

June 2010

TROUBLED ASSET RELIEF PROGRAM

Treasury's Framework
for Deciding to
Extend TARP Was
Sufficient, but Could
be Strengthened for
Future Decisions



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Highlights of [GAO-10-531](#), a report to congressional committees

TROUBLED ASSET RELIEF PROGRAM

Treasury’s Framework for Deciding to Extend TARP Was Sufficient, but Could be Strengthened for Future Decisions

Why GAO Did This Study

The Department of the Treasury’s (Treasury) authority to purchase, commit to purchase, or commit to guarantee troubled assets was set to expire on December 31, 2009. This important authority has allowed Treasury to undertake a number of programs to help stabilize the financial system. In December 2009, the Secretary of the Treasury extended the authority to October 3, 2010. In our October 2009 report on the Troubled Asset Relief Program (TARP), GAO suggested as part of a framework for decision making that Treasury should coordinate with relevant federal agencies, communicate with Congress and the public, and link the decisions related to the next phase of the TARP program to quantitative analysis. This report discusses (1) the process Treasury used to decide to extend TARP and the extent of coordination with relevant agencies and (2) the analytical framework and quantitative indicators Treasury used to decide to extend TARP. To meet the report objectives, GAO reviewed key documents related to the decision to extend TARP, interviewed agency officials and analyzed financial data.

What GAO Recommends

GAO recommends that the Secretary of the Treasury (1) formalize coordination with FDIC for future TARP decisions and (2) improve the transparency and analytical basis for TARP program decisions. Treasury generally agreed with our recommendations.

What GAO Found

The extension of TARP involved winding down programs while extending others, transforming the program to one focused primarily on preserving homeownership, and improving financial conditions for small banks and businesses. While the extension of TARP was solely the Treasury’s decision, it was taken after significant deliberation and involved interagency coordination. Although sufficient for the decision to extend, the extent of coordination could be enhanced and formalized for any upcoming decisions that would benefit from interagency collaboration, especially with FDIC.

Treasury considered a number qualitative and quantitative factors for key decisions associated with the TARP extension (see table). Important factors considered for the extension of new commitments centered on ongoing weaknesses in key areas of the economy. Treasury underscored that while analysis was possible on the needs or success of individual programs, the fragile state of the economy and remaining downside risks were difficult to know with certainty. Considering this uncertainty, Treasury wanted to extend TARP through October 2010 in order to retain resources to respond to financial instability. Going forward, Treasury could strengthen its current analytical framework by identifying clear objectives for small business programs and providing explicit linkages between TARP program decisions and the quantitative analysis or indicators used to motivate those decisions.

Status of select TARP Programs and Key Factors Driving Treasury’s Decisions

Program type	Treasury’s decision	Key factor driving Treasury’s decision	Key indicators identified by Treasury
Mortgage modification	Program extended, \$10 billion available for new commitments	Weakness in housing market and recent implementation of the program	Foreclosures, delinquencies, trial and permanent mortgage modifications, and housing prices
Small business lending	Programs extended, \$32 billion available for new commitments	Contraction in bank lending and multiple indicators pointing to tight conditions for small business credit	Business and commercial real estate loans, Senior Loan Officer Opinion Survey, and Small Business Economic Trends
Bank capital	Programs closed	Banks’ ability to raise capital on private markets	Common equity issuance
Asset-backed security (ABS) markets	Program closed	Recovery in ABS markets	ABS pricing spreads, program utilization, and ABS issuances
Legacy (“troubled”) assets	Program closed	Recovery of mortgage-related securities	Prices and spreads for certain mortgage-related securities

Source: GAO analysis of Treasury documents and interviews.

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Abbreviations

AGP	Asset Guarantee Program
AIFP	Automotive Industry Financing Program
AIG	American International Group
CAP	Capital Assistance Program
CBLI	Consumer & Business Lending Initiative
CDFI	community development financial institutions
C&I	commercial and industrial
CMBS	commercial mortgage-backed securities
CPP	Capital Purchase Program
EESA	Emergency Economic Stabilization Act
FDIC	Federal Deposit Insurance Corporation
Federal Reserve	Board of Governors of the Federal Reserve System
FinSOB	Financial Stability Oversight Board
GM	General Motors
HAMP	Home Affordable Modification Program
HUD	Department of Housing and Urban Development
MHA	Making Home Affordable Program
NFIB	National Federation of Independent Business
PPIP	Public Private Investment Program
RMBS	residential mortgage-backed securities
SCAP	Supervisory Capital Assessment Program
SLOOS	Senior Loan Officer Opinion Survey
TALF	Term Asset-Backed Securities Loan Facility
TARP	Troubled Asset Relief Program
TIP	Targeted Investment Program
TLGP	Temporary Liquidity Guarantee Program
Treasury	Department of the Treasury

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United States Government Accountability Office
Washington, DC 20548

June 30, 2010

Congressional Committees

In response to the recent financial crisis, the United States has initiated extraordinary interventions aimed at moderating its impact. The Board of Governors of the Federal Reserve System (Federal Reserve), the Federal Deposit Insurance Corporation (FDIC), and the Department of the Treasury (Treasury) have taken the lead in combating the worst episode of financial instability since the Great Depression and, by many measures, the most severe recession since the end of World War II. Among the crisis-driven interventions was the Troubled Asset Relief Program (TARP), which was authorized by the Emergency Economic Stabilization Act (EESA) of 2008. EESA gave Treasury the authority to purchase or guarantee “troubled assets” that were deemed to be at the heart of the crisis—including mortgages and mortgage-backed securities—and any other financial instrument Treasury determined it needed to purchase to help stabilize the financial system.¹ Over the last 20 months, the activities initiated under TARP have covered a broad range of activities including, injecting capital into key financial intuitions, purchasing and guaranteeing assets, providing credit protection, and providing incentives for modifying residential mortgages, among other things.

Although the United States’ financial system has become more stable and economic conditions appear to be improving, the economy remains fragile and potential threats remain. As a result Treasury, the Federal Reserve, FDIC, and other government agencies continue to take steps to stabilize financial markets and strengthen the economic recovery. However, eventually the government plans to withdraw this exceptional public support from the financial system. The termination and winding down of many federal government programs is already under way.

¹EESA, Pub. L. No. 110-343, 122 Stat. 3765 (2008), (codified, as amended, at 12 U.S.C. §§ 5201 *et seq.*). EESA originally authorized Treasury to purchase or guarantee up to \$700 billion in troubled assets. The Helping Families Save Their Homes Act of 2009, Pub. L. No. 111-22, Div. A, 123 Stat. 1632 (2009), amended EESA to reduce the maximum allowable amount of outstanding troubled assets under EESA by almost \$1.3 billion, from \$700 billion to \$698.741 billion. The act requires that the appropriate committees of Congress be notified in writing that the Secretary of the Treasury, after consultation with the Federal Reserve Chairman, has determined that it is necessary to purchase other financial instruments to promote financial market stability. Section 3(9) of the act (codified at 12 U.S.C. § 5202(9)).

In response to the need to develop an exit strategy without compromising the nascent recovery, on December 9, 2009, the Secretary of the Treasury (Secretary) announced the next steps in TARP. Specifically, the Secretary (1) extended the authority provided under EESA to October 3, 2010; (2) announced that several TARP programs would be terminated and additional commitments would be made with respect to others; and (3) notified Congress that Treasury expected to use no more than \$550 billion out of the approximately \$700 billion authorized by EESA.

In addition to authorizing TARP, EESA also provided GAO with broad oversight authorities for actions taken under TARP and requires GAO to report at least every 60 days on TARP activities and performance.² To fulfill our statutorily mandated responsibilities, we have been reviewing numerous TARP programs and monitoring and providing updates on financial market and economic indicators. In our October 2009 TARP report, we suggested as part of a credible and robust framework for decision making that Treasury should coordinate with relevant federal agencies, communicate with Congress and the public, and link the decisions related to the next phase of the TARP program to quantitative analysis.³ This report, which expands on our October 2009 report, examines the process the Secretary used in deciding to extend TARP. Specifically, this report discusses (1) the process Treasury used to decide to extend TARP and the extent of coordination with relevant agencies and (2) the analytical framework and quantitative indicators Treasury used to decide to extend TARP.

To meet the report objectives, we reviewed key documents related to the decision to extend TARP, including reports issued by the Financial Stability Oversight Board (FinSOB) and other documents that Treasury identified as reflecting the analytical framework used. As part of our review we analyzed data on the state of the economy and financial markets and continued to monitor indicators that might be suggestive of the performance and effectiveness of TARP. We also interviewed Treasury and Federal Reserve officials and received official responses to our questions from FDIC. Because Treasury is terminating and winding down some programs and allocating additional resources to others, we reviewed

²Section 116 of EESA, 122 Stat. at 3783 (codified at 12 U.S.C. § 5226).

