. Although the guarantee was originally designed to be in place for five to ten years, Citigroup requested that it be terminated in December 2009 in conjunction with Citigroup’s repayment of the \$20 billion TIP investment. This was because Citigroup’s financial condition had improved and the bank raised over \$20 billion of private capital. The banking regulators approved this request.

## 5. TARP Investment Program Descriptions

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In connection with the termination, Treasury and the FDIC kept most of the premium paid. That is, the government retained a total of \$5.3 billion of the \$7.1 billion of preferred stock (which had since been converted to trust preferred securities). Of this amount, Treasury retained \$2.23 billion, and the FDIC and Treasury agreed that, subject to certain conditions, the FDIC would transfer up to \$800 million of trust preferred securities to Treasury at the close of Citigroup's participation in the FDIC's Temporary Liquidity Guarantee Program.

For the period that the Citigroup asset guarantee was outstanding prior to termination in December 2009, Citigroup made no claims for loss payments to the government, and consequently Treasury made no guarantee payments of TARP funds to Citigroup. Thus, all payments received to date, and the income received from the sale of the securities described above, will constitute a net gain to the taxpayer. As of September 30, 2010, total dividends received from the securities were approximately \$440 million. On September 30, 2010, Treasury sold the trust preferred securities for proceeds of approximately \$2.25 billion. Treasury still holds its Citigroup warrants and expects to receive another \$800 million in trust preferred securities from the FDIC, both of which should provide the taxpayer with an additional gain.

### **2. Status as of September 2010**

The Asset Guarantee Program is now closed. No payments were made. The fee from Bank of America, and securities and dividends received from Citigroup, will result in a positive return for taxpayers.

## 5. TARP Investment Program Descriptions

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### E. Warrant Dispositions

#### 1. Program and Goals

As required by EESA, Treasury received warrants from TARP banks to provide taxpayers with an additional return on the government's investment. For each CPP and TIP investment in a publicly traded company, Treasury received warrants to purchase, at a fixed exercise price, shares of common stock equal to 15 percent of the aggregate liquidation preference of the senior preferred investment. The per share exercise price was set at the 20-trading day trailing average of the bank's common stock price as of the time it was given preliminary approval for the TARP investment.

The warrants may be exercised at any time over a ten year period. These public warrants include certain customary anti-dilution provisions to protect their value to Treasury in the event the company issues more stock or takes certain other actions. For CPP investments in a privately-held company, an S-corporation, or certain mutual institutions, Treasury received warrants to purchase, at a nominal cost, additional preferred stock (these securities are referred to as "warrant preferreds") or subordinated debentures (these securities are referred to as "warrant sub debt") equivalent to five percent of the aggregate liquidation preference of the primary CPP investment. These warrant preferreds and warrant sub debt securities pay a higher dividend or interest rate than the primary CPP investment. Treasury immediately exercised these kinds of warrants at the closings of the investments.

Upon repaying its TARP preferred stock investment, a financial institution may repurchase its warrants at an agreed upon fair market value. In all cases, Treasury follows a consistent evaluation process to ensure that taxpayers receive fair market values for the warrants. If an institution decides not to repurchase its warrants, Treasury has the contractual right to sell the warrants. Treasury has followed a policy of disposing of warrants as soon as practicable if no agreement is reached on a repurchase. Thus far, Treasury has utilized a modified Dutch public auction methodology to dispose of warrants that are not repurchased by the bank.

#### 2. Status as of September 2010

To date, the disposition of warrants has succeeded in significantly increasing taxpayer returns on the Capital Purchase Program and Targeted Investment Program preferred investments that have been repaid. As of September 30, 2010, Treasury has received more than \$8 billion in gross proceeds from the disposition of warrants associated with 58 CPP investments and one (1) TIP investment, consisting of approximately (i) \$3 billion from issuer repurchases at agreed upon fair market values and (ii) \$5 billion from auctions. In the auctions, clearing prices have been set through robust competition among large numbers of bidders. For those investments, which represent approximately \$140 billion in capital, Treasury has received an absolute return of 4.2 percent from dividends and an added 5 percent return from the sale of the warrants for a total absolute return of 9.2 percent. For the \$20 billion TIP investment in Bank of America Corporation, Treasury received an internal rate of return of 15.3 percent. These returns are not predictive of the eventual returns on the entire CPP and TIP portfolios.

Treasury has released two semi-annual Warrant Disposition Reports that provide additional information regarding the disposition process and the results of the warrant sales. The reports can be found on our website at [www.FinancialStability.gov/latest/reportsanddocs.html](http://www.FinancialStability.gov/latest/reportsanddocs.html).

## 5. TARP Investment Program Descriptions

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### F. Community Development Capital Initiative

Communities underserved by traditional banks and financial services providers have found it more difficult to obtain credit in the current economic environment. Community Development Financial Institutions (CDFIs) exist to provide financing to these communities. CDFIs offer a wide range of traditional and innovative financial products and services designed to help their customers access the financial system, build wealth and improve their lives and the communities in which they live. In particular, CDFIs focus on providing financial services to low- and moderate- income, minority, and other underserved communities. CDFIs are certified by Treasury's CDFI Fund, which was created for the purpose of promoting economic revitalization and community development in low-income communities.

#### 1. Program and Goals

Most CDFIs have been adversely affected by the financial crisis. Treasury launched the Community Development Capital Initiative to help viable certified CDFIs and the communities they serve cope with effects of the financial crisis.

Under this program, CDFI banks and thrifts received investments of capital with an initial dividend or interest rate of 2 percent, compared to the 5 percent rate offered under the Capital Purchase Program. CDFI banks and thrifts applied to receive capital up to 5 percent of risk-weighted assets. To encourage repayment while recognizing the unique circumstances facing CDFIs, the dividend rate will increase to 9 percent after eight years, compared to five years under CPP.

CDFI credit unions could also apply to receive secondary capital investments at rates equivalent to those offered to CDFI banks and thrifts and with similar terms. These institutions could apply for up to 3.5 percent of total assets, which is an amount approximately equivalent to the 5 percent of risk-weighted assets available to banks and thrifts.

Treasury established a process for reviewing CDCI applications that relied on the appropriate federal regulators, similar to that described under "*CPP - Role of bank regulators*" above. For this program, viability was determined by the CDFI's federal regulator on a pro-forma basis. That is, pro forma viability took into account additional capital injections from private investors made prior to, or concurrently with, Treasury's investment. CDFIs were not required to issue warrants under this program. In addition, CDFIs that participated in CPP and were in good standing could exchange securities issued under CPP for securities under this program.

#### 2. Status as of September 2010

Treasury completed funding under this program in September 2010. The total investment amount for the CDCI program under TARP is approximately \$570 million for 84 institutions. Of this amount, approximately \$363.3 million from 28 banks was exchanged from investments under the Capital Purchase Program into the CDCI.

## 5. TARP Investment Program Descriptions

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### Programs Designed to Unlock Credit for Small Businesses and Consumers

Credit was extremely constrained for small businesses and consumers during the financial crisis. Availability of credit is critical for small businesses to grow and for consumers to make home improvements, buy a new car, or send their children to college. Recognizing the vital importance that small businesses and consumers have for the overall economy, Treasury launched three programs to address the credit constraints faced by these groups: the Term Asset-Backed Securities Loan Facility (TALF), the Public Private Investment Program (PPIP) and the SBA 7(a) Securities Purchase Program. Although the specific goals and implementation methods of each program differed, the overall goal of these three programs was the same – to restart the flow of credit to meet the critical needs of small businesses and consumers.

#### G. Term Asset-Backed Securities Loan Facility

The Term Asset-Backed Securities Loan Facility is a key part of the Obama Administration's Financial Stability Plan and the major initiative under the TARP's Consumer and Business Lending Initiative (CBLI). TALF is a joint Federal Reserve-Treasury program that was designed to restart the asset-backed securitization markets that had ground to a virtual standstill during the early months of this financial crisis. The ABS markets historically have helped to fund a substantial share of credit to consumers and businesses. The effects of this issuance standstill were many: limited availability of credit to households and businesses of all sizes, an unprecedented widening of interest rate spreads, sharply contracting liquidity in the capital markets and a potential to further weaken U.S. economic activity.

##### 1. Program and Goals

###### *a. Program design*

Pursuant to its Federal Reserve Act Section 13(3) authority, the Federal Reserve Bank of New York (FRBNY) agreed to extend up to \$200 billion in non-recourse loans to borrowers to enable the purchase of AAA-rated asset-backed securities (ABS), including those backed by consumer loans, student loans, small business loans, and commercial real estate loans. In return, the borrowers pledged the eligible collateral as security for the loans, including the amount of the equity "haircut" provided by the individual borrower. Should a borrower default upon its TALF loan or voluntarily surrender the collateral, the collateral would be seized and sold to TALF LLC, a special purpose vehicle created by FRBNY to purchase and hold seized or surrendered collateral.

Treasury's role in TALF is to provide credit protection for the program through the purchase of subordinated debt in TALF LLC. The funds would be used to purchase the underlying collateral associated with TALF loans in the event the borrower surrendered the collateral or defaulted upon its loan. Treasury originally committed to purchase \$20 billion in subordinated debt from TALF LLC, or 10 percent of the maximum amount of loans that could be issued. This commitment was later reduced to \$4.3 billion after the program closed to new lending in June 2010 with \$43 billion in loans outstanding, so that the commitment remained at 10 percent of the outstanding loans.

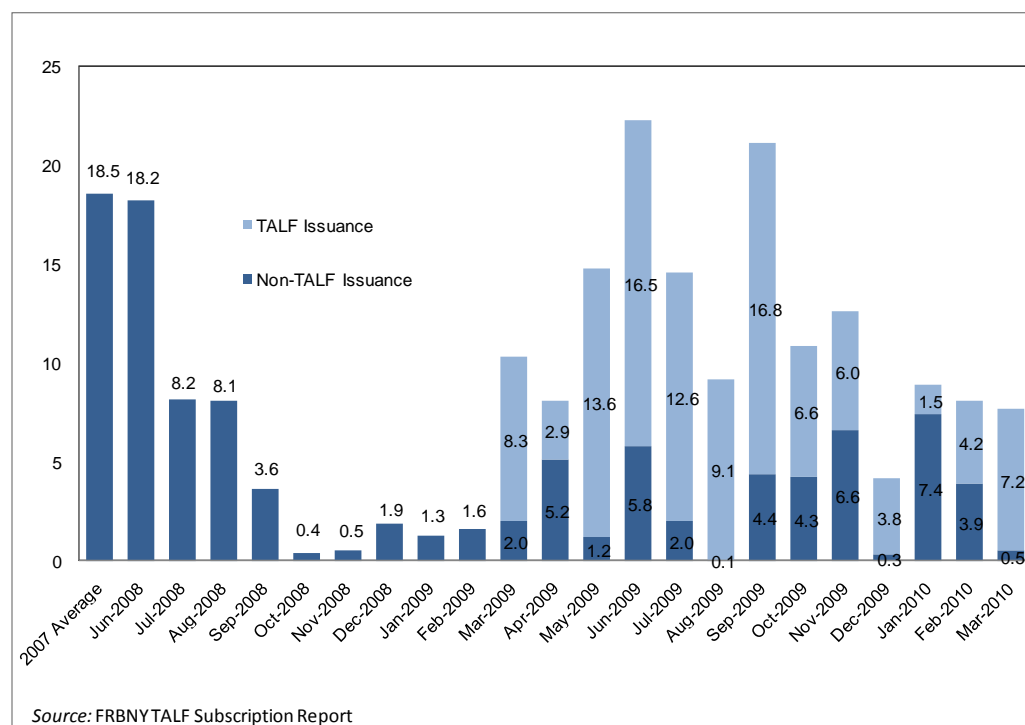
Although TALF was designed to provide up to \$200 billion in loans secured by eligible collateral, the positive effects of TALF on liquidity and interest rate spreads resulting from the announcement of TALF made utilization of the full amount unnecessary. As TALF positively impacted the market for asset-backed securities, investors became able to access cheaper funds in the restarted capital markets. The program was at first extended past the original termination date of December 2009 to March 2010, for



## 5. TARP Investment Program Descriptions

non-mortgage-backed ABS and legacy CMBS collateral, and to June 2010, for newly issued CMBS collateral. Given the improvements in the markets, by program close the FRBNY had approximately \$70 billion in loans under TALF. Of that amount, \$33 billion (or 47 percent) in TALF loans remained outstanding as of September 8, 2010.

**Figure 5-B: Total Consumer ABS Issuance during TALF**



### ***b. Protection of taxpayer interests***

TALF was designed to provide borrowers with term loans of up to five years against highly rated securities, which are forfeited in the event a loan is not repaid. TALF employs a number of other safeguards to protect taxpayers' interests including the following:

- TALF borrowers bear the first loss risk in all securities pledged as collateral for TALF loans due to the substantial haircuts (set by reference to borrower's equity in the securities) required of those borrowers. Haircuts ranged from 5 percent to 20 percent based on asset quality thereby further limiting risk.
- Eligible securities must have received two AAA ratings from the major rating agencies, and none of the major rating agencies can have rated the security below AAA or placed the security on watch for a downgrade.
- Protection is provided by the risk premium included in the TALF loan rates. The interest rate spread provides accumulated excess interest in TALF LLC as a first loss position. The available excess spread to fund forfeited loans is \$476 million as of August 2010.

## 5. TARP Investment Program Descriptions

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- Each ABS issuer must engage an external auditor to offer an opinion that supports management's assertion that the ABS is TALF eligible. Further protection is provided by FRBNY and their collateral monitors that assess the risk associated with ABS and CMBS collateral and perform due diligence.

### 2. Status as of September 2010

TALF is widely credited for achieving its purpose of encouraging lending to consumers and businesses while operating under a conservative structure that protects taxpayer interests. The facility has ceased making new loans as noted above. By improving credit market functioning and adding liquidity to the system, TALF has provided critical support to the financial system. This has allowed lenders to meet the credit needs of consumers and small businesses, and has strengthened the overall economy.

Specifically, TALF achieved its objectives of increasing credit availability and liquidity in the securitization markets and reducing interest rate spreads. Secondary spreads narrowed significantly across all eligible asset classes by 60 percent or more. For instance, spreads on AAA-rated auto receivables fell sharply from a peak of 600 basis points in the fourth quarter of 2008 to 21 basis points over their benchmarks today. Spreads in the secondary market for CMBS have declined from 1500 basis points over its benchmark to 210 basis points as of September 16, 2010.

Moreover, the improvements in the secondary credit market contributed to the re-start of the new-issue market. According to the Federal Reserve Bank of New York, issuance of non-mortgage asset-backed securities jumped to \$35 billion in the first three months of TALF lending in 2009, after having slowed to less than \$1 billion per month in late 2008.<sup>6</sup>

In November 2009, TALF funds also facilitated the first issuance of commercial mortgage-backed securities since June 2008. This helped re-open the market for such securities. Following that deal, there have been additional commercial mortgage-backed deals funded without assistance from TALF.

As the liquidity premium on securitized credit has decreased and credit conditions have improved, TALF has become a less attractive source of financing. The cost of funds for borrowers who utilized the TALF has in many cases become more expensive than the cost of funds in the private sector. This is reflected in the high amount of borrower prepayments which have totaled \$35.3 billion - one-third of aggregate TALF loans - in spite of the longer maturity - three- and five-year - terms of TALF loans. If these trends continue, and prepayments continue, this may lead to an earlier than originally expected exit from the program.

The maturity date on the Treasury loan to the TALF LLC is March 2019. Treasury's engagement may extend beyond this period if collateral is sold to TALF LLC which will require active management of the assets. To date, the TALF program has experienced no losses and all outstanding TALF loans are well collateralized. Treasury and FRBNY continue to see it as highly likely that the accumulated excess interest spread will cover any loan losses that may occur without recourse to the dedicated TARP funds. Therefore, Treasury does not expect any cost to the taxpayers from this program.

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<sup>6</sup> Reflections on the TALF and the Federal Reserve's Role as Liquidity Provider;  
<http://www.newyorkfed.org/markets/talf.html>.

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### H. Public Private Investment Program

The Legacy Securities Public Private Investment Program (PPIP), another key component of the Financial Stability Plan, was designed to purchase troubled legacy securities (i.e., non-agency residential mortgage-backed securities (“RMBS”) and commercial mortgage-backed securities (“CMBS”)) that were central to the problems facing the U.S. financial system, and thereby help ensure that credit is available to households and businesses and ultimately drive the U.S. toward economic recovery.

#### 1. Program Goals and Design

##### ***a. The Goal: Unlock credit markets for legacy securities to allow financial institutions to repair their balance sheets and extend new credit***

During the crisis, many financial institutions and investors were under extreme pressure to reduce indebtedness. This de-leveraging process pushed down the market prices for many financial assets, including troubled legacy RMBS and CMBS, below their fundamental value. Institutions and investors were trapped with hard-to-value assets, marked at distressed prices on their balance sheets, which constrained liquidity and the availability of credit in these markets.

The purpose of PPIP was to draw new private capital into the market for legacy RMBS and CMBS by providing financing on attractive terms as well as a matching equity investment made by the Treasury Department. By providing this financing, PPIP was designed to help restart the market for these securities, thereby helping financial institutions begin to remove these assets from their balance sheets and allowing for a general increase in credit availability to consumers and small businesses.

The key objectives of the Public Private Investment Program include:

- Support market functioning by acting as a catalyst to bring private capital back to the market for legacy RMBS and CMBS;
- Facilitate price discovery in the markets for mortgage-backed securities, thereby reducing the uncertainty regarding the value of such securities among the banks and other financial institutions holding them and enabling these financial institutions to sell such assets and raise new private capital;
- Restore confidence in and create an environment conducive to new issuance of new credit; and
- Protect taxpayer interests and generate returns through long-term investments in eligible assets by following predominantly a buy and hold strategy.

##### ***b. Program Design***

Following the completion of fundraising, Treasury has committed approximately \$22 billion of equity and debt financing to eight Public Private Investment Funds (PPIFs). These funds were established by private sector fund managers for the purpose of purchasing eligible RMBS and CMBS from eligible financial institutions under EESA. This represented a reduction from Treasury’s initial allocation of \$30

## 5. TARP Investment Program Descriptions

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billion in potential capital commitments, because there was less aggregate demand from private sector investors due to improved market conditions for legacy non-agency RMBS and CMBS.<sup>7</sup>

The equity capital raised from private investors by the PPIP fund managers has been matched by Treasury. Treasury has also provided debt financing up to 100 percent of the total equity committed to each PPIF. PPIFs have the ability to invest in eligible assets over a three-year investment period from their initial closing. They then have up to five additional years, which may be extended for up to two more years, to manage these investments and return the proceeds to Treasury and the other PPIF investors. PPIP fund managers retain control of asset selection, purchasing, trading, and disposition of investments.

The profits generated by a PPIF, net of expenses, will be distributed to the investors, including Treasury, in proportion to their equity capital investments. Treasury also receives warrants from the PPIFs, which gives Treasury the right to receive a percentage of the profits that would otherwise be distributed to the private partners that are in excess of their contributed capital. The program structure spreads risk between the private investors and Treasury, and provides taxpayers with the opportunity for substantial gain.

The following fund managers currently participate in PPIP:

- AllianceBernstein, LP and its sub-advisors Greenfield Partners, LLC and Rialto Capital Management, LLC;
- Angelo, Gordon & Co., L.P. and GE Capital Real Estate;
- BlackRock, Inc.;
- Invesco Ltd.;
- Marathon Asset Management, L.P.;
- Oaktree Capital Management, L.P.;
- RLJ Western Asset Management, LP.; and
- Wellington Management Company, LLP.