³GAO, *Troubled Asset Relief Program: One Year Later, Actions Are Needed to Address Remaining Transparency and Accountability Challenges*, GAO-10-16 (Washington, D.C.: Oct. 8, 2009).

the indicators that Treasury officials used to inform these decisions. We believe that these data, considered as a whole, are sufficiently reliable for the purpose of summarizing TARP activity and presenting and analyzing trends in the economy and financial markets. However, we discuss some limitations about the data on credit conditions for small businesses. For additional information on the scope and methodology for this engagement, see appendix I.

We conducted this performance audit from March 2010 to June 2010 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Background

As the economy begins to recover from the financial crisis, the extraordinary government interventions taken to stabilize the financial system will need to be withdrawn. The consequences of financial crises—specifically systemic bank-based crises—on economic activity have been well documented.⁴ As a result, governments and monetary authorities typically undertake interventions, even though the resulting actions raise concerns about moral hazard and can come at a significant expense to taxpayers. Given its severity and systemic nature, the recent global financial crisis prompted substantial interventions starting as early as September 2007, after the first signs of serious trouble in the subprime mortgage market surfaced (see app. II). In the early stages of the financial crisis, the observable policy responses were a Department of Housing and Urban Development (HUD)-initiated foreclosure prevention program, a Federal Reserve lending facility for depository institutions, and currency

⁴Although varying in terms of their type and intensity, financial crises can result in costly interruptions to economic growth and the road to recovery can be long. Empirical work exploring commonalities in banking crises in advanced economies finds that the average cost, in terms of annual output lost, is about 2 percent, with a recovery time of about 2 years. However, some financial crises have resulted in more significant output declines with growth remaining at lower levels for years after the initial decline in economic activity. See Reinhart, C. and K. Rogoff, “Is the 2007 U.S. Subprime Crisis So Different? An International Historical Comparison,” *American Economic Review* 98, no. 2 (2008).

swap arrangements with various foreign central banks.⁵ As the crisis intensified, additional lending facilities were created, followed by separate actions by the Federal Reserve, Treasury, and others that dealt with financial sector issues on a case-by-case basis. These actions included facilitating JPMorgan Chase & Co.'s purchase of Bear Stearns Companies, Inc.; addressing problems at Fannie Mae and Freddie Mac by placing them into conservatorship; working with market participants to prepare for the failure of Lehman Brothers; and lending to American International Group (AIG) to allow it to sell some of its assets in an orderly manner.

Although Treasury had begun to take a number of broader steps, including establishing a temporary guarantee program for money market funds in the United States, it decided that additional and comprehensive action was needed to address the root causes of the financial system's stresses. The passage of EESA and authorization of TARP provided Treasury with the framework it needed to begin its more comprehensive and coordinated course of action that ultimately resulted in several programs. Some TARP funds were utilized to launch joint programs or to support efforts principally led by other regulators.⁶ Concurrent with the announcement of the first TARP program, the Federal Reserve and FDIC also announced other actions that were intended to stabilize financial markets and increase confidence in the U.S. financial system. This system-wide approach was also coordinated with a number of foreign governments as part of a global effort.

The various initiatives under TARP are detailed below.

- **Capital Purchase Program (CPP).** CPP was intended to restore confidence in the banking system by increasing the amount of capital in the system. Treasury provided capital to qualifying financial institutions by purchasing preferred shares and warrants or subordinated debentures.

⁵A currency swap is a transaction involving two parties that exchange an agreed amount of two currencies and at the same time agree to unwind the exchange at a future date. These swap lines were designed to increase central banks' ability to provide liquidity to banks requiring nondomestic currency and as an alternative to interbank markets, which were showing signs of significant stress.

⁶Some programs involved exceptional assistance to particular institutions, such as AIG, because of their systemic importance or supported particular markets. For a full exploration of these programs see Congressional Research Service, *Government Intervention in Response to Financial Turmoil* (February 2010).

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- **Capital Assistance Program (CAP).** CAP was designed to further improve confidence in the banking system by helping ensure that the nation’s largest banking institutions had sufficient capital to cushion themselves against larger than expected future losses, as determined by the Supervisory Capital Assessment Program (SCAP)—or “stress test”—conducted by federal regulators.
 - **Consumer & Business Lending Initiative (CBLI).** CBLI was designed to support new securitizations in consumer and business credit markets, especially for auto, student, and small business loans; credit cards; and new and legacy securitizations of commercial mortgages to increase credit availability in these markets and now includes small business lending programs as well. A portion of the CBLI funds were used to support the Federal Reserve’s Term Asset-Backed Securities Loan Facility (TALF). Under TALF, the Federal Reserve provided loans to private investors who pledged securitizations as collateral and Treasury provided a government backstop against certain losses.
 - **Public Private Investment Program (PPIP).** PPIP was designed to facilitate the purchase of “legacy assets” as part of Treasury’s efforts to facilitate price discovery in markets for these assets, repair balance sheets throughout the financial system, and increase the availability of credit to households and businesses. The legacy securities program, or “S-PPIP,” partnered Treasury and private sector equity funding leveraged by Treasury loans to purchase and hold legacy residential mortgage-backed securities (RMBS) and commercial mortgage-backed securities (CMBS). In the original plan, PPIP was to also include a partnership between Treasury and FDIC to purchase and hold legacy loans, through the legacy loans program, or “L-PPIP,” but it was never implemented as a joint venture using TARP funds.⁷
 - **Making Home Affordable Program (MHA).** MHA was launched to offer assistance to homeowners through a loss-sharing arrangement with mortgage investors and an incentive-based system for borrowers and servicers in order to prevent avoidable foreclosures. Under MHA, Treasury developed the Home Affordable Modification Program (HAMP) as its cornerstone effort to meet EESA’s goal of protecting home values and preserving homeownership by helping at-risk homeowners avoid potential foreclosure, primarily by reducing their monthly mortgage payments.

⁷FDIC now uses the program concept in the sale of receivership assets.

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- **Targeted Investment Program (TIP).** The stated purpose of TIP was to foster market stability and thereby strengthen the economy by making case-by-case investments in institutions that Treasury deemed critical to the functioning of the financial system. TIP was designed to prevent a loss of confidence in financial institutions that could (1) result in significant market disruptions, (2) threaten the financial strength of similarly situated financial institutions, (3) impair broader financial markets, and (4) undermine the overall economy.
 - **The AIG Investment Program.** Formerly the Systemically Significant Failing Institutions program, the goal of the AIG Investment Program was to provide stability in financial markets and avoid disruptions to the markets from the failure of a systemically significant institution. Treasury has purchased preferred shares and warrants in AIG and provided a facility for additional investment as needed up to a limit.
 - **Asset Guarantee Program (AGP).** AGP provided government assurances for certain assets held by financial institutions that are viewed as critical to the functioning of the nation's financial system. The goal of AGP was to encourage investors to keep funds in the institutions. According to Treasury, placing guarantees, or assurances, against distressed or illiquid assets was viewed as another way to help stabilize the financial system.
 - **Automotive Industry Financing Program (AIFP).** The goal of AIFP was to help stabilize the American automotive industry and avoid disruptions that would pose systemic risk to the nation's economy. Under this program, Treasury has authorized TARP funds to help support automakers, automotive suppliers, consumers, and automobile finance companies. A sizeable amount of funding has been to support the restructuring of Chrysler Group LLC (Chrysler) and General Motors Company (GM).

Taken together, the concerted actions by Treasury and others have been credited by many market observers with averting a more severe financial crisis, although there are critics who believe that markets would have recovered without government support. Particular programs have been reported to have had the desired effects, especially if stabilizing the financial system and restoring confidence was considered to be the principal goal of the intervention. In our October 2009 and February 2010 reports we noted that some of the anticipated effects on credit markets and the economy had materialized while some securitization markets had

experienced a tentative recovery.⁸ Yet, experience with past financial crises, coupled with analysis of the specifics of the current situation, has led the Congressional Budget Office to predict a modest recovery that will not be robust enough to appreciably improve weak labor markets through 2011. Full recovery will likely take some time given years of excesses, including imprudent use of leverage at financial institutions, overvalued asset prices, and major imbalances in the fiscal and household sectors. Negative shocks like the recent turmoil in international capital markets stemming from European sovereign debt issues have the potential to delay the recovery as well.

Because markets have stabilized, private markets have reopened, and economic growth has resumed, the federal government has begun to move into the exit phase of its financial stabilization initiatives. The winding down of government support is made more pressing by the need to exit market distorting interventions as quickly as possible and to begin shifting focus from the financial crisis to stabilizing the government debt-to-gross domestic product ratio. Crisis-driven interventions are designed to be temporary because they distort the normal functioning of markets and involve public capital when, under normal conditions, private capital is more desirable.⁹ Moreover, as we have pointed out in previous reports, the U.S. government faces an unsustainable long-term fiscal path. While these fiscal imbalances predate the financial crisis, the government's response to the crisis has exacerbated an already challenging fiscal environment.¹⁰ As a result, even as some programs have ramped up to address specific

⁸See GAO, *Troubled Asset Relief Program: Treasury Needs to Strengthen Its Decision-Making Process on the Term Asset-Backed Securities Loan Facility*, [GAO-10-25](#) (Washington, D.C.: Feb. 5, 2010) and [GAO-10-16](#).