In addition, PPIP fund managers have established meaningful partnership roles for small, minority-, and women-owned businesses. These roles include, among others, asset management, capital raising, broker-dealer, investment sourcing, research, advisory, cash management and fund administration services. Collectively, PPIP fund managers have established relationships with ten leading small-, minority-, and women-owned firms, located in five different states.

### 2. Status as of September 2010

#### *a. PPIF status*

The PPIFs have completed fundraising and closed on approximately \$7.4 billion of private sector equity capital, which was matched 100 percent by Treasury, representing \$14.7 billion of total equity capital. Treasury also committed to provide \$14.7 billion of debt capital, representing \$29.4 billion of total purchasing power to the program. As of September 30, 2010, PPIFs have drawn-down approximately \$18.6 billion of total capital (63 percent of total purchasing power), which has been invested in eligible

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<sup>7</sup> The “legacy securities PPIP” was announced in conjunction with a “legacy loan PPIP” to be implemented by the FDIC. The combined size of the both programs was initially contemplated to be \$100 billion.

## 5. TARP Investment Program Descriptions

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assets and cash equivalents pending investment.<sup>8</sup> The reduction of Treasury's maximum commitment from \$30 billion to \$22 billion, after the announcement of the program contributed to improved market conditions, allowed Treasury to accomplish its objectives with an efficient use of taxpayer funds.

### ***b. Support market functioning***

The announcement and subsequent implementation of PPIP were keys to reducing the illiquidity discount embedded in these legacy securities and the uncertainty associated with their value, which created an environment conducive for financial institutions to begin trading and selling their holdings of such assets. According to the National Information Center<sup>9</sup>, the non-agency RMBS and CMBS holdings of the top 50 bank holding companies holdings were \$237 billion as of June 30, 2010, approximately \$47 billion or 17 percent lower than levels from a year earlier. We believe that PPIP played a role in helping restart the market for such securities, thereby allowing banks and other financial institutions to begin reducing their holdings in such assets at more normalized prices.

### ***c. Facilitate price discovery***

Since the announcement of PPIP in March 2009, prices for representative legacy securities have increased by as much as 75 percent for RMBS and CMBS. As illustrated in the chart below<sup>10</sup>, benchmark indices for a standardized basket of subprime non-agency RMBS reference obligations from the 2006 vintage, originally rated AAA, and a standardized basket of CMBS reference obligations from the 2007 vintage, originally rated AAA, have appreciated between 50 percent and 80 percent.

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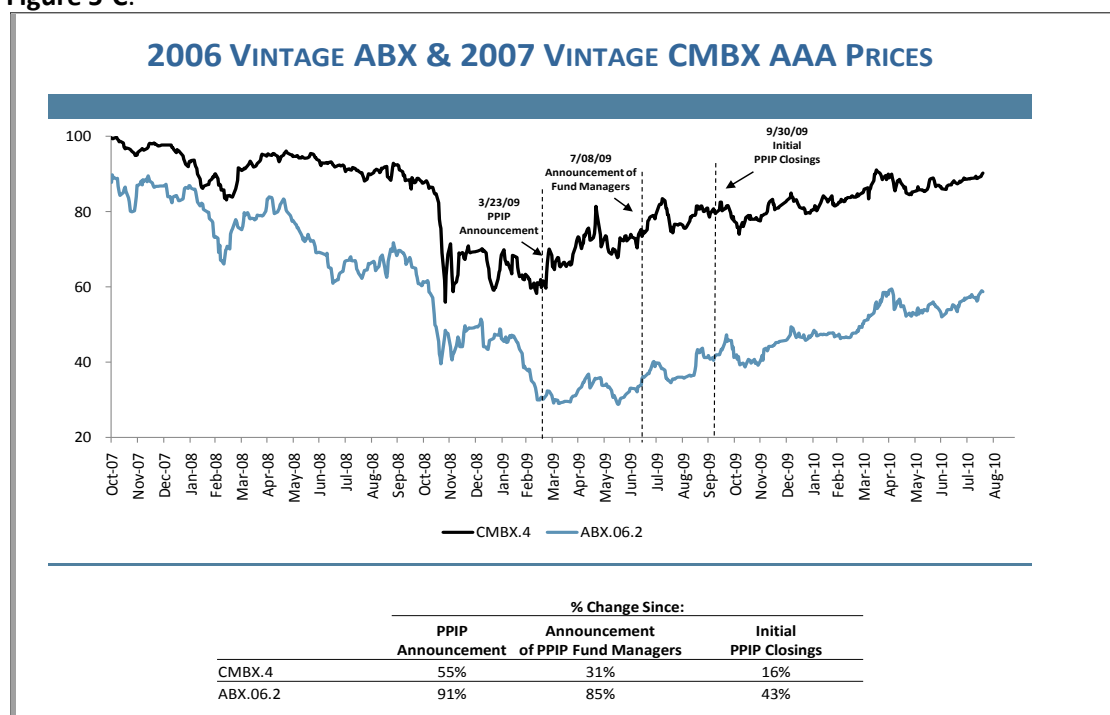
<sup>8</sup> The next Public Private Investment Program Quarterly Report, available at [www.FinancialStability.gov/roadtostability/legacysecurities.html#reports](http://www.FinancialStability.gov/roadtostability/legacysecurities.html#reports), will have information through September 30, 2010.

<sup>9</sup> The National Information Center is a repository of financial data and institution characteristics collected by the Federal Reserve System.

<sup>10</sup> The ABX is a liquid, tradable tool developed by Markit, which allows investors to take positions in a standardized basket of subprime non-agency RMBS reference obligations via credit default swap contracts. The CMBX is a liquid, tradable tool developed by Markit, which allows investors to take positions in a standardized basket of CMBS reference obligations via credit default swap contracts. Such indices have become widely used benchmarks for the performance of (i) subprime non-agency RMBS and (ii) CMBS, respectively.

## 5. TARP Investment Program Descriptions

Figure 5-C:



### ***d. Extending New Credit***

Since the announcement of the program in March 2009, approximately ten new CMBS and RMBS transactions have been brought to market, collectively representing approximately \$5 billion in new issuance to date. Although smaller than the annual issuance prior to the financial crisis, we believe that these transactions, particularly in CMBS, represent meaningful steps toward new credit formation in the marketplace.

### ***e. Returns to Taxpayers***

Although the PPIFs have been in operation for only a short time, each of the eight PPIFs has generated positive investment returns for Treasury, with net internal rates of return since inception ranging from 13 percent to 37 percent as of June 30, 2010. The PPIFs have generated cumulative unrealized equity gains in excess of funded capital contributions of more than \$600 million as of June 30, 2010 to all investors (Treasury and private investors). As of September 30, 2010, the PPIFs also have made approximately \$215 million of interest and dividend payments and distributions to Treasury. Because the PPIFs are still in the early stages of their investment life cycles, it would be premature to draw any meaningful long-term conclusions regarding the performance of individual PPIFs or the program in general. However, Treasury has been encouraged by the performance of the PPIP fund managers to date.

## 5. TARP Investment Program Descriptions

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### *f. PPIP Going Forward*

The PPIFs are still in their first year of investing, having only drawn approximately 63 percent of their potential purchasing power as of September 30, 2010, and are expected to continue deploying and reinvesting their capital in eligible assets through 2012. As time progresses, Treasury anticipates that the PPIP fund managers will continue to make prudent investment decisions that are consistent with their long-term, buy and hold strategy, and that the PPIFs will serve as a stabilizing force in the market.



## 5. TARP Investment Program Descriptions

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### I. SBA 7(a) Securities Purchase Program

Small businesses have played an important role in generating new jobs and growth in our economy. The Small Business Administration's (SBA) 7(a) Loan Guarantee Program assists start-up and existing small businesses that face difficulty in obtaining loans through traditional lending channels. SBA 7(a) loans help finance a wide variety of business needs, including working capital, machinery, equipment, furniture and fixtures.

The initiative to unlock credit for small business included support for the primary market (i.e. loan origination) and secondary market support (i.e. securities market). The primary market support, an initiative separate from TARP, included temporarily increasing loan guarantees from 75 percent to 90 percent of an SBA 7(a) loan balance, as well as eliminating certain loan origination fees. These actions, which were part of the Recovery Act, made it easier for small businesses to obtain SBA 7(a) loans.

#### 1. Program and Goals

To ensure that credit flows to entrepreneurs and small business owners, Treasury took measures to complement the Obama Administration's actions to help small businesses recover and grow, including a program to purchase SBA guaranteed securities ("pooled certificates"). Treasury developed the SBA 7(a) Securities Purchase Program to purchase SBA guaranteed securities from pool assemblers. By purchasing in the open market, Treasury injected liquidity - providing cash to pool assemblers - enabling those entities to purchase additional loans from loan originators. In this manner, Treasury acted as a patient provider of incremental liquidity to foster a fluid secondary market, which in turn benefits small business lending.

The design and the launch of the program experienced delays due to the reluctance of pool assemblers (sellers) to participate in the program, citing concerns about EESA restrictions, general hesitancy in doing business with the government and 'TARP stigma'. Notwithstanding these initial hurdles, secondary market purchases of SBA 7(a) securities originated on or after July 1, 2008 commenced in March 2010. This coincided with the expiration of the ABS portion of the TALF, which had helped to fund SBA 7(a) loans, along with credit card, automotive and student loans, among others. The SBA 7(a) Securities Purchase Program extended the liquidity assistance for the credit markets supporting small business loans. The SBA 7(a) secondary market support is intended to create an effective, fluid secondary market, which promotes additional lending in the primary market by providing originators an avenue to sell their issuances and obtain cash for additional lending, and thus improve the capital inflows to fund small businesses.

Since the launch of the program Treasury has conducted transactions with two pool assemblers. An external asset manager purchases the SBA 7(a) securities on behalf of Treasury directly from those pool assemblers (sellers) in the open market. Treasury utilized independent valuation service providers to gain additional market insight in order to make informed purchases.

#### 2. Status as of September 2010

The SBA 7(a) Securities Purchase Program was focused in scope and appropriate in scale relative to the market. Currently, there are approximately \$15 billion<sup>11</sup> SBA 7(a) securities outstanding, of which \$5

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<sup>11</sup> Based on data from SBA.gov as of July 31, 2010.

## 5. TARP Investment Program Descriptions

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billion<sup>12</sup> were issued on or after July 1, 2008 (the eligible universe for the SBA 7(a) Securities Purchase Program). The market has received the program well based on comments from the market participants and the fact that secondary market prices have strengthened.

Securities purchased by Treasury comprised about 700 loans ranging across approximately 17 diverse industries including: retail, food services, manufacturing, scientific and technical services, health care and educational services. The program has supported loans from 39 of the 50 states in the country, indicating a broad geographic impact.

As of September 30, 2010, Treasury has conducted 31 transactions totaling approximately \$357 million. The program ceased purchasing securities in conjunction with the expiration of purchase authority under the Act. Treasury will continue to manage existing positions.

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<sup>12</sup> Colson Online Factor Database, [www.colsonservices.com](http://www.colsonservices.com)

## 5. TARP Investment Program Descriptions

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### J. Automotive Industry Financing Program (AIFP)

The Automotive Industry Financing Program (AIFP) was begun in December 2008 to prevent a significant disruption of the U.S. automotive industry, because the potential for such a disruption posed a systemic risk to financial market stability and would have had a negative effect on the economy. In 2008, the auto industry lost nearly 35 percent of its sales volume and almost 400,000 jobs, and both GM and Chrysler were on the verge of disorderly liquidations. This could have caused millions of additional job losses.

Recognizing the danger, Treasury extended temporary loans to GM and Chrysler in December 2008. After the Obama Administration took office, it agreed to provide additional investments conditioned on each company and its stakeholders participating in a fundamental restructuring. Sacrifices were made by unions, dealers, creditors and other stakeholders, and the restructurings were achieved through bankruptcy court proceedings in record time. As a result, GM and Chrysler are more competitive and viable companies, supporting American jobs and the economy. Operating results have improved, the industry has added jobs, and the TARP investments have begun to be repaid.

#### 1. Programs and Goals

##### *a. Automotive companies*

Short-term funding was initially provided to General Motors (GM) and Chrysler on the condition that they develop plans to achieve long-term viability. In cooperation with the Obama Administration, GM and Chrysler developed satisfactory viability plans and successfully conducted sales of their assets to new entities in bankruptcy proceedings. Chrysler completed its sale process in 42 days and GM in 40 days. Treasury provided additional assistance during these periods.

In total, Treasury has provided approximately \$80 billion in loans and equity investments to GM, GMAC (now known as Ally Financial), Chrysler, and Chrysler Financial. The terms of Treasury's assistance impose a number of restrictions including rigorous executive compensation standards, limits on luxury expenditures, and other corporate governance requirements.

While some have questioned why TARP was used to support the automotive industry, both the Bush and Obama Administrations determined that Treasury's investments in the auto companies were consistent with the purpose and specific requirements of EESA. Among other things, Treasury determined that the auto companies were and are interrelated with entities extending credit to consumers and dealers because of their financing subsidiaries and other operations, and that a disruption in the industry or an uncontrolled liquidation would have had serious effects on financial market stability, employment and the economy as a whole.

##### *b. Supplier and warranty support programs*

In the related **Auto Supplier Support Program (ASSP)**, Treasury provided loans to ensure that auto suppliers receive compensation for their services and products, regardless of the condition of the auto companies that purchase their products. In the **Auto Warranty Commitment Program (AWCP)**, Treasury provided loans to protect warranties on new vehicles purchased from GM and Chrysler during their restructuring periods.

## 5. TARP Investment Program Descriptions

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In early 2009, auto suppliers faced the risk of uncontrolled liquidations across the sector. Fifty-four (54) supplier-related bankruptcies occurred in 2009 as the industry went through a painful restructuring. Today, in part due to the support provided by Automotive Supplier Support Program (ASSP), the auto supply base appears to have stabilized. Suppliers are now breaking even at a lower level of North American production.<sup>13</sup>

### 2. General Motors

Treasury provided \$50 billion under TARP to General Motors. This began in December 2008, with a \$13.4 billion loan by the Bush Administration to General Motors Corporation (GM or Old GM) to fund working capital. Under the loan agreement, GM was required to submit a viable restructuring plan. The first plan GM submitted failed to establish a credible path to viability, and the deadline was extended to June 2009 for GM to develop an amended plan. Treasury loaned an additional \$6 billion to fund GM during this period.

To achieve an orderly restructuring, GM filed for bankruptcy on June 1, 2009. Treasury provided \$30.1 billion under a debtor-in-possession financing agreement to assist GM during the restructuring. A newly formed entity, General Motors Company (New GM), purchased most of the assets of Old GM under a sale pursuant to Section 363 of the bankruptcy code (363 Sale). When the sale to New GM was completed on July 10, Treasury converted most of its loans to 60.8 percent of the common equity in the New GM and \$2.1 billion in preferred stock. At that time, Treasury held \$6.7 billion in outstanding loans.

Approximately \$986 million remained with Old GM (now known as Motors Liquidation Company) for wind-down costs associated with its liquidation.

#### *a. Repayments*

New GM has repaid the \$6.7 billion loan in full. (The rest of the investment is equity which will be sold as described below.) In December 2009, New GM began quarterly repayments of \$1 billion on the loan. In January 2010, New GM and Treasury amended the loan agreement to require cash that New GM held in an escrow account to be applied to repay the loan by June 30, 2010. After New GM repaid Treasury \$1 billion on March 31, 2010, the outstanding loan balance fell to approximately \$4.7 billion, all of which was repaid on April 21, 2010, from the escrowed funds.

#### *b. Ownership structure*

New GM currently has the following ownership: Treasury (60.8 percent), GM Voluntary Employee Benefit Association (VEBA) (17.5 percent), the Canadian Government (11.7 percent), and Old GM's unsecured bondholders (10 percent). As part of the restructuring, GM issued warrants to acquire additional shares of common stock to VEBA and Old GM (for distribution to the creditors of Old GM following confirmation of a plan of liquidation by the bankruptcy court).

#### *c. General Motors initial public offering*

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<sup>13</sup> UBS Investment Research, "US Auto Supplier Survey Q2 2010" (July 8, 2010).

## 5. TARP Investment Program Descriptions

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Treasury has indicated the most likely exit strategy for the AIFP equity investments is a gradual sale beginning with an initial public offering of New GM. In June 2010, Treasury provided guidance on its role in the exploration of an IPO by New GM. The following are excerpts from the statement:

- The exact timing of an IPO will be determined by New GM in light of market conditions and other factors.
- The overall size of the offering and relative amounts of primary and secondary shares will be determined at a later date.
- The selection of the lead underwriters was made by New GM, subject to Treasury's agreement that the selection was reasonable. Treasury will determine the fees to be paid to the underwriters.

In August 2010, New GM filed a registration statement on Form S-1 with the U.S. Securities and Exchange Commission (SEC) for a proposed IPO consisting of common stock to be sold by certain of its stockholders, including Treasury, and the issuance by the company of its Series B mandatory convertible junior preferred stock. Treasury will retain the right, at all times, to decide whether and at what level to participate in the offering.

### 3. Chrysler

Treasury has provided a total commitment of \$15.8 billion to Chrysler and Chrysler Financial of which \$12.7 billion has been utilized. In January 2009, Treasury loaned \$4 billion to Chrysler Holding (the parent of Chrysler Financial and Old Chrysler). Under the loan agreement, Chrysler was required to implement a viable restructuring plan. In March 2009, the Administration determined that the business plan submitted by Chrysler failed to demonstrate viability and concluded that Chrysler was not viable as a stand-alone company.

President Obama subsequently laid out a framework for Chrysler to achieve viability by partnering with the international car company Fiat. As part of the planned restructuring, in April 2009, Chrysler filed for bankruptcy protection. In May 2009, Treasury provided \$1.9 billion to Chrysler (Old Chrysler) under a debtor-in-possession financing agreement for assistance during its bankruptcy proceeding.

#### *a. New Chrysler*

In June 2009, a newly formed entity, Chrysler Group LLC (New Chrysler), purchased most of the assets of Old Chrysler under a 363 Sale. Treasury provided a \$6.6 billion loan commitment to New Chrysler, and received a 9.9 percent equity ownership in New Chrysler. Fiat transferred valuable technology to Chrysler and, after extensive consultation with the Obama Administration, committed to building new fuel efficient cars and engines in U.S. factories.

Treasury's remaining investments in New Chrysler consist of 9.9 percent of common equity and a \$7.1 billion loan (including undrawn commitments and \$500 million assumed from Chrysler Holding). New Chrysler currently has the following ownership: Chrysler Voluntary Employee Benefit Association (VEBA) (67.7 percent), Fiat (20 percent), Treasury (9.9 percent), and the Government of Canada (2.5 percent).

#### *b. Old Chrysler*

## 5. TARP Investment Program Descriptions

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In April 2010, the bankruptcy court approved Old Chrysler's Plan of Liquidation. As a result, the \$1.9 billion debtor-in-possession loan provided to Old Chrysler in May 2009 was extinguished and the assets remaining with Old Chrysler, including collateral security attached to the loan, were transferred to a liquidation trust. Treasury retained the right to recover the proceeds from the liquidation of the specified collateral, but does not expect a significant recovery from the liquidation proceeds.

### ***c. Settlement with Chrysler Holding***

The original \$4 billion loan made to Chrysler Holding in January 2009 went into default when Old Chrysler filed for bankruptcy. In July 2009, \$500 million of that loan was assumed by New Chrysler. In May 2010, Treasury accepted a settlement payment of \$1.9 billion as satisfaction in full of the remaining debt obligations associated with the original loan. The final repayment, while less than face value, was significantly more than Treasury had previously estimated to recover following the bankruptcy and greater than an independent valuation provided by Keefe, Bruyette and Woods, Treasury's adviser for the transaction.