⁹For example, even when they are seen as necessary, the interventions provide support to market participants in ways that can influence resource allocation and impede prices from reverting to more appropriate values. Additionally, the willingness to provide support to systemically important institutions can distort private incentives leading to activities that would not occur in the absence of a perceived government backstop. See Claessens, Stijn, Giovanni Dell'Ariccia, Deniz Igan, and Luc Laeven, "Lessons and Policy Implications from the Global Financial Crisis," IMF Working Paper, February 2010.

¹⁰Even before the financial crisis, the nation's finances were not sustainable over the long term. See GAO, *U.S. Government Financial Statements: Fiscal Year 2009 Audit Highlights Financial Management Challenges and Unsustainable Long-Term Fiscal Path*, [GAO-10-483T](#) (Washington, D.C.: Apr. 14, 2010) and GAO, *Debt Management: Treasury Was Able to Fund Economic Stabilization and Recovery Expenditures in a Short Period of Time, but Debt Management Challenges Remain*, [GAO-10-498](#) (Washington, D.C.: May 18, 2010).

issues, many others have either expired or are already winding down—including those utilizing TARP funds (see app. II). Many programs were designed to wind down naturally, force financial institutions to raise private capital, or become unattractive to participants once markets recovered.

Treasury’s authority under EESA to purchase, commit to purchase, or commit to guarantee troubled assets was set to expire on December 31, 2009, unless the Secretary submitted a written certification to Congress extending these authorities.¹¹ In anticipation of the upcoming decisions on the future of TARP, the need to unwind the extraordinary federal support across the board, and the fragile state of the economy we made recommendations to Treasury in our October 2009 report. Specifically, we suggested that any decision to extend TARP be made in coordination with relevant policymakers. We also suggested that Treasury make use of quantitative analysis wherever possible to support the rationale and communicate its determinations to Congress and the American people. We noted that without a robust analytic framework, Treasury may be challenged in effectively carrying out the next stages of its programs. Treasury responded that in deciding whether to extend TARP authority beyond December 31, 2009, the Secretary would “coordinate with appropriate officials to ensure that the determination is considered in a broad market context that takes account of relevant objectives, costs, and measures” and would communicate the rationale for the decision.

Although Treasury Undertook a Deliberative Process in Deciding to Extend TARP, It Could Strengthen Coordination

The extension of TARP involves the winding down of some programs while making additional funds available for commitment under other programs, transforming the primary focus of TARP to that of preserving homeownership, and improving financial conditions for small banks and businesses. While the decision to extend TARP was solely Treasury’s decision, it was taken after significant deliberation and involved interagency coordination and consultation. Although sufficient for the decision to extend, the extent of coordination could be enhanced and formalized for any upcoming decisions that would benefit from interagency collaboration.

¹¹EESA § 120, 122 Stat. at 3788 (codified at 12 U.S.C. § 5230). As used in this report, the term “commitment” (and variants thereof) means a legally enforceable obligation against the government.

The Decision to Extend TARP Involved Terminating and Winding Down Some Programs and Making New Commitments in Select Areas

On December 9, 2009, the Secretary announced that he was extending Treasury's authority under EESA to purchase, commit to purchase, or commit to guarantee troubled assets until October 3, 2010 (TARP expiration date). After the expiration date, no TARP funds can be committed, but there may be expenditures to fund commitments entered into prior to the expiration date. The extension of TARP permits Treasury to reallocate existing commitments and make additional funds available for some programs. As is shown in table 1, according to Treasury, new commitments through October 3, 2010, will be limited to MHA and small business lending programs through CBLI.¹² The funds allocated to MHA have not been increased beyond the initial \$50 billion Treasury estimated would be committed under the TARP-funded program. At time of the decision to extend, Treasury had committed \$40 billion under existing MHA programs; however, according to Treasury, they had always contemplated additional MHA programs, such as programs to address negative equity. Treasury indicated that the extension of TARP gave them more time and flexibility to build out those programs as well as more time to decide how best to allocate the remaining \$10 billion in order to prevent avoidable foreclosures. All other programs, including TIP, have closed or will close by June 30, 2010, and no additional funds will be committed under those programs.¹³ However, additional expenditures, which have already been apportioned and accounted for, could occur after the TARP termination date for TALF, PPIP, and the AIG Investment Program to fund commitments made prior to December 2009, and investments acquired through a variety of TARP actions remain under Treasury's management. Nevertheless, the extension has formally moved TARP from a program with a heavy focus on capitalizing institutions and stabilizing securitization markets to one focused primarily on mitigating preventable foreclosures and improving financial conditions for small banks and small businesses.

¹²Consideration was originally given to the extension of TALF.

¹³For the purposes of this report "closed" means no new agreements to undertake transactions will occur through the program after the expiration date, but does not necessarily imply no activity is occurring. As we discuss, many of the programs have resulted in equity investments, loans, and lines of credit that remain outstanding.

Table 1: Status of TARP Programs as of June 7, 2010

Dollars in billions

Program	Status	Projected Use of funds	Disbursements
CPP	Closed; warrants and preferred shares held	\$204.89	\$204.89
CAP	Closed; no investments made	n/a	n/a
TIP	Closed; warrants held	40.00	40.00
AIG Investments Program	Closed; equity held	69.84	47.54
AGP (Citigroup)	Closed; trust preferred securities with warrants held	5.00	0
AIFP	Closed; loans outstanding, investments held	84.84	79.69
MHA ^a	Extended; \$10 billion available for new commitments ^b	50.00	1.45
CBLI			
TALF	Closed for ABS and MBS; closes June 30, 2010, for new CMBS; investments held	20.00	0.10
Reserve for programs to support small business ^c	Extended; \$30 billion available for new commitments	30.00	0
Community Development Capital Initiative (CDCI)	Extended; \$1 billion available for new commitments	1.00	0
Unlocking Credit for Small Businesses	Extended, \$1 billion available for new commitments	1.00	0.6
Subtotal		52.00	0.16
PPIP	Closed; loans outstanding, equity and debt held	30.00	11.44

Source: GAO analysis of Treasury documents.

Note: For a detailed description of selected programs see [GAO-10-16](#) and [GAO-10-25](#).

^aIncludes HAMP.

^bSince the decision to extend was announced \$1 billion of the remaining \$10 billion has been committed.

^cPending legislation the Small Business Lending Fund (SBLF) will operate outside of TARP.

Treasury estimates that new commitments under MHA and CBLI could increase the costs of TARP by \$25 billion. Even with these additional costs, Treasury expects that TARP will ultimately cost taxpayers \$105.4 billion, more than \$200 billion less than initially estimated.¹⁴ The Secretary

¹⁴GAO will be reviewing the cost estimate as part of the audit of the Office of Financial Stability Fiscal Year 2010 Financial Statements.

also notified Congress that Treasury expected to use no more than \$550 billion of the approximately \$700 billion authorized by EESA but reserved the authority to use the remaining funds to respond “to an immediate and substantial” threat to the economy “stemming from financial instability.” In the absence of such threats, Treasury indicated that those resources would be used to pay down the federal debt over time. In his letter to Congress communicating the decision, the Secretary also expressed a desire to expedite both the liquidation of the equity investments and the repayment of funds extended to TARP recipients.¹⁵ As of June 7, 2010, total TARP repayments were roughly \$195 billion. Pending legislation, if enacted, would require the Secretary to use any amounts repaid by financial institutions for debt reduction.¹⁶

The decision to extend TARP followed months of deliberation and internal discussions that began in August 2009. Treasury officials told us that while the decision to extend TARP could have been made earlier, it was not made until December to be certain that extension was necessary and so that the Secretary would be able to consider what conditions to place on the extension to balance the need to minimize the cost to taxpayers while ensuring that the program met its core objectives. According to Treasury officials, this decision was made at the highest levels within the agency. Discussions centered on how to phase out TARP and other government programs adopted in response to the financial crisis generally, as well as what limits to place on an extension, and what programs would not need to be continued beyond the original expiration date of December 31, 2009. Treasury officials indicated this discussion generally did not take place at the program level, but included a range of officials from various Treasury offices. Internal memos and briefing documents suggest considerable deliberation took place on the effectiveness of existing government actions as well as the likely effectiveness of potential policy options to address remaining threats to financial stability. Other programs operated by Treasury and other government agencies were important parts of these deliberations. According to Treasury, the modest pace of the economic recovery and concern about exiting TARP prematurely meant that the likelihood of not extending was low, but programs that were no longer

¹⁵The government now holds significant equity interests in several companies including AIG, Citigroup, GMAC Inc. and GM, and smaller investments in several financial institutions through CPP.