### ***d. Chrysler Financial***

In January 2009, Treasury announced that it would lend up to \$1.5 billion to a special purpose vehicle (SPV) created by Chrysler Financial to enable the company to finance the purchase of Chrysler vehicles by consumers. In July 2009, Chrysler Financial fully repaid the loan, including the additional notes that were issued to satisfy the EESA warrant requirement, together with interest.

## **4. Ally Financial (formerly GMAC)**

Treasury has invested approximately \$17 billion in Ally Financial. This began with an investment by the Bush Administration of \$5 billion in December 2008. Treasury also lent \$884 million of TARP funds to GM (one of GMAC's owners) for the purchase of additional ownership interests in a rights offering by GMAC. In May 2009, federal banking regulators required GMAC to raise additional capital by November 2009 in connection with the SCAP/stress test. Treasury exercised its option to exchange the loan with GM for 35.4 percent of common membership interests in GMAC. Treasury also purchased \$7.5 billion of convertible preferred shares from GMAC, which enabled GMAC to partially meet the SCAP requirements. Additional Treasury investments in GMAC were contemplated to enable GMAC to satisfy the SCAP requirements. These were completed in December 2009, when Treasury invested an additional \$3.8 billion in GMAC. Today, Treasury's investment consists of 56.3 percent of the common stock, \$11.4 billion of mandatorily convertible preferred securities (which may be converted into common stock at a later date) and \$2.7 billion of trust preferred securities.

## **5. Status as of September 2010**

### ***a. Auto supplier support and warranty commitment program***

Treasury has recovered all amounts invested under the supplier and warranty programs. With the emergence of New GM and New Chrysler from bankruptcy proceedings and with the threat of liquidation greatly reduced, credit market access for suppliers improved. In July 2009, Treasury reduced the base commitment under the supplier support program to \$3.5 billion. As scheduled, the program closed in April 2010 after full repayment of all loans, which had totaled not more than \$413 million, with interest. The warranty program was terminated in 2009, and the \$640 million advanced under the program was assumed and/or repaid in the bankruptcy sale transactions by New GM and New Chrysler.

## 5. TARP Investment Program Descriptions

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### *b. Outlook on automotive industry following restructurings and repayments*

Today, the domestic auto industry continues to recover. U.S. sales improved in the first half of 2010 with annualized auto sales running at 11.1 million vehicles (compared to 9.6 million in the first half of 2009 and 10.4 million for the full year of 2009). Since the GM and Chrysler bankruptcies concluded last year, U.S. auto industry employment has increased by 62,100 jobs.

As the outlook for the domestic auto industry has improved and the estimated value of Treasury's investments has increased, the projected cost of AIFP has decreased (from approximately \$28.2 billion as of November 2009, to \$17 billion as of August 2010).

- GM repaid \$7 billion to Treasury, and is currently preparing for an initial public offering in which Treasury may elect to sell shares. In the first six months of 2010, GM achieved two consecutive quarters of positive operating profit and net income – its first quarterly profits since 2007.
- Likewise, after taking one-time charges last year associated with its restructuring, Chrysler posted two consecutive quarters of operating profit. With respect to Old Chrysler, Treasury was repaid \$1.9 billion, which was significantly more than Treasury had previously estimated to recover.
- Each of Ally Financial's four operating businesses has generated a profit so far this year.



## 5. TARP Investment Program Descriptions

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### K. American International Group, Inc. (AIG) Investment Program

“We acted because the consequences of AIG failing at that time, in those circumstances, would have been catastrophic for our economy and for American families and businesses.”

- Secretary Geithner, Written Testimony before the House Committee on Oversight and Government Reform (January 27, 2010), available at: <http://www.treas.gov/press/releases/tg514.htm>.

In September of 2008, panic in the financial system was deep and widespread. Fannie Mae and Freddie Mac were placed into conservatorship; Lehman Brothers filed for bankruptcy; and Merrill Lynch was acquired by Bank of America in a last-minute rescue. Major banks, such as Washington Mutual and Wachovia, experienced debilitating deposit withdrawals, eventually collapsed, and were acquired. Money market funds also suffered a broad run, threatening what was considered one of the safest investments for Americans. The commercial paper market was also disrupted, threatening a vital source of funding for many businesses. No one knew how deeply the markets and the economy would fall, and private lenders massively retrenched risk.

Amidst these events, on Friday, September 12, American International Group (AIG) officials informed the Federal Reserve and Treasury that the company was facing potentially fatal liquidity problems. Although it was neither AIG’s regulator nor supervisor, the Federal Reserve Bank of New York (FRBNY) immediately brought together a team of people from the Federal Reserve, the New York State Insurance Department, and other experts to consider how to respond to AIG’s problems. Congress gave the Federal Reserve authority to provide liquidity to the financial system in times of severe stress, and it acted to fulfill that responsibility.

At the time, AIG was the largest provider of conventional insurance in the world, with approximately 75 million individual and corporate customers in over 130 countries. AIG’s assets exceeded \$1 trillion. It was significantly larger than Lehman Brothers. It insured 180,000 businesses and other entities employing over 100 million people in the U.S. It was a large issuer of commercial paper and the second largest holder of U.S. municipal bonds. AIG’s parent holding company, which was largely unregulated, engaged in financial activities that strayed well beyond the business of life insurance and property and casualty insurance. Its financial products unit was a significant participant in some of the newest, riskiest, and most complex parts of the financial system.

In the chaotic environment of September 2008, the Federal Reserve and Treasury concluded that AIG’s failure could be catastrophic. Among other things, if AIG had failed, the crisis would have almost certainly spread to the entire insurance industry, and its failure would have directly affected the savings of millions of Americans in ways that Lehman’s failure did not. Therefore, the government took action to protect the financial system.

AIG needed a durable restructuring of both its balance sheet and its business operations. Falling asset prices generated substantial losses on the company’s balance sheet. They also increased the payments to counterparties that AIG was required to make under the terms of credit protection contracts it had sold. AIG’s insurance subsidiaries experienced significant cash outflows related to a securities lending program, as the value of residential mortgage-backed securities that they had purchased and loaned against cash collateral continued to fall.

## 5. TARP Investment Program Descriptions

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The government faced escalating and unprecedented challenges on many different fronts of the financial crisis during September, October, and November. During that time, the Federal Reserve and Treasury took a series of steps to prevent AIG's disorderly failure and mitigate systemic risks.

### 1. Program and Goals

The initial assistance to AIG was provided by the FRBNY before the passage of EESA and the creation of TARP. The FRBNY provided loans to AIG under the section 13(3) authority of the Federal Reserve Act to lend on a secured basis under "unusual and exigent" circumstances to companies that are not depository institutions:

- In September 2008, the FRBNY provided an \$85 billion credit facility to AIG, and received preferred shares which currently have approximately 79.8 percent of the voting rights of AIG's common stock (known as Series C). The FRBNY created the AIG Credit Facility Trust (the Trust) to hold the shares for the benefit of the U.S. Treasury but the Department of the Treasury does not control the Trust and cannot direct its trustees.

After TARP was enacted, the Treasury and the Federal Reserve continued to work together to address the challenges posed by AIG:

- In November 2008, the Federal Reserve and Treasury jointly announced a package of actions designed to address the continuing vulnerabilities in AIG's balance sheet that threatened its viability and its credit ratings. Treasury invested \$40 billion in senior preferred stock of AIG under the authority recently granted by EESA (the preferred stock was subsequently exchanged in April 2009, for face value plus accrued dividends, into \$41.6 billion of a different series of preferred stock), and it also received warrants to purchase common shares in the firm. The funds were used immediately to reduce the loans provided by the FRBNY. As part of the restructuring, the FRBNY also agreed to lend up to \$22.5 billion to a newly created entity, Maiden Lane II LLC, to fund the purchase of residential mortgage-backed securities from the securities lending portfolio of several of AIG's regulated U.S. insurance subsidiaries, and up to \$30 billion to a second newly created entity, Maiden Lane III LLC, to fund the purchase of multi-sector collateralized debt obligations from certain counterparties of AIG Financial Products Corp. (AIGFP).
- In April 2009, Treasury created an equity capital facility, under which AIG may draw up to \$29.8 billion as needed in exchange for issuing additional shares of preferred stock to Treasury. As of September 30, 2010, AIG has drawn \$7.5 billion from the facility and the remainder will be used in connection with the restructuring plan discussed below.
- In December 2009, the Federal Reserve received preferred equity interests in two special purpose vehicles (SPVs) formed to hold the outstanding stock of AIG's largest foreign insurance subsidiaries, American International Assurance Company (AIA) and American Life Insurance Company (ALICO), in exchange for a \$25 billion reduction in the balance outstanding and maximum credit available under AIG's revolving credit facility with the FRBNY. The transactions positioned AIA and ALICO for initial public offerings or sale.

## 5. TARP Investment Program Descriptions

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### 2. The AIG Restructuring Plan and Taxpayer Exit

On September 30, 2010 AIG announced that it had entered into an agreement-in-principle with the U.S. Department of the Treasury, the FRBNY, and the Trust designed to repay all of the company's obligations to American taxpayers. The restructuring plan will accelerate the timeline for AIG's repayment of the government and will put taxpayers in a considerably stronger position to recoup their investment in the company. At current market prices the value of the 1.655 billion of shares that Treasury will receive is approximately \$64.3 billion,<sup>14</sup> versus the \$47.5 billion that Treasury has invested in the company to date.

The basic terms of the restructuring plan are straightforward in concept: sell sufficient assets to pay off AIG's obligations to the FRBNY, streamline AIG's business portfolio, and recapitalize AIG's balance sheet to support investment grade status without the need for ongoing government support.

More specifically, the plan is premised on three key steps:

#### ***a. Repaying and terminating the FRBNY Credit Facility with AIG***

Today, AIG owes the FRBNY approximately \$21 billion in senior secured debt under the FRBNY credit facility. Under the plan, AIG will repay this entire amount and terminate the FRBNY senior secured credit facility. Funding for this will come primarily from the proceeds of the initial public offering of the company's Asian life insurance business (AIA) and the pending sale of its foreign life insurance company (ALICO) to MetLife.

#### ***b. Facilitating the orderly exit of the U.S. Government's interests in two special purpose vehicles (SPVs) that hold AIA and ALICO***

Today, the FRBNY holds preferred interests in two AIG-related SPVs totaling approximately \$26 billion. Under the plan, AIG will use the remaining \$22 billion of TARP funds available to it (under the Series F preferred stock facility provided in April 2009) and Treasury will receive an equal amount of the FRBNY's preferred interests in the SPVs. Over time, AIG will repay the FRBNY and the Treasury for these preferred interests through proceeds from the sales of AIG Star Life Insurance and AIG Edison Life Insurance, the monetization of the remaining equity stake in AIA, the sale of MetLife equity securities that AIG will own after the close of the ALICO sale, and the monetization of certain other designated assets. The aggregate value of the assets underlying the preferred interests in the SPVs significantly exceeds the liquidation preference of the preferred interests. Treasury does not anticipate incurring any loss from its purchase of the SPV preferred interests.

#### ***c. Retiring AIG's remaining TARP support***

To date, Treasury has invested approximately \$47.5 billion of TARP funds in AIG. Under the plan, Treasury is expected to receive approximately 1.1 billion shares of AIG common stock in exchange for its existing TARP investments in AIG, and an additional 563 million shares of common stock from the exchange of the Series C preferred shares held by the Trust. After the exchange is completed, it is expected that Treasury will sell its stake in AIG into the public markets over time.

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<sup>14</sup> The price of AIG common stock, as of Friday, October 1, 2010, was \$38.86.

## 5. TARP Investment Program Descriptions

The plan is still subject to a number of conditions, and much work remains to be done to close the transactions. Nevertheless, the plan reflects the substantial progress that AIG and the government have made in restructuring the company and reducing the systemic risk that it once posed. The plan also represents a significant step towards ending the government's role in providing assistance to the company.

Over the past two years, the government has worked with AIG to recruit a new CEO, a new Chief Risk Officer, a new General Counsel, a new Chief Administrative Officer, and an almost entirely new Board of Directors. All of these executives and directors are committed to the objective of executing the restructuring plan and paying back taxpayers as promptly as practicable. In addition, the profitability of the AIG's core business – its insurance subsidiaries – has been steadily improving, as has the market's perception of the value of these subsidiaries. The improvement in the value of these businesses and their ultimate sale are central to the AIG restructuring plan.

Upon completion of the restructuring plan, AIG will be a simplified life, property and casualty insurer with solidly capitalized insurance subsidiaries, adequate liquidity, and a stable balance sheet.

### Treasury Positions in AIG, post-Restructuring <sup>(1)</sup>

	TARP	Other (Series C)	Total Treasury
Funds Invested (\$B)	\$69.8	-	\$69.8
Common Equity			
Number of Shares (B)	1.092 <sup>(2)</sup>	0.563 <sup>(3)</sup>	
Value (\$B)	\$42.4 <sup>(4)</sup>	\$21.9 <sup>(4)</sup>	\$64.3
Preferred Interest In AIG SPVs (\$B)	\$22.3 <sup>(5)</sup>	-	\$22.3
<b>Treasury Net Value (\$B)</b>	<b>(\$5.1)</b>	<b>\$21.9</b>	<b>\$16.8</b>

Note: This table shows only Treasury's investments in AIG and does not reflect FRBNY's loans to or interests in AIG. The restructuring plan provides for payment in full of the FRBNY Credit Facility. In addition, the value of the assets held by Maiden Lane II and Maiden Lane III currently exceeds the amounts of the FRBNY loans to those entities, and it is expected that each of those loans will be paid in full.

<sup>(1)</sup> Treasury holds investments in AIG in two forms: equity investments made through TARP and equity provided to the AIG Credit Facility Trust for Treasury's benefit and in connection with the Federal Reserve's creation of the FRBNY Credit Facility in September 2008.

<sup>(2)</sup> After the proposed restructuring of AIG TARP will hold 1.092 billion shares of AIG common stock.

<sup>(3)</sup> After the proposed restructuring of AIG Treasury will receive 563 million shares of AIG common in connection with the wind-down of the AIG Credit Facility Trust.

<sup>(4)</sup> Common equity is valued at the market closing price on October 1, 2010 of \$38.86 per share.

<sup>(5)</sup> After the proposed restructuring of AIG, TARP will hold up to \$22.3 billion of preferred interests in two AIG-related SPVs. The estimated aggregate value of the assets underlying the preferred interests in the SPVs significantly exceeds the liquidation preference of the TARP preferred interests. Therefore, Treasury does not anticipate incurring any loss from its purchase of the SPV preferred in connection with the AIG restructuring. For further details see the 8-K filed by AIG with the SEC on September 30, 2010.

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### 3. Protecting the Taxpayer

Since the rescue of AIG, there have been a number of criticisms leveled at the actions the government took and the decision-making process that resulted in those actions. Representatives of Treasury, the Federal Reserve Board, and the FRBNY have testified on several occasions about the actions that the government took and have provided written responses for the public record.<sup>15</sup> That record should be read by anyone who wants to obtain a full understanding of the government's actions. In this report, we summarize some of the issues that have been raised in that public discussion. We focus on three key questions that have been asked:

- Should AIG have been allowed to fail and go bankrupt?
- Were all other options exhausted before assistance was provided to AIG?
- Were the payments made by AIG to its derivative counterparties appropriate?

#### ***a. Should AIG have been allowed to fail and go bankrupt?***

Some observers have argued that AIG should have been left to fail and file for bankruptcy. However, by virtue of both the size of its balance sheet and the nature of its liabilities, an AIG bankruptcy in September of 2008 would have been catastrophic to global financial and insurance markets. AIG was one of the largest life insurers in the United States. AIG's failure would have directly threatened the savings of millions of Americans. AIG had provided financial protection to municipalities, pension funds, and other public and private entities through guaranteed investment contracts and products that protect participants in 401(k) retirement plans. Doubts about the value of AIG life insurance products could have generated doubts about similar products provided by other life insurance companies, and opened an entirely new channel of contagion and panic.

In addition, upon the filing of a bankruptcy petition by AIG, holders of hundreds of billions of dollars of financial assets "insured" by AIGFP would have been entitled to: (i) immediately terminate their insurance contracts with AIG, (ii) apply the collateral AIG had previously posted with them to their termination claims against AIG, and (iii) offset remaining contractual claims they had against AIG against any other obligation they might owe AIG on any other qualified financial contract. The consequences of this rapid unwinding of AIG's credit insurance would have been severe. Having lost the benefit of AIG's insurance or "wrap" on hundreds of billions of dollars of credit instruments, AIG's counterparties would have sought to replace the insurance if it were available, or (because such insurance was largely unavailable in September of 2008) to sell the underlying credit instruments so as to mitigate future losses.

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<sup>15</sup> See, for example, Secretary Geithner's Testimony before the House Committee on Oversight and Government Reform (January 27, 2010), available at: <http://www.treas.gov/press/releases/tg514.htm>; Written Testimony of Jim Millstein, Chief Restructuring Officer, U.S. Department of the Treasury, before the Congressional Oversight Panel (May 26, 2010), available at: <http://cop.senate.gov/documents/testimony-052610-millstein.pdf>; Federal Reserve Board Chairman Ben S. Bernanke's Testimony before the House Committee on Financial Services (March 24, 2009), available at: <http://www.federalreserve.gov/newsevents/testimony/bernanke20090324a.htm>; Scott G. Alvarez's Testimony before the Congressional Oversight Panel (May 26, 2010), available at: <http://www.federalreserve.gov/newsevents/testimony/alvarez20100526a.htm>; and Thomas C. Baxter's Testimony before the House Committee on Oversight and Reform (January 27, 2010), available at: <http://www.newyorkfed.org/newsevents/speeches/2010/bax100127.html>.

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The widespread sale of hundreds of billions of dollars of a concentrated class of financial assets would have created significant additional downward selling pressure on financial assets, amplifying the selling panic that had already started following the Lehman bankruptcy. Of equal concern, the default by AIG and AIGFP on more than \$100 billion of institutional indebtedness, including \$15 billion of commercial paper and \$85 billion of short-term repurchase obligations, would have exacerbated the stresses in the money market and repo markets.

This damage of AIG's collapse would have rapidly spread beyond Wall Street. Borrowing costs for all businesses would have increased severely, the value of pension funds would have fallen even more sharply, and job losses would have skyrocketed. While the decision to save AIG was not an easy one, it was a better choice for the American people than facing the catastrophic risks of letting it fail given the state of the financial system at the time.

### ***b. Were all other options exhausted?***

Some have suggested that the government should have pursued other options more aggressively, such as a rescue by private firms or a "hybrid" option involving both public and private assistance. However, no one has identified a particular private or "public-private hybrid" solution that could have been achieved in the circumstances, or even a potential specific one that should have been explored. Others have suggested that a pre-packaged bankruptcy might have been possible, even though there was no legal tool available to manage the orderly wind-down of the company. In particular, the government did not have the ability to quickly separate the stable, underlying insurance businesses from the complex and dangerous financial activities carried out primarily by AIGFP.

#### ***1) Private or a hybrid private-public rescue***

The basic fact is that AIG needed over \$60 billion in September 2008 to avoid failure. No private firm was willing to provide it, despite the efforts of AIG and the government to secure support. AIG had already reached out to the private sector for funding but was unable to find companies willing to lend it the amount that it needed to avoid bankruptcy. The government also worked to facilitate a private solution. A series of major investors considered taking action and refused to do so, including Warren Buffett, two of the largest banks, and some of the largest private equity firms in the world.

At the time AIG needed assistance, banks were shrinking credit and were reluctant to lend even to one another. Large private investors were hoarding cash. In short, it was simply not possible, under the circumstances, to prevent the failure of AIG without having the government step in.