¹⁶See Debt Reduction Priority Act, S. 862, 111th Cong. § 3 (2009); Debt Reduction Priority Act, S. 869, 111th Cong. § 3 (2009).

needed were to be terminated. In addition, Treasury believed that while the decision could have been made at an earlier date, officials decided it was better to wait until closer to the certification deadline in order to have a more targeted response. Treasury also considered not extending TARP and instead making up front commitments to problem areas based on available information, but ultimately decided that the additional flexibility and better information that would come from the extension would be preferable.

Treasury Could Strengthen Its Interagency Coordination and Consultation

As part of a robust analytic framework for decision making, we recommended that the Secretary coordinate with the Federal Reserve and FDIC to help ensure that the decision to extend or terminate TARP was considered in a broader market context. Treasury officials said that it had external discussions and consultations in the months prior to the decision to help ensure that the decision-making process incorporated the actions of key financial regulators. Treasury officials also said that the Secretary had discussions with the Chairmen of the Federal Reserve and the FDIC regarding TARP and the status of crisis programs instituted at each respective agency.

Treasury officials noted that EESA required additional coordination with the Federal Reserve because it required the Secretary to consult with the Chairman of the Federal Reserve in order to purchase financial instruments other than those related to residential and commercial real estate.¹⁷ This consultation, which included communication among principals and staff of the two agencies, is represented in several letters by the Chairman to the Secretary reflecting the required consultations prior to the initiation of several TARP programs unrelated to residential and commercial real estate. In addition, Federal Reserve officials stated that the Chairman and Vice Chairman of the Federal Reserve were broadly supportive of the decision to extend TARP. The officials said that the Chairman was consulted by the Secretary on multiple occasions. The Federal Reserve noted that there was consistent coordination at the staff level regarding the TALF program, primarily due to the joint nature of the program. Another forum for coordination around the decision to extend TARP was FinSOB.¹⁸ FinSOB meeting minutes detailed discussions of the

¹⁷EESA § 3(9), 122 Stat. at 3767 (codified at 12 U.S.C. § 5202(9)).

¹⁸FinSOB was established by section 104 of EESA to help oversee TARP and other emergency authorities and facilities granted to the Secretary under EESA. 12 U.S.C. § 5214.

decision to extend TARP and the general economic situation.¹⁹ While there was discussion of the decision, FinSOB did not, nor was it required to, authorize or approve the Secretary's action.

The Secretary also discussed the extension of TARP with the Chairman of FDIC. In particular, both agencies told us that they discussed the timing of FDIC's exit from programs designed to support the banking system. According to Treasury officials, Treasury took into consideration the winding down of FDIC's Temporary Liquidity Guarantee Program (TLGP), which was designed to support bank debt and transaction accounts, in deciding to extend TARP. At the time Treasury made the decision to extend TARP, TLGP was scheduled to end June 30, 2010. FDIC subsequently extended TLGP to December 31, 2010.²⁰

As Treasury shifts into the exit phase of TARP, it faces upcoming decisions that would benefit from continued collaboration and communication with other agencies including:

- decisions about allocating any additional funds to MHA and CBLI,
- decisions about scaling back various programs, and
- ongoing decisions related to the general exit strategy, including unwinding the equity investments held as a result of actions taken under TARP.

Similar to the need for a coordinated course of action to stabilize the financial system and re-establish investor confidence, the general exit from the government interventions will require coordination to develop a unified disengagement strategy. As mentioned previously, TARP is one of

¹⁹This dialogue included financial statistics that are provided to FinSOB on a periodic basis detailing the state of the credit markets and the state of sectors of the economy. The statistics produced for these meetings generally were used to assist monitoring activity and effectiveness for each program under TARP.

²⁰TLGP comprised two distinct components: the Debt Guarantee Program, whereby FDIC guarantees certain senior unsecured debt issued by entities participating in the TLGP, and the Transaction Account Guarantee (TAG) program, where FDIC guarantees all funds held at participating insured depository institutions in qualifying noninterest-bearing transaction accounts. TAG is the component of TLGP that is being extended from a June 30, 2010, termination date until December 31, 2010.

many programs and activities the federal government has put in place over the past year to respond to the financial crisis (see also app. II).²¹

In general, the extent of coordination with the Federal Reserve was consistent with our recommendation and represented the type of collaboration necessary for the next stage of the government response to the crisis. However, the extent of Treasury's coordination with FDIC, while sufficient for the decision to extend TARP, should be enhanced and formalized for any upcoming decisions that would benefit from interagency collaboration. FinSOB, which was established to help oversee TARP and other emergency authorities and facilities granted to the Secretary under EESA, is composed of the Secretary, the Chairman of the Board of Governors of the Federal Reserve, the Director of FHFA, the Chairman of the Securities Exchange Commission, and the Secretary of HUD. Therefore many of the regulators who led the federal response to the financial crisis are already part of a collaborative body. As a result, FinSOB has been a vehicle for formal consultations over TARP decisions among the agencies that are represented on FINSOB under EESA. By adding future program decisions to the agenda, including decisions on future TARP commitments, FinSOB can continue to serve a role in the next phase of the TARP program as well as in the consideration of exit strategies. Because FINSOB membership is set by statute, Treasury should seek to conduct similar consultations with other agencies that are not represented on FinSOB, such as the FDIC, or these agencies could be invited occasionally to discuss specific issues.

Treasury Considered a Number of Qualitative and Quantitative Factors for Key Decisions Associated with the TARP Extension

Treasury considered a number of qualitative and quantitative factors for key decisions associated with the TARP extension. Important factors considered for the extension of TARP centered on ongoing weaknesses in key areas of the economy. Treasury officials noted that housing market indicators, despite previously announced initiatives, and financial conditions for small businesses necessitated further commitments under MHA and small business lending programs. Treasury underscored that while analysis was possible on the need for or success of individual programs, the fragile state of the economy and remaining downside risks were an ongoing source of uncertainty. Considering this uncertainty, Treasury wanted to extend TARP through October 2010 in order to retain

²¹Some programs fulfill similar purposes but may involve greater risk to the government while others may distort markets to a greater degree.

resources to respond to financial instability. On the other hand, Treasury noted that some programs had accomplished their goals and would be terminated. Treasury cited renewed ability of banks to access capital markets, improvements in securitization markets, and stabilization of certain legacy asset prices as motivating the closing of bank capital programs, TALF, and PPIP, respectively. Treasury could strengthen its analytical framework by identifying clear objectives for small business programs and explaining how relevant indicators motivated TARP program decisions.

Treasury officials identified four documents that were central to its efforts to describe and communicate to Congress and the public the framework it used to make decisions related to the extension of TARP, the expansion of some efforts, and the termination of others. Those four documents were (1) the September 2009 report “The Next Phase of Government Financial Stabilization and Rehabilitation Policies”; (2) the December 9, 2009, letter to Congressional leadership certifying the extension of TARP; (3) Secretary Geithner’s December 10, 2009, testimony to the Congressional Oversight Panel; and (4) the “Management Discussion and Analysis” portion of the fiscal year 2009 Office of Financial Stability Agency Financial Report. Based on our analysis of these documents and interviews with Treasury officials, table 2 summarizes the key factors that contributed to Treasury’s program-level decisions associated with the extension of TARP. In addition, we note a number of quantitative indicators identified by Treasury that to some extent measure the key factors that influenced the decisions. We elaborate on the nature of these decisions and the indicators below. AGP, TIP, AIFP, and the AIG Investment Program amounted to exceptional assistance to key institutions on a case-by-case basis, and therefore, the expectation was that these targeted programs would be exited as soon as practical and would not be considered for additional commitments.

Table 2: Status of Select TARP Programs and Key Factors Driving Treasury’s Decisions

Program	Treasury’s decision	Key factor driving Treasury’s decision	Key indicators identified by Treasury
MHA	Program extended, \$10 billion available for new commitments	Weakness in housing market and rolling out of new MHA programs	<ul style="list-style-type: none"> • Foreclosures • Delinquencies (figure 1) • HAMP trial and permanent modifications (figure 2) • Housing prices

Program	Treasury's decision	Key factor driving Treasury's decision	Key indicators identified by Treasury
CDCI, Unlocking Credit for Small Business, and additional programs for small business	Programs extended, \$32 billion available for new commitments	Contraction in bank lending and multiple indicators pointing to tight conditions for small business credit	<ul style="list-style-type: none"> Business and commercial real estate loans Federal Reserve Senior Loan Officer Opinion Survey National Federation of Independent Business's Small Business Economic Trends (figure 3)
CPP and CAP	Programs closed	Banks' ability to raise capital on private markets	<ul style="list-style-type: none"> Common equity issuance (figure 4)
TALF	Program closed	Recovery in ABS markets	<ul style="list-style-type: none"> ABS pricing spreads (figure 7) and TALF utilization (figure 8) ABS issuances
PPIP	Program closed	Recovery in legacy mortgage-related security markets	<ul style="list-style-type: none"> Prices and spreads for legacy securities, including certain RMBS and CMBS (figures 9 and 10)

Source: GAO analysis of Treasury documents and interviews.