#### ***2) Pre-packaged bankruptcy***

Others have suggested that the government should have explored the option of a pre-packaged bankruptcy for AIG. A pre-packaged bankruptcy typically requires months of planning and preparation. By contrast, in September 2008, the FRBNY, having had no previous regulatory or supervisory authority over AIG or AIGFP, did not have time to organize AIG's thousands of creditors and hundreds of regulators (in over 100 countries) into an effective negotiating committee, let alone structure a plan of reorganization with them and implement it.

The impracticality of a pre-packaged plan process for AIG was not merely about timing, however, as there was a more fundamental problem. AIG's business depends on its customers' and lenders' perception of its long-term viability. Unlike a manufacturing or retail company, the stability of a



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financial institution like AIG depends on its customers' and counterparties' confidence that it will be "good for the money". A manufacturer or a retailer can continue to sell its products during the restructuring of its balance sheet so long as it has physical goods to sell. A financial institution like AIG cannot. A balance sheet restructuring involving the compromise of its obligations, whether in or out of formal bankruptcy proceedings, is fundamentally inconsistent with the basic commitment that an insurance company gives to its customers: that it will honor its long-term payment obligations.

Similarly, even with an announced government facility to "bridge" AIG to and through bankruptcy, at the first hint that AIG had commenced negotiations with its creditors over the potential restructuring of their debt, AIG's ability to sell new insurance policies would likely have evaporated. Equally damaging, redemptions of old policies would have further accelerated. Together, the loss of new sales and the increase in redemptions would have created a huge drain on the insurance subsidiaries' liquidity. Similarly, short-term creditors, such as AIG's securities lending counterparties, would have likely refused to roll over their loans, demanding immediate payment instead. That "run" on AIG and its subsidiaries' liquidity would have forced regulators to protect all policyholders in their jurisdictions by ring-fencing the insurers' assets or, in the extreme case, forcing the insurer into wind-down proceedings. In addition, it is probable that in order to effectuate a pre-packaged bankruptcy, the size of a government "bridge" facility would have needed to be much larger than the amount of assistance the government actually provided to stabilize the company.

Moreover, at the time there existed no "resolution authority" to resolve AIG, such as the manner in which the FDIC resolves banks. AIG's liquidity position and the value of its underlying insurance subsidiaries were inextricably linked to the rating of the parent company. So with no other "resolution" alternative, the only way to avoid the systemic risks associated with a chapter 11 filing of AIG was to provide AIG with (i) sufficient liquidity to meet its obligations to its creditors and counterparties in the ordinary course of business in full (so as to avoid any defaults that might trigger insolvency proceedings), and (ii) sufficient equity to maintain AIG's investment grade rating (so as to preserve the viability of its insurance subsidiaries and to avoid further collateral calls at AIGFP).

By contrast, commencement of bankruptcy proceedings for those subsidiaries of AIG that were eligible for chapter 11 relief would have triggered ratings downgrades at each of AIG's major insurance subsidiary groups and would almost certainly have resulted in the commencement of receivership, rehabilitation or wind-down proceedings by local insurance regulators, affecting the redemption and surrender rights of more than 100 million life insurance and annuity policyholders, globally. With its insurance subsidiaries in separate regulatory proceedings in 130 countries, any sale of AIG's major insurance business units as integrated wholes would have been extremely difficult.

These further downgrades by the rating agencies would also have triggered additional collateral calls at AIGFP, putting AIG's liquidity under even greater stress. In all likelihood, the policyholder run on AIG's insurance subsidiaries and the counterparty run on AIGFP would have started in earnest before any pre-packaged plan could have been put to a vote.

### **3) *Conditional lending***

Some have suggested that the government should have made its assistance to AIG conditional on certain creditors taking discounts on their claims. There are a number of reasons why the government did not do so which are discussed in the testimony referred to earlier. Most important, had the government conditioned its assistance on AIG's coercion of certain creditors to reduce their amounts due and owed from AIG, the government would have created the very conditions of default that it was



## 5. TARP Investment Program Descriptions

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seeking to avoid. The coercion would have undercut the government's primary goal in providing AIG with necessary liquidity – enabling AIG to pay its customers and creditors, maintain confidence, and avoid further rating downgrades and default. The tactic has been used in certain sovereign debt restructurings, but it can be used there only because sovereigns cannot go bankrupt, and it generally requires months of planning.

In addition, any attempt to condition the government's lending would have created further uncertainty as to which of AIG's counterparties would have been paid and which would have been forced to take losses. More generally, conditional lending would have undermined the public's trust in the government's commitment to the broader range of extraordinary financial stability initiatives underway during that very fragile period. One of the objectives at the time was to calm market participants. The market uncertainty (and the potential allegations of favoritism) that would have followed from conditional lending would have undermined that aim. Such an action would have caused confusion and doubt about what the government might do. For instance, would the government force the creditors of other institutions to take haircuts as a condition of assistance and, if so, which ones?

Finally, conditional lending might not necessarily have even worked: would a creditor who was pressed for a discount simply refuse and declare a default? In sum, conditional lending would have heightened the risk of an AIG default, which is what the government was trying to – and did – avoid.

### ***c. Was the treatment of AIG's derivative counterparties appropriate?***

Various questions have been raised about how AIG's counterparties were treated when Maiden Lane III was established. While the financial contracts involved were complex, basically, AIG had agreed to insure the value of certain risky securities called multi-sector CDOs. The value of these securities was tied to pools of other assets, mostly subprime mortgages. As the financial crisis intensified, the value of the securities fell sharply, and AIG had to post collateral or make payments on the insurance.

The problem was that AIG had written billions of dollars of insurance on these CDOs without sufficient capital. AIG was fine as long as the prices of the assets it insured didn't fall, and its own credit rating didn't fall. But if either happened, it would be in trouble. In the fall of 2008, both events occurred. The value of the assets and AIG's credit rating fell, bringing AIG to the brink of bankruptcy.

By August of 2008, AIG had already paid out over \$16 billion to counterparties on contracts similar to the ones that Maiden Lane III was designed to address. When the Federal Reserve established the initial credit facility on September 16, 2008, it knew that there could be further demands of this sort. In the midst of the ongoing financial crisis, the underlying mortgage securities were likely to continue to decline in value.

The government faced the following options: let AIG default on these contracts; continue to lend AIG money so it could meet its short-term obligations; or restructure the contracts to stop the hemorrhaging, and potentially recover value on them in the future. If the government had let AIG default, it would have gone into bankruptcy, triggering all the disastrous economic consequences described earlier. If the government had simply continued to lend AIG money, it would have fed a vicious cycle. AIG could have made its current payments, but this would have increased AIG's debt at a time when the rating agencies felt AIG already had too much. Any resulting downgrade by the rating agencies would have further threatened AIG's viability, driving more uncertainty and panic through the entire financial system, and requiring even more financial support.

## 5. TARP Investment Program Descriptions

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Instead, the government sought to restructure the contracts. The counterparties held insurance contracts entitling them to full or par value of the contract. Some have suggested that the FRBNY should have used its regulatory authority, or some other means, to coerce AIG's counterparties to accept discounts. This was not a viable option either. If the FRBNY had sought to force counterparties to accept less than they were legally entitled to, market participants would have lost confidence in AIG, customers would have sought other places to do business, and the ratings agencies would have downgraded AIG again. This would likely have led to AIG's collapse and threatened the government's efforts to rebuild confidence in the financial system. This would have likely meant a deeper recession, more financial turmoil, and a much higher long-term cost for American taxpayers.

Operating with these constraints, the FRBNY and AIG initiated discussions with the major counterparties about whether they would be prepared to accept concessions on the prices of the securities. The government knew that the likelihood of success was modest. Relatively quickly, most firms declared that they would not, on any condition, provide such a concession. One said that it was willing to accept a small discount, but only if everybody else would agree to equal concessions on their prices.

In order to cancel the insurance, the CDOs were purchased for fair market value, which at the time was about 48 cents on the dollar.<sup>16</sup> The counterparties also kept the cash that they had already received from AIG. Taken together, these two amounts approximately equaled the original par value that the banks had insured. In designing and implementing this transaction the Federal Reserve's objective was, as it always is, to get the best deal for the taxpayer. The Federal Reserve made judgments about these transactions carefully with the advice of outside counsel and financial experts. Because Maiden Lane III can hold the underlying CDOs to maturity, it is largely immune from short-term volatility and liquidity needs, and is therefore in a better position to maximize the value of the CDO portfolio.

In fact, since Maiden Lane III purchased the securities, they have generated significant cash flows. These have been used to pay down the FRBNY's loan by over \$9 billion. It is likely that Maiden Lane III (as well as Maiden Lane II) will pay the FRBNY back in full and generate a profit for U.S. taxpayers. While the immediate objective was to prevent AIG's collapse, the government believes that strategy that the Federal Reserve and the Treasury pursued in establishing Maiden Lane III will generate a better long-term outcome for taxpayers than would have any alternative available at that time.

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<sup>16</sup> At the time, the CDOs had a fair market value of about \$29.6 billion and a par value of approximately \$62 billion.

## 6. Retrospective on the TARP Housing Initiatives

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This section examines the development, accomplishments, challenges and evolution of Treasury's housing initiatives under TARP. The basic terms of these programs are summarized in the subsection titled "Summary Description of Housing Programs" on page 77.

### A. The Crisis

In the beginning of 2009, the U.S. economy was facing the fallout from a housing bubble that by some measures had doubled home prices in a period of six years. During the heady days of the bubble, lenders had migrated to riskier mortgage products and borrowers had extracted equity from their homes. From 2003 through 2006, the share of mortgages that met the relatively conservative underwriting guidelines of Fannie Mae, Freddie Mac, and the government fell roughly in half, from two-thirds to one-third, while riskier products such as subprime and "Alternative A" (Alt-A) loans gained market share.

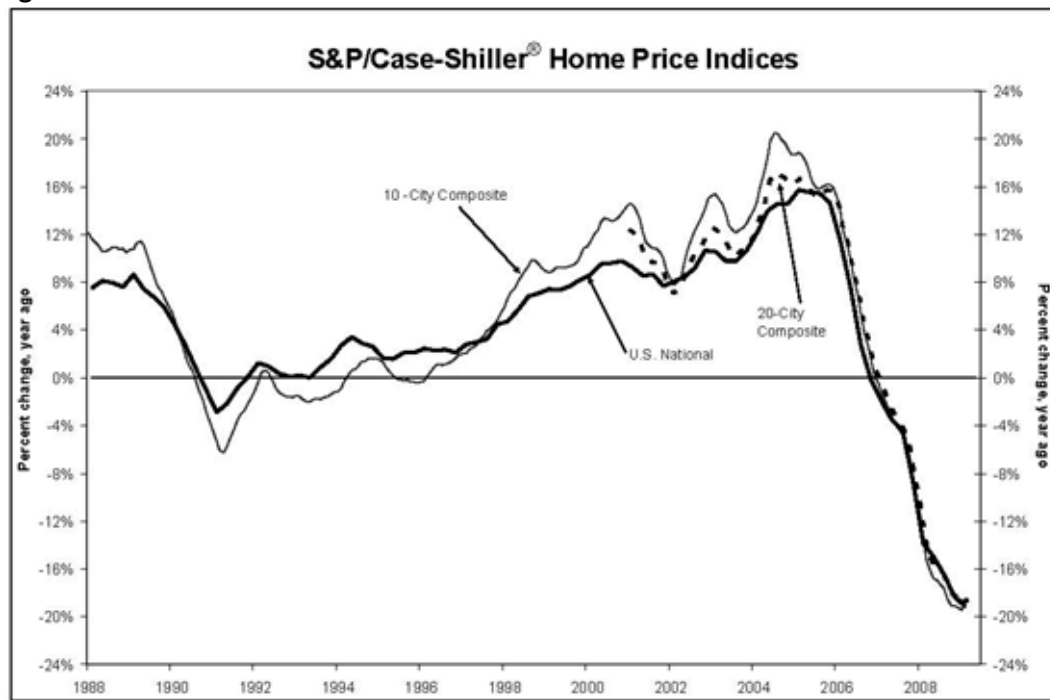
Delinquency rates on mortgages had risen significantly, particularly on riskier products; loans were defaulting at over three times their early-2004 rate. Alt-A and subprime loans, which comprised a combined 19 percent of OCC-regulated banks' portfolios in early 2009, accounted for nearly half of the seriously delinquent loans.

A backlog of seriously delinquent loans had developed, through a combination of state foreclosure moratoria and the inability of servicers to manage the unprecedented volume of defaults.

Stresses in the financial system had reduced the supply of mortgage credit, limiting the ability of Americans to buy homes. Fannie Mae and Freddie Mac had been in conservatorship for over four months. And millions of responsible American families who were making their monthly payments—despite having lost jobs or income—had seen their property values fall, and were unable to sell or refinance at lower mortgage rates. The combination of falling home prices and economic contraction had sharply increased the financial strains on many responsible homeowners. At the beginning of 2009, nearly one-quarter of homeowners owed more on their mortgages than their homes were worth.

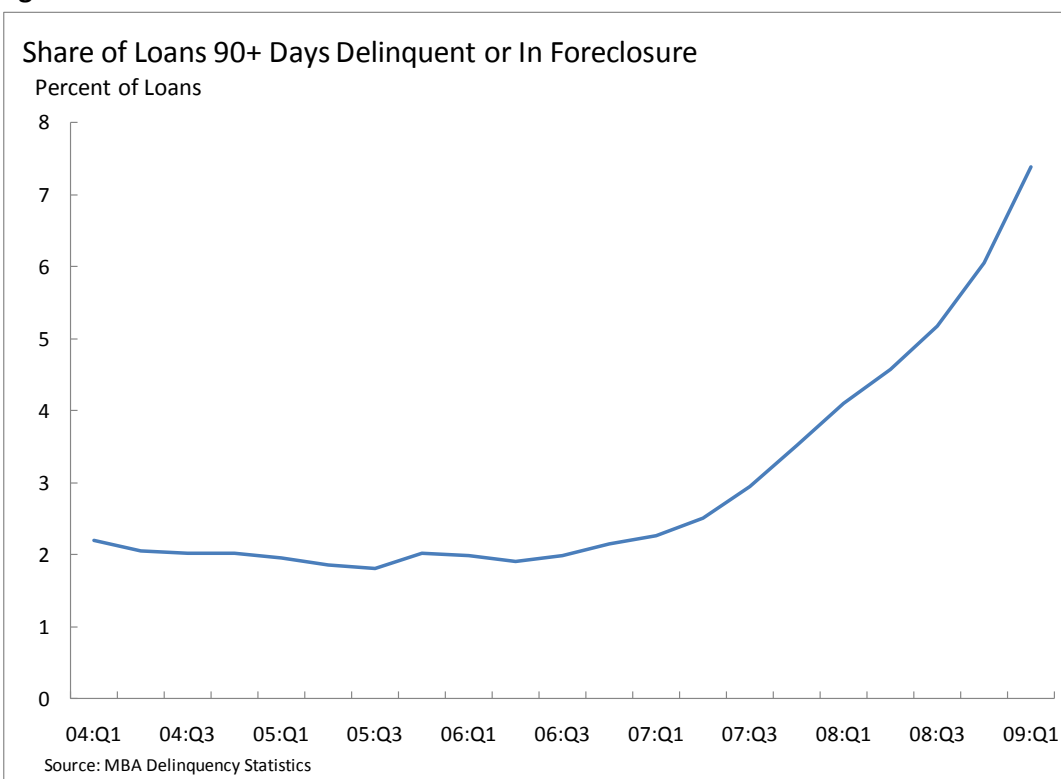
## 6. Retrospective on the TARP Housing Initiatives

Figure 6-A:



Source: Standard & Poor's and Fiserv

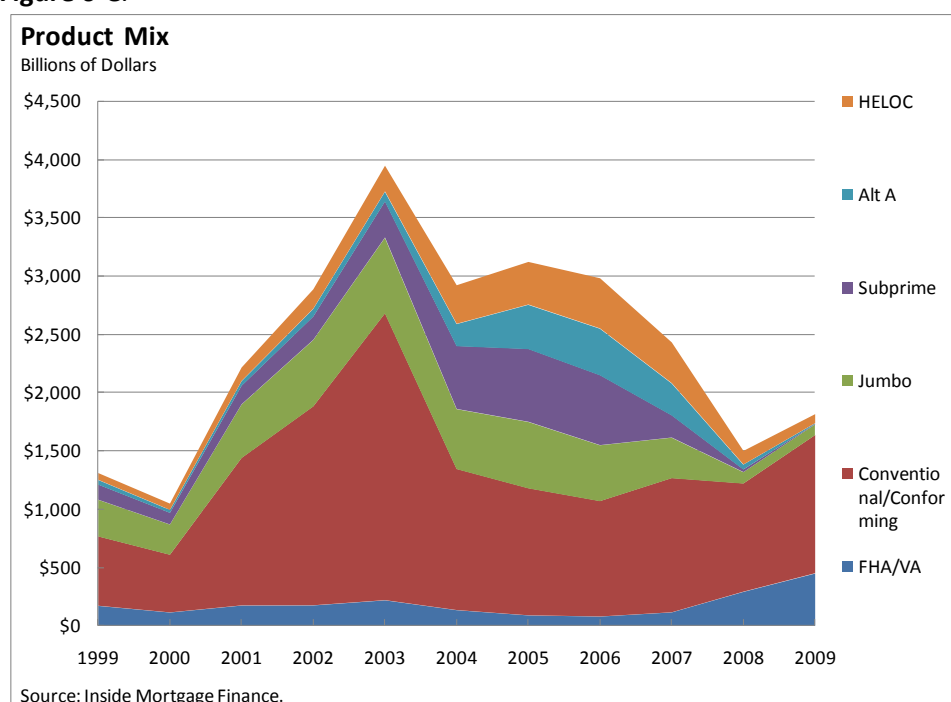
Figure 6-B:



Source: MBA Delinquency Statistics

## 6. Retrospective on the TARP Housing Initiatives

Figure 6-C:



### B. Policy Responses

During its first month in office, the Obama Administration took aggressive action to address the housing crisis. In February 2009, President Obama announced the Homeowner Affordability and Stability Plan. As part of this plan and through other housing initiatives, the Administration took the following actions to strengthen the housing market:

- Launched the Home Affordable Modification Program (HAMP), which would permanently reduce mortgage payments to affordable levels for qualifying borrowers;
- Provided strong support to Fannie Mae and Freddie Mac to ensure continued access to affordable mortgage credit across the market;
- Purchased, through Treasury and with the Federal Reserve, more than \$1.4 trillion in agency mortgage backed securities, which helped keep mortgage rates at historic lows, allowing homeowners to access credit to purchase new homes and refinance into more affordable monthly payments;
- Through the Federal Housing Administration (FHA), provided liquidity for housing purchases at a time when private lending had declined, playing an important counter-cyclical role;
- Supported expanding the limits for loans guaranteed by Fannie Mae, Freddie Mac, and FHA from previous limits up to \$625,500 per loan to \$729,750;
- Expanded refinancing options for Fannie Mae and Freddie Mac loans, particularly for borrowers with negative equity, to allow more Americans to refinance;

## 6. Retrospective on the TARP Housing Initiatives

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- Supported a tax credit for first time homebuyers, which helped 2.5 million American families purchase homes; and
- Through ARRA, provided more than \$5 billion in support for affordable rental housing through low income housing tax credit programs and \$6.92 billion in support for a neighborhood stabilization program to restore neighborhoods suffering concentrated foreclosures.