Note: The table highlights several critical indicators that motivated Treasury's decisions to extend or close a program, but is not intended to be an exhaustive list of indicators Treasury considered or identified. Other indicators are discussed below.

Key Factors Considered Were Ongoing Weaknesses in Key Areas of the Economy

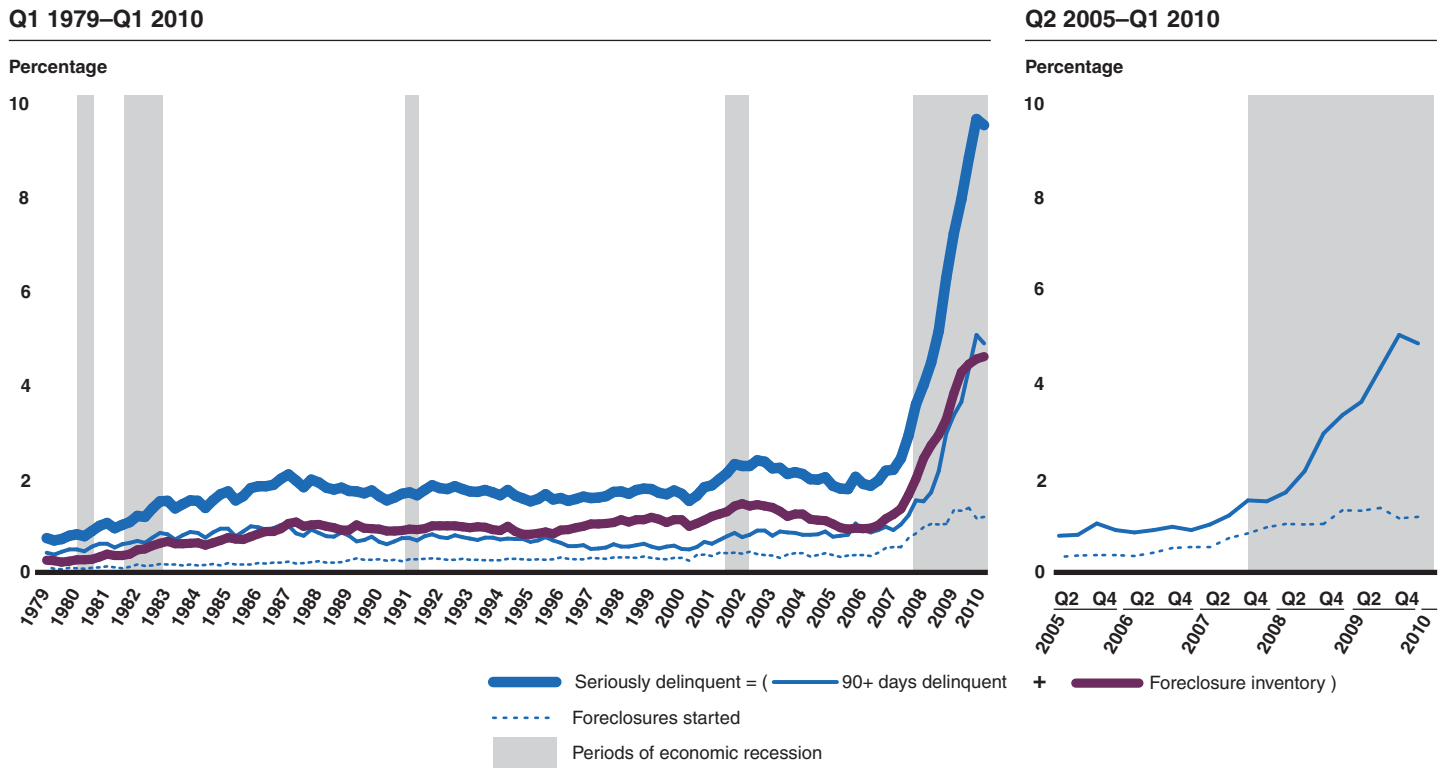
Housing. Rather than allow the program to expire with \$10 billion of the original \$50 billion allocated to MHA remaining uncommitted, Treasury extended the program so that those funds could be used to address continued weaknesses in housing markets and roll out several additional programs that Treasury had not yet had the opportunity to design and implement. Treasury officials noted that various metrics they were monitoring indicated that the recovery had not successfully reached particular areas of the economy (see table 3). Specifically, housing market indicators, such as foreclosures and mortgage delinquencies, remained elevated around the time the decision to extend TARP was made, despite initiatives—like MHA—that were designed to preserve homeownership by directly modifying mortgages for qualified homeowners.²² The percentage of loans in foreclosure (foreclosure inventory) reached 4.58 percent at the end of the fourth quarter of 2009 and continued to increase to an unprecedented high of 4.63 percent in the first quarter of 2010 (see fig. 1). Over the same period the serious delinquency rate—defined as the

²²As Treasury notes, not all foreclosures are preventable given that many homeowners overextended themselves and purchased homes that were not affordable to them in the long run, or suffered unanticipated life events that cause them to be unable to continue paying their mortgages.

percentage of mortgages 90 days or more past due plus those in foreclosure—fell only slightly from 9.67 to 9.54 percent. Although not shown, the serious delinquency rate for subprime loans exceeded 30 percent in the most recent two quarters, indicating the large proportion of subprime loans in trouble. Foreclosure starts, which reflect new foreclosures filings, peaked at 1.42 percent in the third quarter of 2009 before declining over the next two periods to roughly 1.2 percent. By any measure however, foreclosure and delinquency statistics for housing remain well above their historical averages. Moreover, although not explicitly mentioned by Treasury, a comparison of trends in delinquent mortgages and new foreclosure starts indicate that more foreclosures are looming. While the foreclosure start rate grew 36 percent from the last quarter of 2007 to the last quarter of 2009, the rate for delinquencies of 90 days or more grew by 222 percent over the same period (see fig. 1).²³ This suggests mortgages are not rolling from delinquency to foreclosure as expected and that lenders are not initiating foreclosures on many loans normally subject to such actions. To the extent that foreclosure mitigation programs are ineffective, or a large number of the trial modifications represent unavoidable foreclosures, the resulting foreclosures will continue to weigh on the housing market.

²³From the fourth quarter of 2009 to the first quarter of 2010 delinquencies have fallen somewhat, while the foreclosure starts has remained fairly constant.

Figure 1: Percentage of Loans 90 days Past Due, in Foreclosure and Seriously Delinquent



Source: Thomson Reuters Datastream.

Note: “90 plus days delinquent” refers to loans that are 90 days or more past due. “Seriously delinquent” refers to loans that are 90 days or more delinquent plus those in foreclosure.

Treasury also noted that extending TARP provides the flexibility to modify MHA to respond to the changing dynamics of the foreclosure crisis. Treasury noted early in the crisis that many foreclosures were the result of subprime, predatory, and fraudulent lending activity; however, as the financial crisis progressed, Treasury has modified and expanded its efforts because unemployment and negative equity have become the primary drivers of foreclosures, calling for a different approach to homeownership preservation. Treasury has modified MHA to deal with these issues by allowing more borrowers to qualify for modification—including borrowers with Federal Housing Administration (FHA) loans, who are currently in bankruptcy proceedings or who owe more than the current value of their home. Moreover, Treasury also plans to increase the incentives provided to servicers for writing down mortgage debt, and has included incentives for writing down second liens. Treasury is also implementing programs in addition to existing MHA programs that will address these issues, such as