As Mark Zandi (a former economic adviser for Senator John McCain’s 2008 presidential campaign) and Alan S. Blinder (a former economic adviser for President Clinton) noted in a paper released in July 2010, the government’s financial and fiscal policies tend to reinforce each other, such that the combined effect exceeds the sum of the parts. For example, providing housing tax credits as part of the stimulus boosts housing demand and therefore house prices. Foreclosures decrease, and the financial system suffers smaller losses, which, in turn, enhances the effectiveness of the government’s efforts to stabilize the financial system.

### C. Design of HAMP

As part of that Homeowner Affordability and Stability Plan, pursuant to the authority granted in EESA, the Obama Treasury Department began work on a program that would improve the affordability of mortgages for responsible homeowners, consistent with the mandate of EESA to promote financial stability while protecting taxpayers. Developing the program posed very difficult and challenging policy tradeoffs—how to make meaningful interventions that yield a high probability of participation and broadly support borrower success while minimizing the cost to the government, moral hazard, adverse selection, and operational and financial risks and complexity.

In addition, legal and other constraints required Treasury to develop a voluntary program that would support servicers’ efforts to modify mortgages. TARP had originally been conceived as a program to purchase troubled assets directly from the balance sheets of banks, and to the extent Treasury acquired mortgages, it had authority to modify them directly. TARP was not primarily used for this purpose. EESA authorized certain types of programs to assist homeowners but constrained Treasury’s ability to set up a mandatory modification program. Direct assistance to borrowers would not be consistent with the law, and valid mortgage contracts would have to be respected by any program Treasury established. Consequently, these legal constraints forced Treasury to seek the voluntary cooperation of mortgage servicers and investors.

While designing a program to improve the affordability of mortgages for responsible homeowners was difficult, the problem facing the mortgage industry was clear: loan servicers were simply unequipped to manage the magnitude of the crisis before them. The servicers were structured and staffed to perform a limited role: collecting payments and foreclosing on delinquent mortgages. They did not have the systems, staffing, operational capacity or incentives to engage with homeowners on a large scale and offer meaningful relief from unaffordable mortgages. Moreover, the expansion of private securitizations during the housing boom left servicers in a complicated legal situation; contractual language designed during the heady days of the bubble vaguely bound them to maximize investor returns, but little specific guidance existed on how that might be accomplished if the environment turned sour. At the time, there was no consensus among loan servicers about how to respond to responsible borrowers who were willing to continue making payments but were in need of some mortgage assistance.

## 6. Retrospective on the TARP Housing Initiatives

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In August 2008, Sheila C. Bair, Chairman of the FDIC, announced a plan for the FDIC to systematically modify troubled mortgages owned or serviced by IndyMac Federal Bank. The program would use a standardized modification process, including interest rate reduction, term extension, and principal forbearance, to achieve a mortgage affordability target, defined as a monthly mortgage payment of no more than 38 percent of gross monthly income, which was later lowered to 31. The FDIC program also proposed a decision-making framework that explicitly compared the difference in cash flows a mortgage-holder would receive with and without an FDIC modification, and the probability the borrower would ultimately suffer foreclosure in either case.

Though the scale of the FDIC/IndyMac program was small relative to the national crisis, the introduction of a standardized modification objective, a method for achieving it, and a decision-making framework marked a breakthrough in the mortgage investing and servicing industries' approach to foreclosure avoidance. Toward the end of 2008, a group of counselors, mortgage companies, investors, and other mortgage market participants called the Hope Now Alliance proposed a streamlined loan modification approach, which represented its best plan to offer relief to borrowers and to preserve its members' investments in mortgages. Shortly thereafter, Fannie Mae and Freddie Mac adopted the streamlined loan modification as policy. This standardized modification would reduce the borrower's obligation to no more than 38 percent of the borrower's income through any combination of interest rate reduction, term extension, and principal forbearance.

The Hope Now Alliance framework demonstrated the private sector's willingness to work toward finding solutions to improve borrower and investor outcomes. But the program had serious drawbacks. The proposed modification framework lacked a mechanism for deciding when to apply the mortgage modification. Servicers' legal obligations toward modifying securitized loans remained uncertain, and servicers continued to be paralyzed by the need to seek approval from investors on a mortgage-by-mortgage basis. There were no accepted timeframes for servicer decisions. As a result, the streamlined loan modification was applied irregularly, and repayment plans – rather than more permanent modification solutions – remained a favored tool for servicers. In the first quarter of 2009, only half of modifications lowered borrowers' payments, and nearly 40 percent of servicers' home retention efforts took the form of repayment plans rather than modifications or modification trials. As a result, hundreds of thousands of responsible American families simply lost their homes.

The Obama Administration recognized the momentum in the private sector reflected in Hope Now's efforts and sought to build upon it. Understanding that the solution was incomplete, the Administration concluded that government had a crucial role to play in clarifying legal arrangements between servicers and securitized trusts, creating uniformity in the decision-making process, and subsidizing more generous modifications that would better stabilize borrowers.

The Administration challenged itself to develop a program that would protect taxpayers at the same time that it broadly offered responsible, but struggling, homeowners the opportunity to remain in their homes at more affordable payment levels. The Administration determined that in order to achieve these objectives simultaneously, it was critical to leave the financial risk of modification re-default with the investors. Ultimately, the program should offer the opportunity to many, but the taxpayer should pay only to the extent the distressed borrower is assisted by a permanent modification that remains in effect.



## 6. Retrospective on the TARP Housing Initiatives

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HAMP was built around four core principles, designed to help the large segment of at-risk homeowners for whom foreclosure is avoidable and who want to stay in their homes.

First, the program focused on affordability, in an effort to ensure that borrowers who hope to remain in their homes would be able to afford the modified mortgage payment. Every modification under the program would be required to lower the borrower's monthly mortgage payment to 31 percent of the borrower's monthly gross income, a level estimated to provide reasonable assurance that the modification would be sustainable. The borrower's modified monthly payment would remain in place for five years, which Treasury expected would provide sufficient time for the housing market and the financial system to recover.

Second, HAMP would protect the taxpayer by employing an innovative pay-for-success structure and requiring the investor in the mortgage to retain the risk of future re-default. This structure aligned the interests of servicers, investors, borrowers and taxpayers and encouraged loan modifications that would be both affordable for borrowers over the long term and cost-effective for taxpayers. Servicers would receive an up-front payment of \$1,000 for each successful modification after completion of the trial period, and "pay for success" fees of up to \$1,000 per year for three years, if the borrower continued to make payments on time and in full. Homeowners would earn up to \$1,000 in principal reduction each year for five years if they remained current. HAMP also matches reductions in monthly payments dollar-for-dollar with the lender/investor as they are reduced from 38 percent of the borrower's income (a 38 percent debt-to-income ratio, or "DTI") to 31 percent DTI. This requires the lender/investor to share with the Treasury the first loss in reducing the borrower's payment down to a 38 percent DTI, requiring lenders/investors to share in the burden of achieving affordability. To encourage the modification of current loans expected to default, HAMP provides additional incentives to servicers and lenders/investors after current loans are modified. These incentives were deemed crucial to the success of a program that, under EESA, would have to elicit the voluntary participation of servicers, investors and homeowners.

Third, while participation in HAMP would be voluntary for mortgage servicers, servicers who chose to participate would be prevented from "cherry-picking" loans to modify in a manner that might deny assistance to qualified borrowers at greatest risk of foreclosure. Any servicer that signed up for the program would be required to evaluate every eligible loan using a standard net present value (NPV) test. If the test was positive, the servicer would be required to modify the loan.

Fourth, unemployed borrowers would be allowed to participate in the program. Unemployed borrowers who had nine months or more of unemployment insurance remaining would be eligible to include it in their income for consideration in the NPV calculation. Unemployed borrowers are also allowed to include other sources of passive income like rental income and income from an employed spouse.

The basic HAMP terms were as follows: a participating HAMP servicer applies a series of modification steps to reduce the homeowner's monthly mortgage payment to 31 percent of the homeowner's gross (pre-tax) income, in the following order: rate reduction to as low as two percent; term extension up to 40 years; and principal deferral (or forbearance, at the servicer's option). The modified interest rate is fixed for a minimum of five years. Beginning in year six, the rate may increase no more than one percentage point per year until it reaches the Freddie Mac Primary Mortgage Market Survey rate (essentially the market interest rate) at the time the permanent modification agreement was prepared.

## 6. Retrospective on the TARP Housing Initiatives

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Before a mortgage is permanently modified, the homeowner must make the new, reduced monthly mortgage payment on time and in full, and submit the necessary documentation, during a trial period of three months to demonstrate that the modified monthly payment is sustainable. Homeowners who make payments on permanently modified loans on time accrue an incentive of \$1,000 per year to reduce the amount of principal they owe up to a maximum of \$5,000.

Any modification offer will provide a binding reduction in payments for borrowers who continue to meet the full terms of the modification, whether in the trial phase or after having converted to a permanent modification.

### D. HAMP Targeting

Protecting taxpayers required that the new program not aim to prevent all foreclosures. It would be unfair to ask taxpayers to subsidize mortgages for speculators and owners of million-dollar homes or vacation homes. Homeowners were facing foreclosure for a number of reasons, many of them outside the control of the borrowers: some were put in unsustainable loans; many saw their incomes decline. In addition, Treasury recognized that homeowners who could not afford to remain in their homes even after receiving a substantial reduction in payments could be served better by assistance in relocating to more affordable housing. Furthermore, Treasury recognized that preventing all foreclosures would be extremely expensive, would further increase the “shadow” inventory of housing stock, and would delay the stabilization of housing prices at realistic levels reflecting a rebalancing of supply and demand.

The Administration therefore identified four separate groups, and took a different approach toward each:

1. Homeowners who either are likely to find ways to remain in their homes without government assistance or, for policy reasons, the government should not assist. This group includes homeowners with jumbo mortgages, non-owner occupied homes and speculative properties. The program would not assist these homeowners.
2. Homeowners who are very likely to lose their homes, even with government assistance. This group includes homeowners who purchased homes that they simply could not afford, either as a result of poor underwriting or because they provided incomplete or misleading information (often at the urging of originators). It also includes homeowners who lost their jobs, are unlikely to regain employment with compensation comparable to their prior incomes and, due to high debt-to-income ratios, would likely default even with a lower monthly payment. The program would assist these homeowners in relocating, but trying to prevent foreclosure would not be a justified or constructive intervention.
3. Homeowners who have made the decision that they no longer want to remain in their homes, regardless of affordability, did not respond to repeated efforts to contact them and were willing to walk away from their mortgages. The program would not assist these homeowners.
4. Middle-class working homeowners in owner-occupied homes who are at risk of losing their homes but for whom government assistance would significantly improve the odds they would avoid foreclosures. Helping these homeowners would prevent unnecessary pain and suffering and would help to stabilize housing markets. **This was the target group for loan modifications through HAMP.**

## 6. Retrospective on the TARP Housing Initiatives

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The program that Treasury developed, HAMP, was therefore an important part – but only one part – of the Obama Administration’s comprehensive response to the financial and housing crisis. Based on economic conditions at the time, HAMP was expected to offer up to three to four million responsible American homeowners at risk of foreclosure reduced monthly mortgage payments that were sustainable over the long-term, providing these homeowners with a chance to modify their mortgages and avoid foreclosure.

It is important to emphasize that HAMP was not intended to help all borrowers. As noted above, it was intended to help an important segment of borrowers who were currently at-risk of foreclosure or who would be at risk prior to the end of 2012, including only those homeowners who:

- owned and occupied their homes as a primary residence;
- had loan balances less than \$729,750;
- took out their mortgages prior to Jan. 1, 2009;
- had contractual mortgage payments that were greater than 31 percent of their gross monthly income;
- could afford to make reasonable payments on modified mortgages;
- could provide documentation of income and hardship; and
- wanted to remain in their homes and were willing to remain current on their payments and comply with program terms.

The Administration originally projected that the new program would offer help to three to four million families through the end of 2012, expecting most of these to families to act on the offer of help and to receive a permanent modification. Treasury developed other strategies to transition borrowers out of homeownership in the manner least disruptive to them or their communities, when a trial modification did not convert to a permanent solution. Among this target population, Treasury also expected that there would unfortunately still be some borrowers who would not respond to outreach efforts or who would not act on trial modification offers when extended, though every effort was planned to reach out to this population. Despite recognizing that not every trial modification would be successful, working with servicers, housing counselors and others, Treasury would strive to reach as many eligible borrowers as possible.

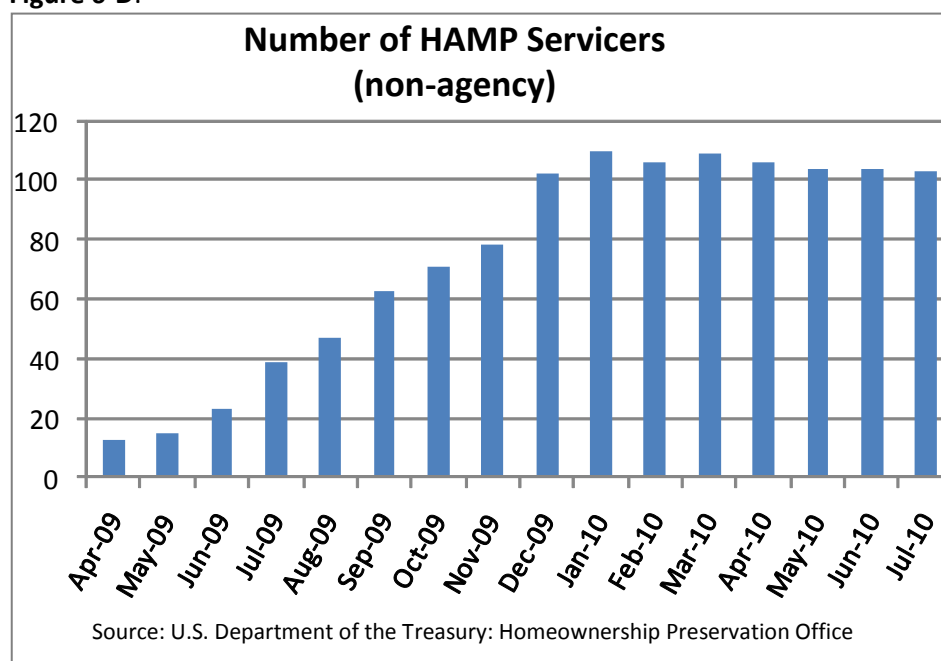
### E. Early Successes and Challenges

In the first year of the HAMP program, Treasury made substantial progress in many key areas. Treasury brought all stakeholders to the table -- servicers, investors, lenders, homeowners -- to assist as fast as possible. Treasury set a goal of 500,000 trial modifications by November 1, 2009. Even though participation was voluntary in accordance with EESA, Treasury quickly recruited servicers to the program. Over one hundred non-agency servicers signed up for HAMP, in addition to the many hundreds servicing loans on behalf of Fannie Mae and Freddie Mac. Close to ninety percent of mortgage loans nationwide were quickly covered by participating servicers.

## 6. Retrospective on the TARP Housing Initiatives

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Figure 6-D:



Almost one month ahead of the November 1, 2009 benchmark, HAMP reached the 500,000 trial loan modifications milestone. This goal had pushed servicers to ramp up program implementation and sustain a faster pace of modifications; trial modifications were being issued at a faster rate than new homeowners were becoming eligible, helping to address the backlog of distressed homeowners who had received little assistance since the housing crisis became apparent in mid-2007. As of the end of February 2010, 822,000 borrowers had been in the trial phase of the modification process for more than three months and could be otherwise eligible for conversion subject to document submission and remaining current on payments. Of these, 32 percent had received permanent modifications or had been approved for permanent modification (170,000 permanent and another 92,000 approved for permanent).

Nearly 1.4 million borrowers were in contact with their servicers and were approved for and extended a modification offer, with 1.1 million of these approved offers resulting in modification trials. The run rate of eligible borrowers approved for and starting modifications was at or above the target rate set internally by Treasury of 20,000 – 25,000 per week. The 1.1 million borrowers who started modifications had their payments reduced by a median amount of more than \$500. And even those borrowers who did not ultimately obtain a permanent modification received real relief as a result of reduced payments during the trial period, along with the opportunity to become current or pursue a foreclosure alternative like a short sale.

While the overall number of borrowers in permanent modifications rose substantially, the conversion rate to permanent modifications was below anticipated levels. When the program launched in May 2009, servicers were explicitly provided flexibility to approve borrowers for trial modifications without documentation of income in order to reach more borrowers more quickly. This approach was intended to provide more immediate relief and allow the program meet pent-up demand for modifications after two years of crisis conditions, “buy time” for many homeowners to find permanent solutions outside of the foreclosure process and facilitate housing market stabilization. Though some servicers required

## 6. Retrospective on the TARP Housing Initiatives

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some documents up front, in practice most servicers started trials on the basis of a verbal income statement from the borrower. In the early fall and over the coming months, as the first large numbers of borrowers reached a trial length that would allow them to become eligible for conversion to a permanent modification, servicers experienced substantial difficulty in collecting and processing applications and making decisions based on the documentation provided. The modification conversion process was much more challenging than Treasury originally anticipated as a result of several factors, including insufficient capacity and execution at most servicers, a lack of borrower willingness or ability to provide necessary documentation, frequent inconsistencies between verbal and verified income that resulted in borrowers being deemed ineligible for the program (e.g., a borrower's verified income demonstrated that a borrower already had a contract payment below 31 percent of the borrower's monthly income), and a process that proved more complex administratively than originally conceived.

Therefore, Treasury's most immediate and critical challenge became working with servicers to increase the rate at which trial modifications were converted to permanent modifications as quickly as possible. As the first round of modifications reached the deadline to convert, Treasury caused servicers to implement an aggressive conversion campaign to address the challenges that borrowers were confronting in receiving permanent modifications. To prevent homeowners from losing their residences during the extended trial period, Treasury issued guidance prohibiting servicers from foreclosing on homeowners before their eligibility for a modification had been determined.

On January 28, 2010, Treasury issued new guidance requiring servicers to begin collecting documents upfront no later than June 1, 2010. This was done in direct response to the challenges of collecting documents during the trial period, and to help better ensure that more borrowers who start modifications are able to convert to permanent status.

As noted, the program made substantial progress in many key areas through early 2010. The 1.4 million offers and 1.1 million trial modifications put Treasury on track to meet the initial goal of offering help to up to three to four million borrowers via a modification. The pace over most of the first year of roughly 100,000 modification starts per month suggested a final total of over four million trial modifications.

In the spring of 2010, the move to collect documents upfront to achieve better overall conversions reduced the pace of modification offers materially; however, Treasury expects that requiring documentation up front will substantially improve the success rate of trial modifications and speed determinations.

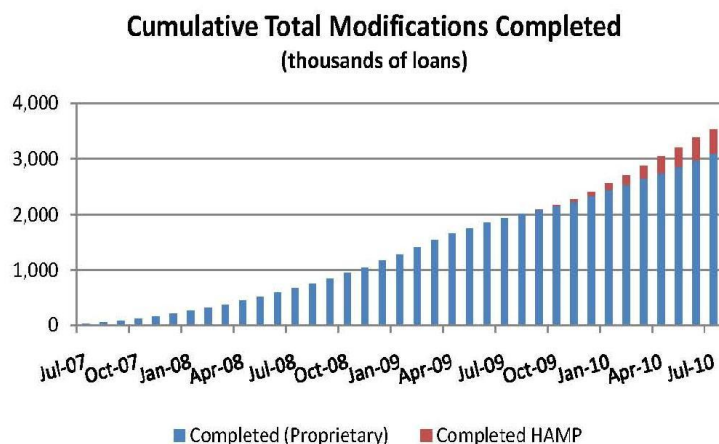
Treasury also expects that the number of borrowers who do not complete trial modifications but ultimately transition to other forms of assistance will grow substantially and will ultimately number in the many hundreds of thousands. A cancelled trial modification does not mean that the program has completely failed a homeowner or that the borrower will inevitably face foreclosure: HAMP explicitly requires servicers to consider these borrowers for other foreclosure prevention options including proprietary modifications or other options like a short sale or deed-in-lieu of foreclosure that also prevent a foreclosure sale. The broader HAMP program provides borrowers with a range of assistance; success can only be measured on an aggregate basis, taking account of homeowners' individual situations and outcomes. Based on survey data from the eight largest servicers, it is estimated that a majority of borrowers who are turned down for a trial modification are offered some sort of foreclosure alternative – usually a modification proprietary to the servicer, or a short sale – rather than proceeding directly to foreclosure.

## 6. Retrospective on the TARP Housing Initiatives

There are a range of important measures of success; keeping in mind the measures mentioned above, as well as others like the effect of HAMP on neighborhood and housing market stabilization, Treasury continues to monitor progress and push for improved results. HAMP has had a substantial impact on avoiding foreclosures so far (foreclosure sale is prohibited for the 200,000 borrowers still active in HAMP trial modifications), and very few borrowers that have qualified for HAMP (including the ability to make a reasonable payment on a modified loan as measured by income sufficient to pass an NPV model) have gone through foreclosure sale to date. In addition, HAMP has transformed the way the mortgage servicing industry treats borrowers in distress. Because of HAMP, servicers have developed constructive private-sector options. Where there was once no consensus plan among loan servicers about how to respond to borrowers in need of mortgage assistance, HAMP has established a universal affordability standard, a 31 percent debt-to-income ratio. This has enhanced servicers' ability to reduce mortgage payments to sustainable levels while simultaneously providing investors with a justification for modifications.

Taking into account HAMP's effect on standardizing and expanding proprietary modifications in the mortgage industry, the number of mortgage modifications has been double the number of foreclosure completions: More than 3.35 million modifications were arranged from April 2009 through the end of July 2010. This includes more than 1.3 million HAMP trial modifications started, more than 510,000 Federal Housing Administration (FHA) loss mitigation and early delinquency interventions, and nearly 1.6 million private sector modifications performed by members of the HOPE Now alliance. Given the complexity of the mortgage modification process and the number of government and non-government modification programs available, homeowners often receive more than one modification arrangement. Therefore it is difficult to determine the exact number of homeowners assisted by multiple programs.

**Figure 6-E:**



Source: Making Home Affordable and HOPE NOW

HOPE NOW has collected data on Completed (Proprietary) Modifications since 2007. Data for Completed HAMP loans began in September 2009.

On the measure of neighborhood and housing market stabilization, the substantial number of foreclosure sales avoided has contributed to a material improvement in market expectations for house prices and to many successive months of stability in home prices in much of the country. But, as

## 6. Retrospective on the TARP Housing Initiatives

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discussed, efforts must continue to capitalize on early encouraging signs and overcome remaining challenges. There are still a number of risk factors that will challenge the stability of the housing markets, including the potential for mortgage rates to rise, continuing elevated levels of delinquencies exacerbated by unemployment and the large number of underwater borrowers, and the associated potential for a substantial increase in the number of foreclosure sales.

Further, it is important to keep in mind that HAMP is only one of many Administration housing efforts that target these challenges: the Administration has also provided substantial support for the housing markets through investment in Fannie Mae and Freddie Mac to help keep mortgage rates affordable; purchase of agency mortgage-backed securities; refinancing opportunities that have allowed more than four million borrowers to refinance since the launch of the Making Home Affordable Program (MHA); and an initiative to provide support and financing to state and local Housing Finance Agencies (HFAs). These HFAs provide, in turn, tens of thousands of affordable mortgages to first time homebuyers and help develop tens of thousands of affordable rental units for working families, including those displaced by the housing crisis and foreclosures.

### ***Second Lien Modification Program***

A few months after launching HAMP, Treasury rolled out its first major expansion of the program: on August 13, 2009, Treasury published guidance introducing the Second Lien Modification Program (referred to as 2MP). Under 2MP, when a borrower's first lien is modified under HAMP and the servicer of the second lien is a 2MP participant, that servicer must offer to modify the borrower's second lien according to a defined protocol, which provides for a lump sum payment from Treasury in exchange for full extinguishment of the second lien, or a reduced lump sum payment from Treasury in exchange for a partial extinguishment and modification of the borrower's remaining second lien. Although 2MP was initially met with reluctance from servicers and investors who did not want to recognize losses on their second lien portfolios, Treasury has signed up several of the largest second lien servicers for 2MP this year. Servicers participating in the 2MP program service a majority of outstanding second liens.

### ***Home Affordable Foreclosure Alternatives Program***

Any modification program seeking to avoid preventable foreclosures has limits, HAMP included. HAMP does not, nor was it ever intended to, address every delinquent loan. Borrowers not qualifying for HAMP may benefit from an alternative that helps the borrower transition to more affordable housing and avoid the substantial costs of a foreclosure. On November 30, 2009, the Administration announced the Home Affordable Foreclosure Alternatives (HAFA) Program, pursuant to which Treasury provides incentives for short sales and deeds-in-lieu of foreclosure for circumstances in which borrowers are unable or unwilling to complete the HAMP modification process. Borrowers are eligible for relocation assistance of \$1,500 and servicers receive a \$1,000 incentive for completing a short sale or deed-in-lieu of foreclosure. In addition, investors are paid up to \$1,000 for allowing short sale proceeds to be distributed to subordinate lien holders.

## **F. The Second Phase of HAMP**

During the fall of 2009, in addition to the challenges articulated above, HAMP faced other challenges. Some servicers fell short of commitments they had made to Treasury to clear out their backlogs of loans in aged trial modifications. Participation in 2MP was lower than Treasury had hoped. The evolution of



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the economic landscape since early 2009 had directed attention toward two problems the program's broad framework had not specifically targeted: unemployment and negative equity. During 2009, employment had deteriorated severely, and while home prices had begun to show signs of stabilizing by late 2009, analysts projected a protracted period of recovery before prices returned to their pre-crisis levels. Unemployment and negative equity appeared to be the main potential causes of defaults going forward. In response, Treasury began designing a new phase of HAMP, with input from various constituencies.

In March 2010, the Obama Administration announced enhancements to HAMP aimed at the unemployment and negative equity problems, including providing temporary mortgage assistance to many unemployed homeowners, encouraging servicers to write down mortgage debt as part of a HAMP modification (the Principal Reduction Alternative, or PRA), allowing more borrowers to qualify for modifications through HAMP, and helping additional borrowers move to more affordable housing when modification is not possible.

### ***Unemployment Program***

The Unemployment Program (UP) requires servicers to grant qualified unemployed borrowers a forbearance period during which their mortgage payments are temporarily reduced for a minimum of three months, and up to six months for some borrowers, while they look for a new job. HAMP servicers are required to offer UP to any unemployed homeowner whose HAMP-eligible loan has not been previously modified under HAMP if the homeowner has been receiving unemployment benefits for three months on the date of the request. If a homeowner does not find a job before the temporary assistance period is over or finds a job with a reduced income, the homeowner will be evaluated for a permanent HAMP modification or may be eligible for HAMP's alternatives to the foreclosure program. Servicers are prohibited from initiating a foreclosure action or conducting a foreclosure sale while the borrower is being evaluated for UP, after a foreclosure plan notice is mailed, during the UP forbearance or extension, and while the borrower is being evaluated for or participating in HAMP or HAFA following the UP forbearance period. Servicers are reimbursed by TARP for any costs associated with UP, and there will be no cost to government or taxpayers from the forbearance plans.

### ***Principal Reduction Alternative***

Under PRA, servicers are required to evaluate the benefit of principal reduction and are encouraged to offer principal reduction whenever the NPV result of a HAMP modification using PRA is greater than the NPV result without considering principal reduction. The principal reduction and the incentives based on the dollar value of the principal reduced will be earned by the borrower and investor based on a pay-for-success structure. Under the contract with each servicer, Treasury cannot compel a servicer to select PRA over the standard HAMP modification even if the NPV of PRA is greater than the NPV of regular HAMP.

### ***Enhancements to Home Affordable Foreclosure Alternatives (HAFA)***

Treasury also doubled relocation assistance payments to homeowners receiving foreclosure alternatives, and increased incentives to servicers and lenders, including incentives for extinguishment of subordinate liens, to encourage more short sales and other alternatives to foreclosure.

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### ***FHA Short Refinance***

In March 2010, the Obama Administration announced adjustments to existing FHA programs that will permit lenders to provide additional refinancing options to homeowners who owe more than their homes are worth because of large declines in home prices in their local markets. This program, known as the FHA Short Refinance program, will provide more opportunities for qualifying mortgage loans to be restructured and refinanced into FHA-insured loans. The terms of this program include that the homeowner must be current on the existing first lien mortgage; the homeowner must occupy the home as a primary residence and have a qualifying credit score; the mortgage investor must reduce the amount owed on the original loan by at least 10 percent; the new FHA loan must have a balance less than the current value of the home; and total mortgage debt for the borrower after the refinancing, including both the first lien mortgage and any other junior liens, cannot be greater than 115 percent of the current value of the home – giving homeowners a path to regain equity in their homes and affordable monthly payments. TARP funds will be made available up to \$11 billion in the aggregate to provide additional coverage to lenders for a share of potential losses on these loans and to provide incentives to support the write-downs of second liens and encourage participation by servicers.

### ***Housing Finance Agency Innovation Fund for the Hardest Hit Housing Markets***

On February 19, 2010, the Administration announced the \$1.5 billion Housing Finance Agency Innovation Fund for the Hardest Hit Housing Markets (HFA Hardest Hit Fund, or HHF) for state housing finance agencies in the nation's hardest hit housing markets to design innovative, locally targeted foreclosure prevention programs. This first round of the HFA Hardest Hit Fund was intended to help address the housing problems facing those states that have suffered an average home price drop of more than 20 percent from their respective peaks in the housing bubble. The states included in this first round of HHF were California, Florida, Arizona, Michigan, and Nevada. Funds were allocated to these states according to a formula based on severity of home price declines and unemployment. HFAs designed the state programs themselves, tailoring the housing assistance to their local needs. Treasury required that the programs comply with the requirements of EESA, such as seeking to prevent avoidable foreclosures. All of the funded program designs are posted online at <http://www.FinancialStability.gov/roadtostability/hardesthitfund.html>.

In March 2010, the Obama Administration announced an expansion of the HFA Hardest Hit Fund to target an additional five states with high shares of their populations living in local areas of concentrated economic distress. The second HHF included up to \$600 million in funding for locally-tailored measures to help families stay in their homes or otherwise avoid foreclosure. The \$600 million in funds is equivalent on a per person basis to the \$1.5 billion awarded in the first HHF. While the first HHF targeted five states affected by home price declines greater than 20 percent, the second HHF targeted states with the highest concentration of their populations living in counties with unemployment rates greater than 12 percent, on average, over the months of 2009. (States that were allocated funds under the first HHF program were not eligible for the second HHF program.) The five states that received allocations based on this criterion were North Carolina, Ohio, Oregon, Rhode Island, and South Carolina.

On August 11, 2010, in recognition of the particular challenges faced by states with extraordinarily high unemployment, the Administration announced that Treasury will make an additional \$2 billion of assistance available for HHF programs for homeowners struggling to make their mortgage payments due to unemployment. The 18 states and jurisdictions eligible for this additional funding had high sustained

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unemployment rates over the last 12 months (through June, 2010) that were at or above the national average. This includes nine of the original HHF states (California, Florida, Michigan, Nevada, North Carolina, Ohio, Oregon, Rhode Island and South Carolina), which can use the funding for an existing unemployment bridge program or to implement the model provided, as well as Alabama, the District of Columbia, Georgia, Illinois, Indiana, Kentucky, Mississippi, New Jersey and Tennessee. Each state will use the funds for targeted unemployment programs that provide temporary assistance to eligible homeowners to help them pay their mortgages while they seek re-employment or additional employment or undertake job training.

On September 29, 2010, the Administration announced that Treasury will make an additional \$3.5 billion of assistance available for the states and jurisdictions participating in HHF to expand the reach of their programs to help more struggling homeowners. Funds will be allocated to these 18 states and the District of Columbia based on population size.

### G. Accomplishments

HAMP has achieved three critical goals:

- It has provided immediate relief to many struggling homeowners;
- It has used taxpayer resources efficiently; and
- It has transformed the way the entire mortgage servicing industry operates.

Eighteen months into the program, HAMP has helped more than 1.3 million homeowners by reducing their monthly mortgage payments to more affordable levels. This includes more than 460,000 homeowners whose mortgage terms have been modified permanently. These homeowners have experienced a 36 percent median reduction in their mortgage payments—more than \$500 per month—amounting to a total, program-wide savings of nearly \$3.2 billion. In short, hundreds of thousands of American families have been able to avoid foreclosure and keep their homes because of HAMP.

*“HAMP serve[d] as a catalyst ... a mobilizing event to push servicers to take broader actions at a more rapid pace,” and noted that “it pushed other investors, including Fannie and Freddie, to move in a direction of programmatic home loan modifications.”*

-Wells Fargo Home Mortgage Co-President Michael Heid (testimony before Congress)<sup>17</sup>

*“One of the significant advantages of HAMP has been the establishment of standards. And in particular, the debt-to-income ratio that was used, even on our proprietary programs prior to HAMP, was higher than 31 percent.”*

- Bank of America Home Loan President Barbara DeSoer (testimony before Congress)<sup>18</sup>

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<sup>17</sup> Hearings on Foreclosure Prevention Part II: “Are Loan Servicers Honoring Their Commitments to Help Preserve Homeownership?” before the Committee on Oversight and Government Reform United States House of Representatives (June 24, 2010) (statement of Michael J. Heid, Co-President of Wells Fargo Home Mortgage).

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In the year following initiation of HAMP, home retention strategies changed dramatically. In the first quarter of 2009, nearly half of mortgage modifications increased borrowers' monthly payments or left their payments unchanged. By the second quarter of 2010, 90 percent of mortgage modifications lowered payments for the borrower. This change means borrowers are receiving better solutions. Modifications with payment reductions perform materially better than modifications that increase payments or leave them unchanged. Moreover, even holding the percentage payment reduction constant, modifications appear to have improved since 2008. For modifications made in 2008, 15.8 percent of modifications that received a 20 percent payment reduction were 60 days or more delinquent three months into the modification. For the 2010 vintage, that delinquency rate has fallen almost in half, to 8.2 percent. The OCC's Mortgage Metrics Report from 2010:Q2 attributes the improvement in mortgage performance to "servicer emphasis on repayment sustainability and the borrower's ability to repay the debt."

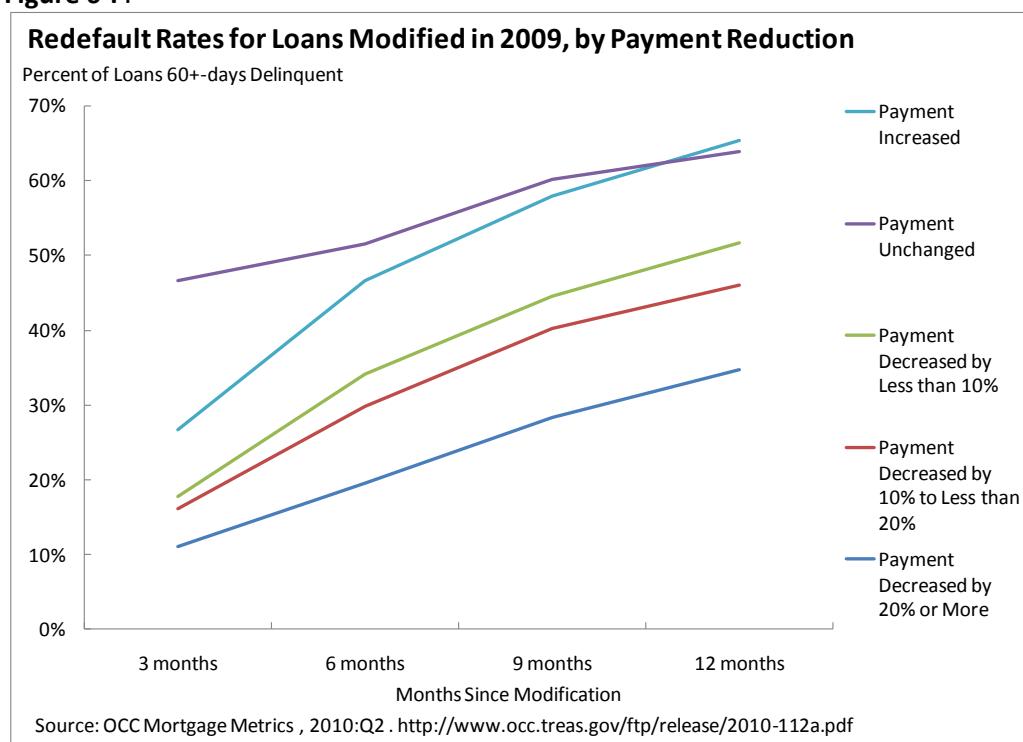
Early indications suggest that the re-default rate for permanent HAMP modifications is significantly lower than for historical private-sector modifications—a result of the program's focus on properly aligning incentives and achieving greater affordability. For HAMP modifications made in the fourth quarter of 2009, OCC records show that 7.9 percent of loans were delinquent three months into the modification and just 10.8 percent were delinquent six months into the modification. The comparable delinquency rates for non-HAMP modifications made in the same quarter were 12.1 percent and 22.4 percent, respectively. For modifications made in the first quarter of 2010, the delinquency rates for HAMP and non-HAMP modifications are similar – 10.5 percent and 11.6 percent delinquent at three months, respectively. Convergence between the HAMP and non-HAMP re-default rates going forward may suggest that the industry is adopting the HAMP modification standard.

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18 Hearings on Foreclosure Prevention Part II (statement of Barbara DeSoer, President of Bank of American Home Loans).

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Figure 6-F:



Borrowers who do not ultimately qualify for HAMP modifications often receive alternative forms of assistance. Approximately one-half of homeowners who apply for HAMP modifications but do not qualify have received some form of private-sector modification. Less than ten percent have lost their homes through foreclosure. Industry representatives testifying at foreclosure prevention hearings before the Committee on Oversight and Government Reform United States House of Representatives on June 24, 2010 indicated that many of their private-sector modifications are intended to assist borrowers who are not eligible for HAMP.

HAMP uses taxpayer resources efficiently. HAMP's "pay-for-success" design utilizes a trial period to ensure that taxpayer-funded incentives are used only to support borrowers who are committed to staying in their homes and making monthly payments, and the investor retains the risk of the borrower re-defaulting into foreclosure. No taxpayer funds are paid to a servicer or an investor until a borrower has made three modified mortgage payments on time and in full. The majority of payments are made over a five-year period only if the borrower continues to fulfill this responsibility. These safeguards ensure that spending is limited to high-quality modifications. Comprehensive public reporting provides an additional layer of accountability, assuring that servicers fulfill their obligation to contact and help at-risk borrowers in exchange for taxpayer-funded incentives.

There is a worthwhile point to be made about who should "count" as being helped by administration housing programs. The Administration originally projected that HAMP would offer help to three to four million families through the end of 2012, expecting most of these to families to act on the offer of help and to receive a permanent modification. From one perspective counting borrowers who get a HAMP permanent modification or a FHA Short Refinance loan is over-inclusive, because some of the families will re-default and end up in foreclosure in any event, although these programs will increase the odds

## 6. Retrospective on the TARP Housing Initiatives

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that they can prevent foreclosure and receive valuable temporary relief (up to \$6,000 per year) as long as they remain current.