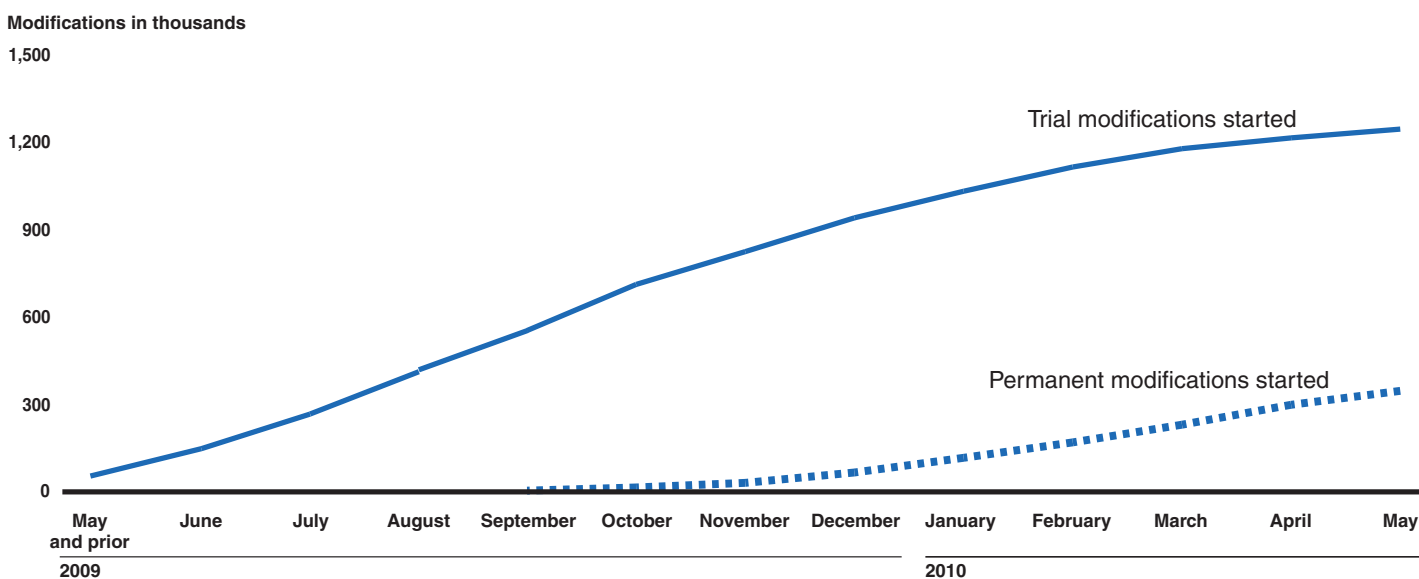
the HFA Hardest-Hit fund and a refinance program with FHA, and expects to use the full \$50 billion for all these combined efforts. Treasury officials acknowledged that the consequences of interventions may prevent the housing market from fully correcting and may also increase moral hazard by writing down mortgages for borrowers with negative equity. However, Treasury officials and others have identified reducing the number of unnecessary foreclosures as critical to the economic recovery. Because not all homeowners are expected to qualify for a HAMP modification or other mortgage relief programs under MHA, enhancements to the program are to include relocation assistance to some borrowers that use foreclosure alternatives such as a short sale or a deed-in-lieu of foreclosure.²⁴

In addition to continued weakness in the housing markets and the need for flexibility, Treasury noted that when the decision to extend the program was made, HAMP had only recently been implemented and needed time to ramp up to its full potential and build out all program components. In our July 2009 report and March 2010 testimony on HAMP, we noted that the program faced implementation challenges and that Treasury's projection that three to four million borrowers could be helped by offering loan modifications was based on several uncertain assumptions and might be overly optimistic. Treasury cited the slow pace of conversions of homeowners from trial modifications to permanent modifications as an important reason to extend its ability to have funds available for commitments related to foreclosure mitigation and housing market stabilization. Total trials versus permanent modifications continued to track the initial slow pace (see fig. 2). In October 2009, permanent modifications started totaled an estimated 2 percent of the total cumulative government-sponsored enterprise (GSE) and non-GSE HAMP trials started, before increasing to just 4 percent and 7 percent for November and December 2009, respectively. Treasury believed that the extension would allow the program the necessary time to reach its full potential by providing more time to complete the significant backlog of modifications, as well as giving the servicers the opportunity to build up their capacity, and finally allowing the public and investors time to better understand the requirements and opportunity presented by the HAMP process. The latest trial-to-permanent modification conversion rate has

²⁴A short sale allows a borrower to avoid foreclosure by selling the home for less than value of the outstanding loan. A deed-in-lieu involves the deeding the property to the servicer prior to a completed foreclosure sale.

now reached an estimated 28 percent of total cumulative HAMP trials (see fig. 2). It should be noted that there is a 3-month wait time during the trial period. Therefore, contemporaneous comparison of trial versus permanent modifications is not the most meaningful, since trials entered into within the last 3 months are not eligible for conversion into payments.

Figure 2: Cumulative GSE and Non-GSE HAMP Trial and Permanent Modifications



Source: GAO analysis of Treasury data.

Our June 2010 report on Treasury’s implementation of HAMP is an update of our prior July 2009 report and March 2010 testimony findings.²⁵ Specifically, it addressed (1) the extent to which HAMP servicers have treated borrowers consistently and (2) the actions that Treasury has taken to address certain challenges, including the conversion of trial modifications, negative equity, redefaults, and program stability. While one of Treasury’s stated goals for HAMP was to standardize the loan modification process across the servicing industry, we found inconsistencies in how servicers were treating borrowers under HAMP that could lead to inequitable treatment. Specifically, the servicers we contacted varied in the timing of HAMP outreach to delinquent borrowers,

²⁵GAO, *Troubled Asset Relief Program: Further Actions Needed to Fully and Equitably Implement Foreclosure Mitigation Programs*, GAO-10-634 (Washington, D.C.: June 24, 2010).

the criteria used to determine if borrowers were in imminent danger of default, and the tracking of borrower complaints about servicer's implementation of HAMP. Additionally we found that while Treasury had taken some steps to address the challenges we had previously reported on, it urgently needed to finalize and implement remaining program components and ensure the transparency and accountability of these efforts. In particular, we reported that Treasury had been slow to implement previously announced programs it identified as needed to address the housing problems hindering the current economic recovery, including its second-lien modification and foreclosure alternatives programs. We noted that Treasury recently announced additional HAMP components to help deal with the high number of foreclosures such as programs to help borrowers with high levels of negative equity and unemployed borrowers, which needed to be prudently designed and implemented as expeditiously as possible. Going forward, as Treasury continues to design and implement new HAMP-funded programs, we reported that it will be important that Treasury develop sufficient capacity—including staffing resources—to plan and implement programs, establish meaningful performance measures, and make appropriate risk assessments.

Treasury indicated that it plans to track performance measures of the number of HAMP modifications (trial and permanent) entered into, the redefault rate, and the change in average borrower payments to evaluate the program going forward. However, foreclosure and delinquency data used to motivate the decision to allocate the full budgeted resources to MHA and other housing programs, although also influenced by general market forces such as falling housing prices and unemployment, should provide an indication of the effectiveness of these efforts.²⁶

Small business lending. Treasury decided to allocate new resources to small business lending based on the contraction in bank lending and other indicators of small business credit conditions. However, Treasury has yet to set explicit objectives for its small business lending programs. Treasury

²⁶While the foreclosure rate stands at a record high, the rate of increase has slowed since the first quarter of 2009, increasing just 1.1 percent from the fourth quarter of 2009 to the first quarter of 2010. It is too early to say whether the leveling off of the foreclosure inventory is an indicator of the effectiveness of foreclosure mitigation programs or due to other factors that may delay the completion of the foreclosure process. It is also possible that in the absence of HAMP and programs designed to preserve homeownership, the foreclosure rate would be higher.

wants to support lending to creditworthy small businesses by providing capital to small banks. A drop in the volume of lending could be explained by a combination of reduced demand for loans, higher credit standards, or banks' lack of capital to make new loans. Demand for business loans, including small business loans, has dropped considerably since 2008, and credit standards have risen, according to Federal Reserve data. At the time of the extension, Treasury set aside \$30 billion for programs to support small business lending. Since that time, Treasury has decided to try to create a Small Business Lending Fund through legislation outside of TARP, due to concerns that many banks would not participate in a TARP program. In addition, Treasury expects to make up to \$1 billion in new capital investments in community development financial institutions (CDFI) and purchase up to \$1 billion in Small Business Administration loan securitizations, to improve access to credit for small businesses.²⁷ Relative to larger corporations, small businesses generally have difficulty directly accessing capital markets as an alternative source of financing and are therefore largely reliant on bank lending.²⁸ While Treasury has stated that bank lending has contracted, Treasury refers to data on outstanding bank loans (loan balances) of all sizes that reflect a number of economic conditions that may not be related to new lending and may not capture potentially divergent conditions for large and small firms. We found in previous work that changes in loan balances may not be a good proxy for new lending.²⁹ In particular, while outstanding commercial and industrial loans and commercial real estate loans have fallen, losses on a loan portfolio and loan repayments may help explain this drop.³⁰

²⁷CDFIs are financial institutions that provide financing and related services to communities and populations that lack access to credit, capital, and financial services. To become certified, an organization must: be a legal entity, have an eligible primary mission, be a financing entity, serve an eligible target market, be accountable to the target market, provide corresponding development services, and not be controlled by a government entity.

²⁸According to the 2003 Federal Reserve Survey of Small Business Finances, more than 5 percent of small businesses accessed alternative forms of financing, including venture capital.

²⁹This analysis was limited to a specific time period, the third quarter of 2008 to the first quarter of 2009. See [GAO-10-16](#).

³⁰For example, a Federal Reserve Bank of Atlanta analysis argues that drop in consumer credit outstanding since the financial crisis began is largely due to charge-offs. Legislative proposals for a Small Business Lending Fund take such charge-offs into account.

For firms of all sizes, lack of comprehensive data on new lending makes assessing business credit conditions particularly difficult. For example, interest rates, on their own, may not be a good indicator of the availability of credit. Specifically, financial institutions may ration credit based on the quality of the borrower, rather than continuing to lend, but charging a wider distribution of interest rates to customers of varying credit quality. As a result, the volume of new lending (loan originations) would be a valuable indicator of credit availability; however, only limited data on loan originations exist. For example, origination data exist only for certain kinds of loans (e.g., mortgages) or only for a small subset of banks (e.g., the largest CPP participants). Moreover, there are no consistent historical data on lending to small businesses. Treasury officials and others have acknowledged the limitations of data in this area, which Treasury officials have noted, making determining when enough has been done difficult.³¹

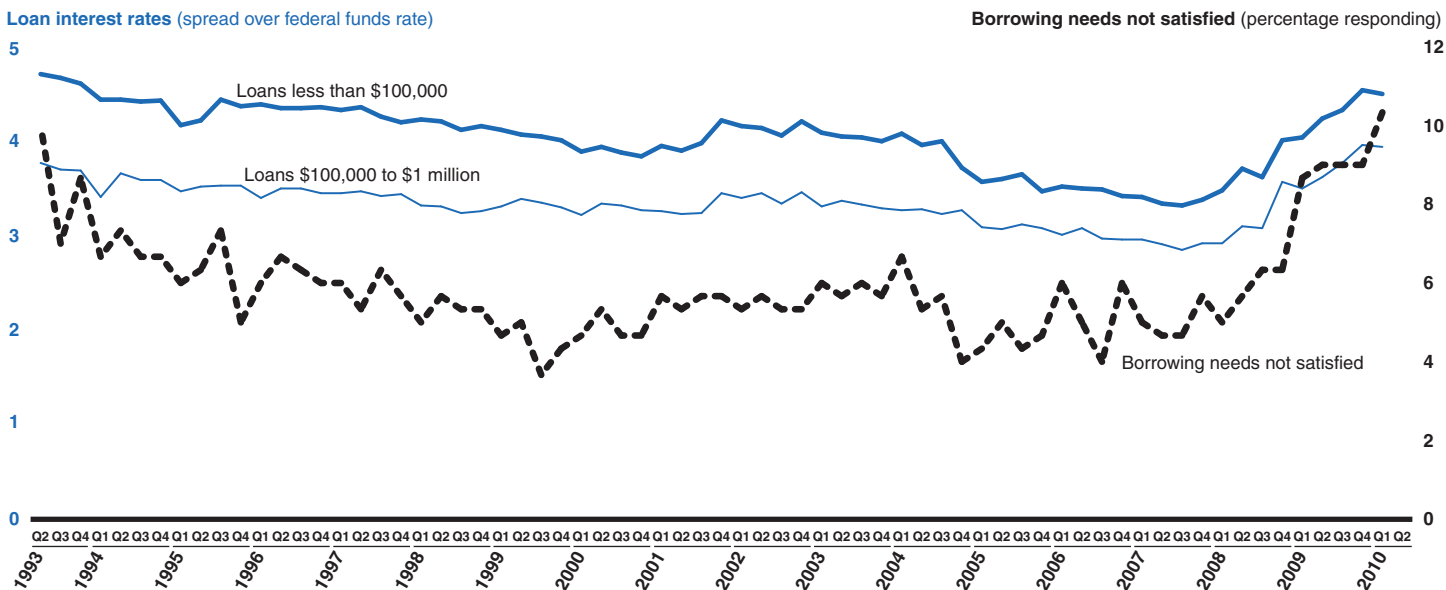
While the availability of small business credit is difficult to quantify definitively, Treasury officials noted that a number of indicators of small business lending point to reduced access to credit. Officials identified the Federal Reserve's Senior Loan Officer Opinion Survey (SLOOS) and the National Federation of Independent Business (NFIB) survey, among other sources. Taken together, these indicators, although imperfect, generally point to a tight credit environment for small firms. SLOOS surveys loan officers on, among other things, lending standards for commercial and industrial loans, and features responses by borrower size (small versus large and medium). The survey responses show significant tightening of lending standards for firms of all sizes, although conditions have tightened more in the last year for small firms than for larger firms. The NFIB Small Business Economic Trends survey contains a number of questions on access to credit. Respondents are NFIB members, with nearly half of all respondents from firms with five or fewer employees.³² A question on borrowing needs ("During the last three months, was your firm able to satisfy its borrowing needs?") may be indicative of changes in access to credit for firms of this size. We compared responses to this question to

³¹Congressional Oversight Panel, *May Oversight Report: The Small Business Credit Crunch and the Impact of the TARP*. This report notes the absence of high quality data on small business lending.

³²Our analysis of the composition of NFIB survey respondents found that the firm size distribution is broadly representative of the distribution of firms in the United States. However, we found that the survey over-represents some industries, including manufacturing and construction, while under-representing some skilled service industries. As such, respondents may not reflect the credit experiences of all firms in the economy.

interest rate spreads for loans of less than \$1 million (a proxy for loans to small businesses) from the Federal Reserve’s Survey of Terms of Business Lending. These spreads are premiums over the federal funds rate and indicate the risk banks perceive in making small loans. We found that the percentage of respondents reporting that their borrowing needs had not been satisfied showed the same broad pattern as spreads for loans of less than \$1 million (see figure 3). In particular, both show a spike in recent years, with increases in risk premiums for small loans and the proportion of small businesses reporting that their borrowing needs had not been met.³³

Figure 3: Interest Rate Spreads for Small Loans and Small Business Borrowing Needs, Second Quarter 1993 through First Quarter 2010



Source: GAO analysis of data from the Federal Reserve and National Federation of Independent Business.

³³Spreads on large loans have risen more than small loans since their trough (156 basis points versus 109 to 118 basis points), but spreads on small loans have risen more since the financial crisis began (estimated at third quarter 2008) by 86 to 88 basis points versus 68 basis points for larger loans.

Another Important Factor Was the Ability to Respond to Financial Instability

Because the economy was still fragile and downside risks remained, Treasury identified the need to retain resources to respond to threats to financial stability as an important consideration in deciding to extend TARP. According to Treasury officials, if the economic recovery were in jeopardy, the TARP extension gave Treasury the capability to react should financial markets need further assistance. Treasury noted several continued areas of weakness that supported the need to retain resources, without making them available for commitment under specific programs. Areas of weakness included the elevated pace of bank failures, high unemployment, and commercial real estate losses. Although banks in the United States had made progress in raising capital and recognizing losses on legacy assets and loans, substantial asset deterioration is expected across some loan classes, such as commercial real estate and consumer and corporate loans.³⁴ Because banks will likely continue to take steps to reduce leverage, credit conditions are expected to remain tight while high unemployment continues to weigh on residential real estate markets and consumer spending. As indicated above, uncommitted funds up to the total amount authorized by EESA could be used to respond to financial instability or growing weakness that would threaten the recovery. As of June 7, 2010, this amount is roughly \$163 billion and remains available for commitment, assuming repayments are not deployed in other efforts.

Treasury noted that, among other reasons, it extended TARP to maintain the capacity to respond to unforeseen threats or unanticipated shocks. Federal Reserve officials similarly noted that unanticipated events, not foreshadowed by market data, have been the hallmark of the crisis. The failure, or near failure, of a systemically important financial institution would be a critical threat to financial stability. Treasury, FDIC and the Federal Reserve responded to the failure, or near failure, of large financial institutions during the crisis with programs to provide assistance, such as guarantees and capital, to keep institutions solvent, including AGP for Citigroup and AIG Financial Assistance. According to Federal Reserve officials, one of the reasons they supported the extension of TARP was the inadequacy of available statutory tools to deal with threats to financial stability, such as the failure of a large financial institution. One proposed tool is an authority for the orderly resolution of large, nonbank financial institutions. In previous work, we have noted that some interventions to

³⁴Although subject to considerable uncertainty and range of error, recent estimates of legacy loan losses for the United States were revised from \$1.03 trillion to \$885 billion, with more than half of those losses already recognized by the banking sector. See International Monetary Fund's *Global Financial Stability Report* (October 2009 and April 2010).

support failing institutions can undermine market discipline and increase moral hazard.³⁵ For example, in the presence of a government back-stop, firms anticipate government assistance in the future and thus have less incentive to properly manage risk. Regulatory reforms that enhance oversight and capital requirements at large financial institutions—in essence making it more costly to be a large financial institution—would help to counter some erosion of market discipline. Similarly, an effective resolution authority could impose losses on managers, shareholders, and some creditors, but must also properly balance the need to encourage market discipline with the need to maintain financial stability. Treasury officials noted the importance of having financial regulatory reform in place before TARP expires in October 2010.