The “count” is also under-inclusive, because measures to reduce foreclosures help to stabilize housing markets and avoid community-wide costs of foreclosure. The measure is also under-inclusive because every person who is in a temporary modification is getting a significant benefit – the family has several months to remain in the home with a reduced payment and to try to remedy the situation and avoid foreclosure. It is under inclusive because homeowners able to take advantage of HAFA will receive significant help transitioning more quickly and less traumatically to new housing they can afford than they would if they suffered foreclosure. Lastly, it is under-inclusive because many of the unemployed homeowners who receive a temporary forbearance through UP are likely to become re-employed and resume mortgage payments – without the unemployment forbearance program those homeowners might have gone to foreclosure. This is especially important in the case of FHA Short Refinance, which could help to avert a wave of foreclosures due to strategic default, and HHF, which helps states provide targeted assistance to combat deteriorating conditions in local markets. As noted above, HAMP has transformed the way the mortgage servicing industry treats borrowers in distress. Because of HAMP, servicers have developed constructive private-sector options.

Finally, the measure does not include all of the new mortgages provided to families at reasonable cost because of FHA and government interventions with Fannie Mae and Freddie Mac. In many cases, these mortgages have provided financing to help families purchase foreclosed homes and become homeowners, often for the first time since housing has become so much more affordable as a result of the crisis.

### H. Transparency and Accountability

To protect taxpayers and ensure that every TARP dollar is directed toward promoting financial stability, Treasury established rigorous accountability and transparency measures for all of its programs, including HAMP and the other housing programs, as more fully described later in this report. In addition to these public reports, Treasury has worked to maximize the transparency of the housing program to borrowers and ensure that servicers are held accountable. Every borrower is entitled to a clear explanation if he or she is determined to be ineligible for a HAMP modification. Treasury has established denial codes that require servicers to report the reason for modification denials in writing to Treasury. Servicers are required to use those denial codes as a uniform basis for sending letters to borrowers who are evaluated for HAMP but denied a modification. In those letters, borrowers will be provided with a phone number to contact their servicers as well as the phone number of the HOPE hotline, which has counselors who are trained to work with borrowers to help them understand reasons they may have been denied modifications and explain other modification or foreclosure prevention options that may be available to them.

Transparency of the NPV model - a key component of the eligibility test for HAMP - is also important. Treasury increased public access to the NPV white paper, which explains the methodology used in the NPV model. To ensure accuracy and reliability, Freddie Mac, Treasury's compliance agent, conducts periodic audits of servicers' implementation of the model. If servicers' models do not meet Treasury's NPV specifications, Freddie Mac will require the servicers to discontinue use of their own implementation of the model and revert back to the NPV application available from Treasury through the MHA Servicer Portal. As required by the Dodd-Frank Act, Treasury is preparing to establish a web

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portal that borrowers can access to run a NPV analysis using input data regarding their own mortgages, and to provide to borrowers who are turned down for a HAMP modification the input data used in evaluating the application.

All servicers voluntarily participating in HAMP have contractually agreed to follow the HAMP program guidelines, which require the servicer to offer a HAMP modification to all eligible borrowers and to have systems that can process all HAMP-eligible loans. Servicers are subject to periodic, on-site compliance reviews performed by Treasury's compliance agent, Making Home Affordable-Compliance (MHA-C), a separate, independent division of Freddie Mac, to ensure that servicers satisfy their obligations under HAMP requirements in order to provide a well-controlled program that assists as many deserving homeowners as possible to retain their homes while taking reasonable steps to prevent fraud, waste and abuse. Treasury works closely with MHA-C to design and refine the compliance program and conducts quality assessments of the activities performed by MHA-C. Following these reviews, MHA-C provides Treasury with assessments of each servicer's compliance with HAMP requirements. If appropriate, Treasury will implement remedies for non-compliance. These remedies may include withholding or reducing incentive payments to servicers, requiring repayments of prior incentive payments made to servicers with respect to affected loans, or requiring additional servicer oversight.

### I. Looking Ahead for Housing

Since EESA was enacted, the housing market has remained distressed, and although there are promising signs of stabilization, the nature of that distress has changed. In late 2008 and 2009, the nation's housing market was in broad decline, as a result of the subprime mortgage collapse and the effects of the financial crisis and the severe recession. However, in the middle of 2009, house price declines started to show signs of stabilization in much of the country. Home prices leveled off after 30 straight months of decline.

Despite these nascent signs of stabilization at the national level, home prices have continued to decline and foreclosures have continued to rise in certain areas of the country as the nature of the stress in the housing market has evolved from defaults generated by poorly-underwritten loans, such as subprime, Alt-A and option ARM mortgages, to concentrated unemployment, negative equity, excess housing inventory, and rising foreclosures in certain areas of the country, which act as a drag on housing prices and economic recovery in those communities. Negative equity and high unemployment tend to be concentrated in the same regions and appear to exacerbate one another; low equity levels give unemployed borrowers little opportunity to escape their mortgages except through foreclosure or short sale.

As described above, the Administration has responded by expanding the initial version of HAMP that was first announced in February 2009, which was designed to modify conventional first lien loans. HAMP has since been modified to include unemployment programs, second lien relief, foreclosure alternatives (such as short sales and deeds-in-lieu of foreclosure) and principal reduction programs. Recognizing that the housing market conditions vary widely by locality, and are especially stressed by continued unemployment, the Administration has quickly rolled out the HFA Hardest Hit Fund for those states most affected by these issues. In addition, to combat negative equity and improve affordability, Treasury has partnered with FHA in expanding refinance opportunities through the FHA Short Refinance program.



## 6. Retrospective on the TARP Housing Initiatives

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Because they are relatively recent expansions, these additions to HAMP, and of HHF and the FHA Short Refinance program, have not yet begun to penetrate the housing market. Nevertheless, these programs will allow Federal assistance to reach more distressed homeowners and provide additional stability to the housing market going forward. Servicers that participate in HAMP can continue to make modifications through the end of 2012. HHF permits participating HFAs to provide support through their programs until as late as 2017, depending on available funding. And the FHA Short Refinance program is expected to permit homeowners to refinance their mortgage loans and reduce their overall mortgage debt through the end of 2012.

Furthermore, in much the same way that HAMP's first lien modification program has provided a national blueprint for mortgage modifications, these new programs will continue to shape the mortgage servicing industry and act as a catalyst for industry standardization of short sale, refinance and principal reduction programs. The interplay of all these programs will provide a much more flexible response to continued changes in the housing market over the next two years. Rather than ending, TARP's positive effects on the housing market are expected to expand over time.

### J. Summary Description of Housing Programs

#### 1. Making Home Affordable Program (MHA)

##### *a. Home Affordable Modification Program (HAMP)*

The Home Affordable Modification Program (HAMP) is the largest program within MHA. HAMP provides eligible homeowners the opportunity to reduce their monthly mortgage payments to 31 percent of their gross (pre-tax) income.

To qualify for HAMP, a borrower must:

- Own a one- to four-unit home that is a primary residence;
- Have received a mortgage on or before January 1, 2009;
- Have a mortgage payment (including principal, interest, taxes, insurance, and homeowners association dues) that is more than 31 percent of the homeowner's gross monthly income; and
- Owe not more than \$729,750 on a first mortgage for a one-unit property (there are higher limits for two- to four- unit properties).

To create an affordable payment, a participating servicer applies a series of modification steps in the following order: rate reduction to as low as two percent; term extension up to 40 years; and principal deferral (or forbearance, at the servicer's option). The modified interest rate is fixed for a minimum of five years. Beginning in year six, the rate may increase no more than one percentage point per year until it reaches the Freddie Mac Primary Mortgage Market Survey rate (essentially the market interest rate) at the time the permanent modification agreement was prepared.

Before a mortgage is permanently modified, the homeowner must make the new, reduced monthly mortgage payment on time and in full during a trial period of three or four months. Homeowners who

## 6. Retrospective on the TARP Housing Initiatives

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make payments on permanently modified loans on time accrue an incentive of \$1,000 per year to reduce the amount of principal they owe up a maximum of \$5,000.

### ***b. Second Lien Modification Program (2MP)***

Under the Second Lien Modification Program (2MP), an additional component of MHA, Treasury provides incentives for second-lien holders to modify or extinguish a second-lien mortgage when a modification has been initiated on the first lien mortgage for the same property under HAMP. Under 2MP, when a borrower's first lien is modified under HAMP and the servicer of the second lien is a 2MP participant, that servicer must offer to modify the borrower's second lien according to a defined protocol, which provides for a lump sum payment from Treasury in exchange for full extinguishment of the second lien, or a reduced lump sum payment from Treasury in exchange for a partial extinguishment and modification of the borrower's remaining second lien.

### ***c. Home Affordable Foreclosure Alternatives (HAFA) Program***

Under the Home Affordable Foreclosure Alternatives (HAFA) Program, an additional component of MHA, Treasury provides incentives for short sales and deeds-in-lieu of foreclosure for circumstances in which borrowers are unable or unwilling to complete the HAMP modification process. Borrowers are eligible for relocation assistance of \$1,500 and servicers receive a \$1,000 incentive for completing a short sale or deed-in-lieu of foreclosure. In addition, investors are paid up to \$1,000 for allowing short sale proceeds to be distributed to subordinate lien holders.

### ***d. The Unemployment Program (UP)***

The Unemployment Program (UP), an additional component of MHA, requires participating servicers to grant qualified unemployed borrowers a forbearance period during which their mortgage payments are temporarily reduced for a minimum of three months, and up to six months for some borrowers, while they look for new jobs. If a homeowner does not find a job before the temporary assistance period is over or finds a job with a reduced income, the homeowner will be evaluated for a permanent HAMP modification or may be eligible for certain alternatives to the modification program under MHA.

### ***e. Principal Reduction Alternative (PRA)***

Under the Principal Reduction Alternative (PRA), an additional component of MHA, servicers are required to evaluate the benefit of principal reduction and are encouraged to offer principal reduction whenever the NPV result of a HAMP modification using PRA is greater than the NPV result without considering principal reduction. Incentives are paid based on the dollar value of the principal reduced.

## **2. Housing Finance Agency Innovation Fund for the Hardest Hit Housing Markets (HFA Hardest Hit Fund, or HHF)**

The Housing Finance Agency Innovation Fund for the Hardest Hit Housing Markets (HFA Hardest Hit Fund, or HHF) allows state housing finance agencies (HFAs) in the nation's hardest hit housing markets to design innovative, locally targeted foreclosure prevention programs. Five of these states (Arizona, California, Florida, Michigan and Nevada) have had average home price declines greater than 20 percent since the housing market downturn, accounting for the majority of "underwater" mortgages in the

## 6. Retrospective on the TARP Housing Initiatives

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country. The remaining fourteen states and jurisdictions (Alabama, Georgia, Illinois, Indiana, Kentucky, Mississippi, New Jersey, North Carolina, Ohio, Oregon, Rhode Island, South Carolina, Tennessee and Washington, DC) have concentrated areas of economic distress due to unemployment or had an unemployment rate at or above the national average for the past year.

HFAs designed the state programs themselves, tailoring the housing assistance to their local needs. Treasury required that the programs comply with the requirements of EESA, such as seeking to prevent avoidable foreclosures. All of the funded program designs are posted online at <http://www.FinancialStability.gov/roadtostability/hardesthitfund.html>.

### 3. Support for the FHA Short Refinance Program

In March 2010, the Administration announced adjustments to existing FHA programs that will permit lenders to provide additional refinancing options to homeowners who owe more than their homes are worth because of large declines in home prices in their local markets. This program, known as the FHA Short Refinance program, will provide more opportunities for qualifying mortgage loans to be restructured and refinanced into FHA-insured loans.

Among other requirements:

- The homeowner must be current on the existing first lien mortgage;
- The homeowner must occupy the home as a primary residence and have a qualifying credit score;
- The mortgage investor must reduce the amount owed on the original loan by at least ten percent;
- The new FHA loan must have a balance less than the current value of the home; and
- Total mortgage debt for the borrower after the refinancing, including both the first lien mortgage and any other junior liens, cannot be greater than 115 percent of the current value of the home – giving homeowners a path to regain equity in their homes and an affordable monthly payment.

TARP funds will be made available up to \$11 billion in the aggregate to provide additional coverage to lenders for a share of potential losses on these loans and to provide incentives to support the write-downs of second liens and encourage participation by servicers.

## 7. Executive Compensation

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### **Treasury Implemented the Executive Compensation Restrictions Required by the Laws that Created the Troubled Asset Relief Program**

EESA set standards for executive compensation and corporate governance for recipients of financial assistance under the TARP. These executive compensation standards were then expanded under ARRA and Treasury's Interim Final Rule on executive compensation published on June 15, 2009. This rule created the Office of the Special Master for TARP Executive Compensation, and Kenneth R. Feinberg was appointed as Special Master in June 2009.

#### **1. Restrictions on exceptional assistance recipients and other recipients of TARP funds.**

EESA, as amended by ARRA imposed restrictions on executive compensation for all recipients of financial assistance under TARP. The requirements include the following:

- Limits on bonuses and retention awards for the top executives;
- Prohibition on “golden parachutes” for the top executives;
- Limits on compensation to exclude incentives on senior executives to take unnecessary and excessive risks that threaten a firm's value;
- Prohibition on compensation plans that encourage manipulation of reported earnings to enhance the compensation of employees, and a “clawback” provision to permit recovery of certain payments based on earnings statements or other criteria that are later found to be materially inaccurate;
- Establishment of a company-wide policy regarding excessive or luxury expenditures;
- Establishment of a compensation committee composed entirely of independent directors; and
- A requirement for an annual, non-binding “say on pay” shareholder vote regarding compensation required to be disclosed under SEC rules.

Treasury also promulgated rules to implement these provisions that added additional requirements. These included a prohibition on paying “tax gross-ups” to top executives (which are designed to reduce or eliminate the tax burden on an executive relating to compensation arrangements) and a requirement to disclose certain executive perquisites.

Treasury's rules also created the Office of the Special Master, and gave to the Special Master the responsibility to review and approve the compensation of top executives at firms that received “exceptional assistance”. These firms were AIG, Bank of America, Citigroup, General Motors, Chrysler, Ally Financial (formerly GMAC) and Chrysler Financial. The rule required the Special Master to review the individual pay packages of the top 25 most highly compensated employees at each firm and to review the compensation structures for the next 26-100 employees. The rule also outlined certain principles that the Special Master must follow in making his decisions.

The Special Master conducted extensive reviews of executive compensation at these companies for the 2009 and 2010 calendar years and imposed requirements based on the following key principles:

## 7. Executive Compensation

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- For the top 25 individual pay packages: to (i) limit cash salary, (ii) pay incentives in long-term restricted stock, (iii) limit perquisites and “other” compensation, and (iv) limit executive pension and retirement programs; and
- For the next 26-100 employees’ compensation structures: to (i) restrict short-term cash compensation, (ii) tie incentive compensation to real achievement, (iii) make sure compensation structures have a long-term focus, and (iv) align pay practices with shareholder and taxpayer interests.

The review and approval by the Special Master has led to significant reductions in compensation at these firms. This was to ensure that executive pay for the top 100 employees at the firms that received exceptional assistance is in line with long-term value creation and financial stability. For the five firms that were still exceptional assistance recipients for 2010 determinations, a large majority – 84 percent – of top 25 executives covered by the 2009 determinations remained with the companies through the 2010 determinations. The cash and overall compensation of most executives new to the top 25, who mostly filled slots created by employee departures prior to the 2009 determinations, was reduced substantially from historical levels.

*Kenneth R. Feinberg observed in his Final Report that of “the seven [exceptional assistance] firms initially subject to the Office’s jurisdiction, two have completed repayment to the taxpayers and three more have begun to do so—in one case fully returning the “exceptional” assistance . . . Four firms remain in the program, but I am encouraged by their record of retaining top employees and adding outside talent, and hopeful for their eventual repayment.”*

- “Final Report of Special Master for Executive Compensation Kenneth R. Feinberg”, September 10, 2010.

ARRA also required the Secretary to conduct a Look Back Review of bonuses, retention awards, and other compensation paid to each TARP recipient’s Top 25 before the introduction of the additional requirements, to determine if any payments were inconsistent with the purpose of EESA or TARP, or otherwise inconsistent with the public interest. The Office of the Special Master carried out the Look Back Review and published its findings in July 2010. The Special Master did not determine that any reviewed payment was inconsistent with the law or the public interest. However, this outcome does not express a conclusion that these payments were appropriate or advisable, particularly in light of the circumstances facing the financial system generally, and some institutions specifically, in late 2008 and early 2009. Therefore, the Special Master proposed that all TARP recipients adopt a prospective compensation policy (a “brake” policy) that would provide companies the authority to alter pending payments to executives in the event of a financial crisis.

## 7. Executive Compensation

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### 2. TARP helped curb the influence of excessive compensation at TARP recipients, and in doing so, helped lay the ground work for corporate governance reform.

After two years, the executive compensation landscape has changed significantly. While the Office of the Special Master focused on its responsibilities under TARP, a much broader policy initiative was moving forward. These efforts are critical steps to address compensation issues that contributed to the financial crisis, and significant progress has been made to date.

- In September 2009, G-20 leaders confirmed that compensation practices in the financial sector both reflected and encouraged excessive risk-taking, and endorsed standards intended to align compensation practices with long-term value creation and financial stability. These standards are being implemented worldwide.
- In the United States, the Federal Reserve and other federal banking regulators issued guiding principles on how incentive compensation at banks should be designed to protect safety and soundness, and committed to ensuring that banks adopt these principles. The SEC enhanced existing compensation disclosure requirements. The Dodd-Frank Act law requires public companies to give shareholders a “say on pay” vote and strengthens compensation committees’ independence.

*Kenneth R. Feinberg observed that there is a “profound difference in perspective on executive pay practices between some financial institutions and many of the taxpayers whose dollars rescued our economy and financial system. To our great benefit, the Treasury rules that created the Office of the Special Master anticipated the range of difficulties we would encounter, and provided authority to confront them as well as principles for doing so.”*

- “Final Report of Special Master for Executive Compensation Kenneth R. Feinberg”, September 10, 2010.

### 3. Final Report of the Special Master for Executive Compensation

In September 2010, after fourteen months of service, Kenneth R. Feinberg resigned as Special Master for TARP Executive Compensation and issued the “Final Report of Special Master for Executive Compensation Kenneth R. Feinberg” (Final Report). The Final Report summarizes the work of the Office of the Special Master for TARP Executive Compensation during Mr. Feinberg’s tenure as Special Master and includes an overview of the compensation determinations issued for the 2009 and 2010 calendar years. The report also reviews, among other things, the processes (collection of data and analysis) and standards of review used for the determinations.

The 517-page report and exhibits, which include copies of all determination letters, can be found at <http://www.FinancialStability.gov/docs/Exhibits.pdf> and <http://www.FinancialStability.gov/docs/Final%20Report%20of%20Kenneth%20Feinberg%20-%20FINAL.PDF>.

## 8. U.S. Government As Shareholder

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The U.S. Government is a *reluctant* shareholder in private companies and has no interest in owning companies over the long term. This unusual role is an unfortunate consequence of the financial crisis and the recession.

The Obama Administration has stated that core principles will guide Treasury's management of financial interests in private firms. One such principle is that the United States government will not interfere with or exert control over day-to-day company operations. Among other consequences, such involvement might actually reduce the value of the taxpayer's investments and impede the successful transition of the firms to the private sector.

In certain cases, Treasury has sought to pursue strong upfront conditions at the time of investment into a company, such as changes to the board of directors and management, to ensure that TARP funds were deployed in a way that promotes economic growth and financial stability and protects taxpayer value. Thereafter, Treasury has taken a commercial approach to its investments. Treasury does not participate in the day-to-day management of any company in which it has an investment nor is any Treasury employee a director or officer of any such company.

Treasury's investments have generally been in the form of non-voting preferred stock. For example, the preferred shares that Treasury holds in financial institutions under the Capital Purchase Program do not have voting rights except in certain limited circumstances, such as amendments to the charter of the company, or in the event dividends are not paid for several quarters, in which case Treasury has the right to elect two directors to the board.

In a few cases, Treasury has acquired common stock. These include General Motors, Ally Financial (formerly GMAC), Citigroup and Chrysler, and a few small banks.

In the cases where Treasury has acquired voting rights, it has announced that it will follow the following principles in exercising its voting rights: (1) Treasury intends to exercise its right to vote only on certain matters consisting of the election or removal of directors; certain major corporate transactions such as mergers, sales of substantial amounts of assets, and dissolution; issuances of equity securities where shareholders are entitled to vote; and amendments to the charter or bylaws; and (2) on all other matters, Treasury will either abstain from voting or vote its shares in the same proportion (for, against or abstain) as all other shares of the company's stock are voted.

In the case of AIG, the U.S. Treasury is currently the beneficiary of a trust created by the Federal Reserve Bank of New York (FRBNY). That trust owns shares having 79.8 percent of the voting rights of the common stock. The FRBNY has appointed three independent trustees who have the power to vote and dispose of the stock with prior approval of FRBNY and after consultation with Treasury. The trust agreement provides that the trustees cannot be employees of Treasury or the FRBNY. The trust exists for the benefit of the U.S. Treasury, but the Department of the Treasury does not control the trust and it cannot direct the trustees. Treasury also directly owns preferred stock in AIG which does not have voting rights except in certain limited circumstances (such as amendments to the charter). Treasury has the right to appoint directors because AIG failed to pay dividends for four quarters on the preferred stock held by Treasury. Upon consummation of the proposed restructuring plan announced on September 30, 2010, Treasury will receive common shares in exchange for its preferred stock and the trust will be dissolved. As a result, the Treasury will own approximately 92 percent of the common stock of AIG.



## 9. Accountability and Transparency

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The Department of the Treasury is committed to transparency and accountability in all of its programs and policies, including all programs established under EESA. To protect taxpayers and ensure that every dollar is directed toward promoting financial stability, Treasury established comprehensive accountability and transparency measures.

### A. Comprehensive Measures

Treasury publishes hundreds of reports other information about TARP so that the public knows how the money was spent, who received it and on what terms. This includes all contracts governing any investment or expenditure of TARP funds, and more than 275 reports over two years. All of these reports and information are posted on our website, [www.FinancialStability.gov](http://www.FinancialStability.gov), including:

- Lists of all the institutions participating in TARP programs, and all of the investments Treasury has made;
- All investment contracts defining the terms of those investments within five to ten business days of a transaction's closing;
- All contracts with Treasury service providers involved with TARP programs;
- A report of each transaction (such as an investment in or repayment from a bank) within two business days of completing the transaction;
- Monthly reports of dividend and interest received, which allow the American people to see and evaluate the investment income they are receiving from these investments;
- Monthly reports to Congress, which present updates on our investments and programs in a clear, concise manner, and answer basic questions that many Americans have, such as how TARP funds are invested;
- Monthly reports detailing the progress of modifications under the Making Home Affordable program;
- All program guidelines, within two business days of any program launch; and
- A monthly lending survey, and an annual use of capital survey, which contains detailed information on the lending and other activities of banks that have received TARP funds to help the public understand what banks are doing with their TARP funds.

Please see "Section 10 - Additional Resources" for links to the reports described above and other information related to TARP programs.

### B. Audited Financial Statements

Treasury prepares separate financial statements for TARP on an annual basis. The initial Agency Financial Report for the year ended September 30, 2009 is available at [www.FinancialStability.gov](http://www.FinancialStability.gov), and the second Agency Financial Report for the year ending September 30, 2010 will be released in November.

In its first year of operations, TARP's financial statements received an unqualified ("clean") audit opinion from the Government Accountability Office, and a separate report on internal control over financial reporting found no material weaknesses -- unprecedented achievements for a start-up operation with an extraordinary emergency mission. As a result of these efforts, the

## 9. Accountability and Transparency

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Treasury office responsible for implementing TARP -- the Office of Financial Stability -- received a Certificate of Excellence in Accountability Reporting (CEAR) from the Association of Government Accountants.

### C. Oversight by Four Separate Agencies

Congress also established four additional avenues of oversight for TARP:

- The Financial Stability Oversight Board, established by EESA §104;
- Specific responsibilities for the Government Accountability Office as set out in EESA §116;
- The Special Inspector General for TARP, established by EESA §121; and
- The Congressional Oversight Panel, established by EESA §125.

Treasury has productive working relationships with all of these bodies, and cooperates with each oversight agency's effort to produce periodic audits and reports that focus on the many aspects of TARP. Individually and collectively, the oversight bodies' audits and reports have made and continue to make important contributions to the development, strengthening, and transparency of TARP programs.

### D. Congressional Hearings and Testimony

Treasury officials have testified in numerous Congressional hearings since TARP was created. Copies of the written testimony are prepared for those hearings and are available at [www.FinancialStability.gov/latest/pressreleases.html](http://www.FinancialStability.gov/latest/pressreleases.html).

## 10. Additional Resources

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### A. Glossary

**2MP - Second Lien Modification Program:** 2MP offers homeowners a way to lower payments on their second mortgage.

**AAA or Aaa:** The highest rating given to bonds by bond rating agencies.

**ABS - Asset-Backed Security:** A financial instrument representing an interest in a pool of other assets, typically consumer loans. Most ABS are collateralized by credit card receivables, auto loans, student loans, mortgage loans, or other loan and lease obligations.

**ABX – Asset Backed Securities Index:** A measure of the performance of a group of credit default swaps on ABS home equity loans, that serves as an indicator of investor sentiment regarding the performance of subprime mortgage holdings.

**AGP - Asset Guarantee Program:** A TARP program under which Treasury, together with the Federal Reserve and the FDIC, agreed to share losses on certain pools of assets held by systemically significant financial institutions that faced a high risk of losing market confidence due in large part to a portfolio of distressed or illiquid assets.

**AIFP - Automotive Industry Financing Program:** A TARP program under which Treasury provided loans or equity investments in order to avoid a disorderly bankruptcy of one or more auto companies that would have posed a systemic risk to the country's financial system..

**AIG – American International Group, Inc.**

**Alt-A:** A category of mortgages which have a risk potential that is greater than prime but less than subprime.

**ARRA - American Recovery and Reinvestment Act of 2009:** An act that contained, among other things, an economic stimulus package and amendments to EESA that require the Secretary to allow QFIs to repay TARP assistance at any time, subject to regulatory approval.

**ASSP - Auto Supplier Support Program:** A TARP program pursuant to which Treasury provided loans to ensure that auto suppliers receive compensation for their services and products, regardless of the condition of the auto companies that purchase their products.

**AWCP - Auto Warranty Commitment Program:** A TARP program pursuant to which Treasury provided loans to protect warranties on new vehicles purchased from General Motors and Chrysler during their restructuring periods.

**BHC - Bank Holding Company:** A company that controls a bank. Typically, a company controls a bank through the ownership of 25 percent or more of its voting securities.

**CAP - Capital Assistance Program:** A TARP program, created in connection with the SCAP or stress test, in which Treasury offered assistance to financial institutions to ensure that they had adequate capital to absorb losses and to continue to lend even in a worse than expected economic downturn. No funds were provided under the program.

## 10. Additional Resources

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**CBLI - Consumer and Business Lending Initiative:** A series of programs created under TARP which included the TALF, the CDCI, and the SBA 7(a) Securities Purchase Program. These were designed to jump start the credit markets that provide financing to consumers and businesses and otherwise support small banks.

**CBO – Congressional Budget Office.**

**CDCI - Community Development Capital Initiative:** A TARP program that provides low-cost capital to CDFIs to encourage lending to small businesses and help facilitate the flow of credit to individuals in underserved communities.

**CDFI - Community Development Financial Institution:** A financial institution that focuses on providing financial services to low- and moderate- income, minority and other underserved communities, and is certified by the CDFI Fund, an office within Treasury that promotes economic revitalization and community development.

**CDO - Collateralized Debt Obligation:** A financial instrument that entitles the holder to a portion of the cash flows generated by a portfolio of assets, which may include bonds, loans, mortgage-backed securities, or other CDOs.

**CDX – Credit Default Swap Index:** A measure of the performance of a group of credit default swaps.

**CMBS - Commercial Mortgage-Backed Securities:** A financial instrument representing an interest in a commercial real estate mortgage or a group of commercial real estate mortgages.

**CMBX – Commercial Mortgage Backed Securities Index:** A measure of the performance of a basket of credit default swaps on commercial mortgage backed securities.

**CPP - Capital Purchase Program:** A TARP program pursuant to which Treasury invested in preferred equity securities and other securities issued by financial institutions..

**Credit Default Swap –** A contract between two parties pursuant to which one party agrees to make periodic payments in exchange for the counterparty's agreement to pay a sum of money upon the occurrence of a credit default or other event relating to a particular financial instrument.

**Dodd-Frank Act - Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010.**

**DTI - Debt-to-Income Ratio:** A ratio of the debt of a person to the income of such person.

**EESA - Emergency Economic Stabilization Act of 2008:** The law that created the Troubled Asset Relief Program (TARP).

**Fannie Mae - Federal National Mortgage Association.**

**FDIC - Federal Deposit Insurance Corporation.**

**FHA - Federal Housing Administration.**

**FHFA - Federal Housing Finance Agency.**

## 10. Additional Resources

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**FRBNY - Federal Reserve Bank of New York.**

**Freddie Mac - Federal Home Loan Mortgage Corporation.**

**GAO - Government Accountability Office.**

**GSE - Government-Sponsored Enterprises:** Private corporations created by the U.S. Government. Fannie Mae and Freddie Mac are GSEs.

**HAFA – Home Affordable Foreclosure Alternatives Program:** HAFA offers homeowners, their mortgage servicers, and investors an incentive for completing a short sale or deed-in-lieu of foreclosure.

**HAMP - Home Affordable Modification Program:** A TARP program Treasury established to help responsible but struggling homeowners reduce their mortgage payments to affordable levels and avoid foreclosure.

**HERA - Housing and Economic Recovery Act of 2008.**

**HFA:** A state or local **Housing Finance Agency**.

**HFA Hardest Hit Fund (HHF) - The Housing Finance Agency Innovation Fund for the Hardest Hit Housing Markets:** A program Treasury established under TARP to allow HFAs in the nation's hardest hit housing markets to design innovative, locally targeted foreclosure prevention programs.

**HFSTHA - Helping Families Save Their Homes Act of 2009.**

**HUD - U.S. Department of Housing and Urban Development.**

**IMF - International Monetary Fund.**

**IPO - Initial Public Offering.**

**Legacy Securities:** CMBS and non-agency RMBS issued prior to 2009 that were originally rated AAA or an equivalent rating by two or more NRSROs without ratings enhancement and that are secured directly by actual mortgage loans, leases or other assets and not other securities.

**LIBOR - London Interbank Offered Rate:** The rate of interest at which banks borrow funds from other banks, in marketable size, in the London interbank market. LIBOR rates are disseminated by the British Bankers Association.

**MHA - Making Home Affordable:** A comprehensive plan to stabilize the U.S. housing market and help responsible, but struggling, homeowners reduce their monthly mortgage payments to more affordable levels and avoid foreclosure. HAMP is part of MHA.

**MBS - Mortgage-Backed Securities:** A type of ABS representing an interest in a pool of similar mortgages bundled together by a financial institution.

## 10. Additional Resources

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**NPV – Net Present Value:** An NPV test is used to compare the net present value of cash flows from the mortgage if modified under HAMP and the net present value of the cash flows from the mortgage without modification.

**NRSRO - Nationally Recognized Statistical Rating Organization:** A credit rating agency which issues credit ratings that the U.S. Securities and Exchange Commission permits other financial firms to use for certain regulatory purposes.

**Non-Agency Residential Mortgage-Backed Securities:** RMBS that are not guaranteed or issued by Ginnie Mae, Freddie Mac, Fannie Mae, any other GSE or a U.S. federal government agency.

**OFS - Office of Financial Stability,** the office within Treasury that implements TARP.

**PRA – Principal Reduction Alternative Program:** A program that offers mortgage relief to eligible homeowners whose homes are worth significantly less than the remaining amounts owed under their first lien mortgage loans.

**Preferred Stock:** Equity ownership that usually pays a fixed dividend and gives the holder a claim on corporate earnings superior to common stock owners. Preferred stock also has priority in the distribution of assets in the case of liquidation of a bankrupt company.

**PPIF – Public Private Investment Fund:** An investment fund established to purchase Legacy Securities from financial institutions under PPIP.

**PPIP – Public Private Investment Program:** A TARP program designed to improve the health of financial institutions holding real estate-related assets. The program is designed to increase the flow of credit throughout the economy by Treasury partnering with private investors to purchase legacy securities from financial institutions.

**PSPA - Preferred Stock Purchase Agreements:** The preferred stock purchase agreements that were entered into by Treasury and the GSEs pursuant to HERA.

**QFI - Qualifying Financial Institution:** Private and public U.S.-controlled banks, savings associations, bank holding companies, certain savings and loan holding companies, and mutual organizations.

**RMBS - Residential Mortgage-Backed Securities:** A financial instrument representing an interest in a group of residential real estate mortgages.

**S-PPIP - The Legacy Securities Public Private Investment Program.**

**SBA – U.S. Small Business Administration.**

**SBA 7(a) Loan Guarantee Program:** A SBA loan program pursuant to which the SBA guarantees a percentage of loans for small businesses that cannot otherwise obtain conventional loans at reasonable terms.

**SBA 7(a) Securities Purchase Program:** A TARP program under which Treasury purchases securities backed by the guaranteed portions of the SBA 7(a) loans.

## 10. Additional Resources

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**SCAP – Supervisory Capital Assessment Program:** An assessment of capital, sometimes referred to as the “stress test”, conducted by federal banking supervisors to determine if the largest U.S. financial organizations had sufficient capital continue lending and absorb the potential losses that could result from a more severe decline in the economy than projected.

**SEC: U.S. Securities and Exchange Commission.**

**Servicer:** An entity that collects payments and maintains accounts regarding mortgage loans.

**SIGTARP - The Special Inspector General for the Troubled Asset Relief Program.**

**SPV - Special Purpose Vehicle:** An off-balance sheet legal entity that holds the transferred assets presumptively beyond the reach of the entities providing the assets (e.g., legally isolated).

**Stress Test:** See SCAP.

**TIP - Targeted Investment Program:** A TARP program that Treasury created to stabilize the financial system by making investments in institutions that are critical to the functioning of the financial system.

**TALF - Term Asset-Backed Securities Loan Facility:** A program under which the Federal Reserve Bank of New York made term non-recourse loans to buyers of AAA-rated Asset-Backed Securities in order to stimulate consumer and business lending by the issuers of those securities. Treasury used TARP funds to provide credit support for the TALF as part of its Consumer and Business Lending Initiative.

**TARP - Troubled Asset Relief Program:** The Troubled Asset Relief Program, which was established under EESA to stabilize the financial system and prevent a systemic collapse.

**Tier 1 Capital or “core capital”:** A measure of a bank’s assets and liabilities that includes primarily common equity (including retained earnings), limited types and amounts of preferred equity, certain minority interests, and limited types and amounts of trust preferred securities, but excludes goodwill, certain other intangibles and certain other assets. It is used by banking regulators as a measure of a bank’s ability to sustain future losses and still meet depositor’s demands.

**Tier 1 Common (also known as Tangible Common Equity or TCE):** A measure of a bank’s assets and liabilities calculated by removing all non-common elements from Tier 1 Capital, e.g., preferred equity, minority interests, and trust preferred securities. It can be thought of as the amount that would be left over if the bank were dissolved and all creditors and higher levels of stock, such as preferred stock, were paid off. Tier 1 Common is the highest “quality” of capital in the sense of providing a buffer against loss by claimants on the bank. Tier 1 Common is used in calculating the Tier 1 Common Ratio which determines the percentage of a bank’s total assets that is categorized as Tier 1 Common. The higher the percentage, the better capitalized the bank. Preferred stock is an example of capital that may be counted in Tier 1 Capital, but not in Tier 1 Common.

**TruPs - Trust Preferred Security:** A security that has both equity and debt characteristics, created by establishing a trust and issuing debt to it. A company may create a trust preferred security to realize tax benefits, since the trust is tax deductible.

**UP – Unemployment Program:** The Home Affordable Unemployment Program is a supplemental program to HAMP which provides assistance to unemployed borrowers.



## 10. Additional Resources

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**Warrant:** A financial instrument that represents the right, but not the obligation, to purchase a certain number of shares of common stock of a company at a fixed price.

**Warrant Preferred or Warrant Sub Debt:** For CPP investments in a privately-held company, an S-corporation, or certain mutual institutions, Treasury received warrants to purchase, at a nominal cost, additional preferred stock (these securities are referred to as “warrant preferreds”) or subordinated debentures (these securities are referred to as “warrant sub debt”) equivalent to five percent of the aggregate liquidation preference of the primary CPP investment.

## **B. Links to Further Information**

### **Office of Financial Stability, U.S. Department of the Treasury**

- Financial Stability website: <http://www.FinancialStability.gov/>
- Agency Financial Report for Fiscal Year 2009:  
<http://www.ustreas.gov/press/releases/OSF%20AFR%2009.pdf>

### **Warrant Sales**

- Warrant Disposition Reports: <http://www.FinancialStability.gov/latest/reportsanddocs.html>
- Treasury Analysis of Warrant Auction Results (March 18, 2010):  
[www.Treas.gov/offices/economic-policy/reports/Auction-Analysis-3-18-2010.pdf](http://www.Treas.gov/offices/economic-policy/reports/Auction-Analysis-3-18-2010.pdf)

### **Public Private Investment Program Quarterly Reports:**

- [www.FinancialStability.gov/roadtostability/legacysecurities.html#reports](http://www.FinancialStability.gov/roadtostability/legacysecurities.html#reports)

### **Housing Initiatives**

- Monthly Servicer and Performance Report: [www.FinancialStability.gov/latest/reportsanddocs.html](http://www.FinancialStability.gov/latest/reportsanddocs.html)
- Making Home Affordable Website: [www.MakingHomeAffordable.gov](http://www.MakingHomeAffordable.gov)
- Home Affordable Modification Program website (includes Supplemental Directives and the MHA Handbook): [www.HMPAdmin.com](http://www.HMPAdmin.com)
- Monthly Housing Scorecard from the U.S. Department of Housing and Urban Development (HUD):  
[www.HUD.gov/scorecard](http://www.HUD.gov/scorecard)

### **Automotive Company Programs:**

- Executive Office of the President, “A Look Back at GM, Chrysler and the American Auto Industry” (April 21, 2010):  
[http://www.whitehouse.gov/sites/default/files/rss\\_viewer/one\\_year\\_later\\_autos\\_report.pdf](http://www.whitehouse.gov/sites/default/files/rss_viewer/one_year_later_autos_report.pdf)

### **Supervisory Capital Assistance Program and Capital Assistance Program**

- SCAP White Paper: <http://www.FederalReserve.gov/bankinfo/bcreg20090424a1.pdf>

### **Office of the Special Master for TARP Executive Compensation**

- [www.FinancialStability.gov/about/executivecompensation.html](http://www.FinancialStability.gov/about/executivecompensation.html)
- Final Report of the Special Master for TARP Executive Compensation Kenneth R. Feinberg:  
<http://www.FinancialStability.gov/about/executivecompensation.html>

[www.FinancialStability.gov](http://www.FinancialStability.gov)