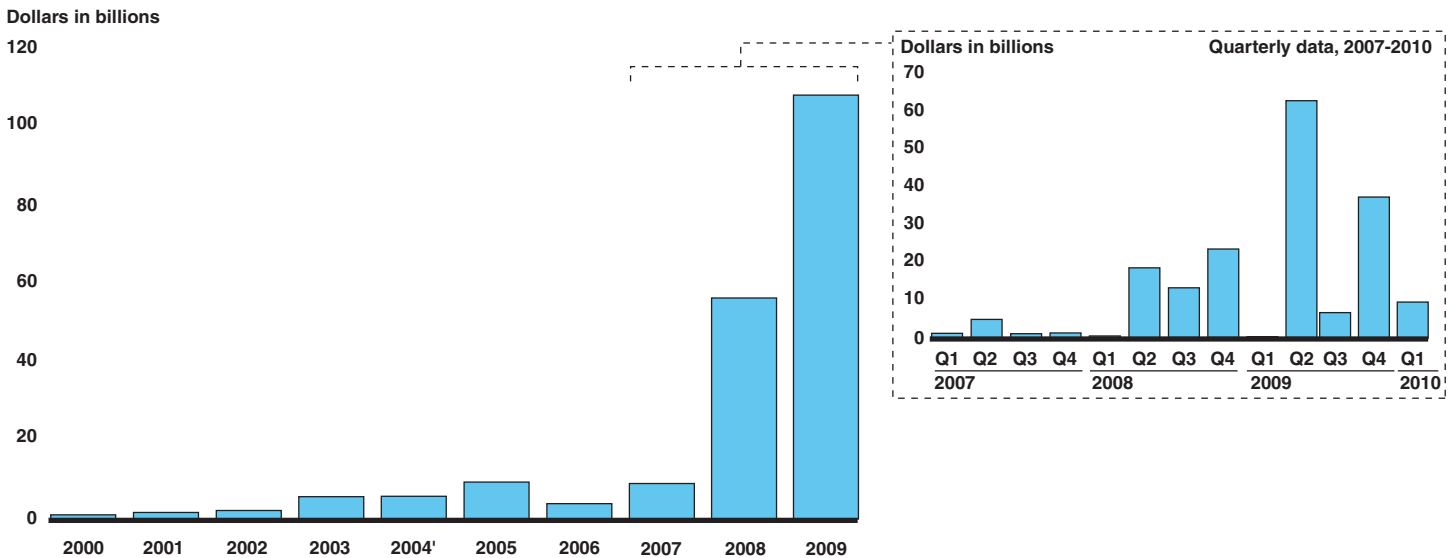
According to Treasury, Programs That Had Accomplished Their Goals Were Terminated

Bank capital programs. Treasury has ended broad programs, such as CPP and CAP, established to improve the solvency of financial institutions to support their ability to lend, based on banks' renewed ability to access private capital markets and issue new equity. Treasury has stated that by building capital, CPP was expected to increase lending to U.S. businesses and consumers. Treasury has disbursed more than \$200 billion for the CPP, and has received \$142 billion in repayments as of May 28, 2010. CAP was designed to help ensure that certain large financial institutions had sufficient capital to withstand severe economic challenges. It was supported by SCAP which assessed capital needs at the 19 largest bank holding companies in the United States. Banks that needed additional capital as a result of SCAP raised \$80 billion from private sources, while GMAC received additional capital from Treasury under AIFP. No CAP investments were made as a result and the program closed on November 9, 2009. Treasury has indicated that the renewed ability of banks to raise capital on private markets was a key measure of success for CPP and CAP and a key consideration in ending these programs. From 2000 to 2007, banks largely did not need to raise capital by issuing common equity, averaging only \$1.3 billion per quarter. Banks and thrifts raised significant amounts of common equity in 2008, averaging \$56 billion per quarter, before issuance dropped precipitously in the first quarter of 2009 to \$200 million—a 99 percent drop from the previous quarter and a 63 percent drop from the year before. Banks and thrifts raised \$63 billion in common

³⁵GAO, *Federal Deposit Insurance Act: Regulators' Use of Systemic Risk Exception Raises Moral Hazard Concerns and Opportunities Exist to Clarify the Provision*, [GAO-10-100](#) (Washington, D.C.: Apr. 15, 2010).

equity in the second quarter of 2009, an increase of 28,000 percent from the previous quarter and 236 percent over the year before (see fig. 4).

Figure 4: Gross Common Equity Issuance by Banks and Thrifts, 2000 to 2010



Source: GAO analysis of data from SNL Financial.

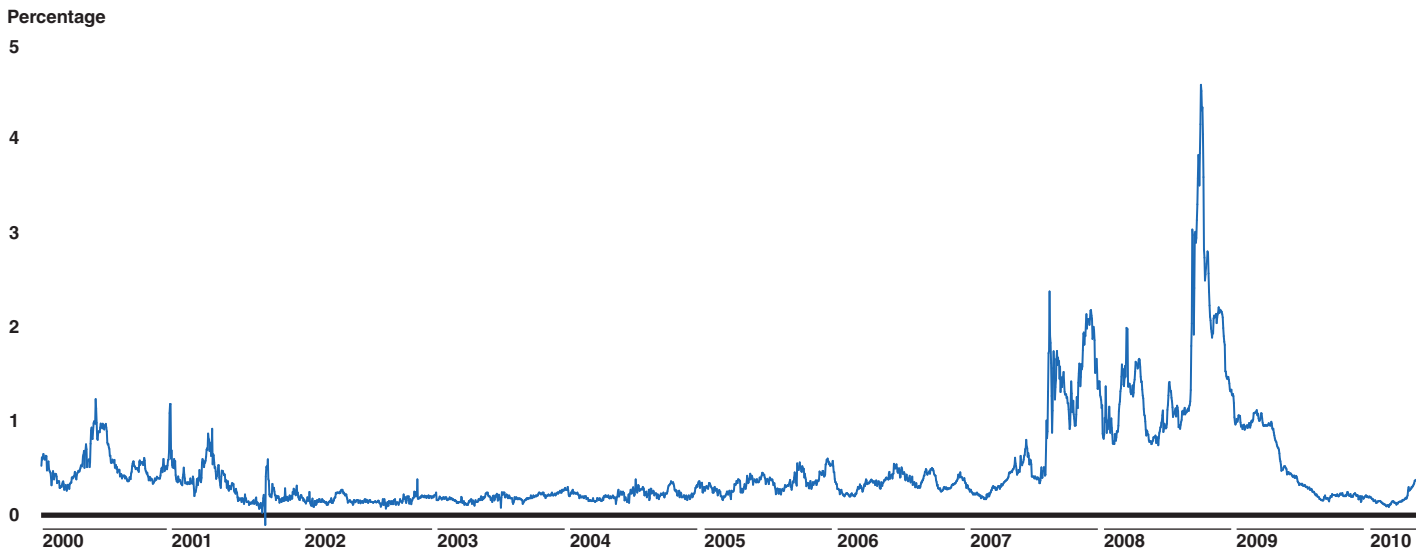
Banks’ renewed ability to raise capital on private markets reflects improvements in perceptions of the financial condition of banks. The 3-month TED spread—the premium of the London interbank offered rate (LIBOR) over the Treasury interest rate of comparable maturity—indicates the perceived risk of lending among banks. The TED spread peaked at more than 450 basis points in October 2008 before falling to less than 15 basis points at the end of the third quarter of 2009 (see fig. 5).³⁶ In previous work, we found that the decline in perceptions of risk in the interbank market could be attributed in part to several federal programs aimed at stabilizing markets that were announced on October 14, 2008, including CPP.³⁷ Nevertheless, the associated improvement in the TED spread cannot be attributed solely to TARP because the announcement of CPP

³⁶A basis point is a common measure used in quoting yields on bills, notes, and bonds and represents 1/100 of a percent of yield. An increase from 4.35 percent to 4.45 would be an increase of 10 basis points.

³⁷See [GAO-10-16](#).

was a joint announcement that also introduced the Federal Reserve’s Commercial Paper Funding Facility program and FDIC’s TLGP. Financial stress re-emerged in the interbank market in May 2010, highlighting the fragile nature of the recovery in the financial system. The TED spread has increased moderately from a low of less than 10 basis points in March 2010 to more than 40 basis points as of mid-June 2010, as concerns about sovereign debt in the European Union has increased. U.S. banks’ exposure to credit risk in Europe and the sensitivity to the global economy has heightened risk premiums among banks lending to each other. While fluctuations in perceived risk in the banking system are natural, and necessary, if risk is to be priced and allocated efficiently, this re-emergence of risk offers some support for Treasury’s decision to retain resources to combat financial instability, especially in light of the limitations of the current financial regulatory system.

Figure 5: TED Spread, 2000 to Present



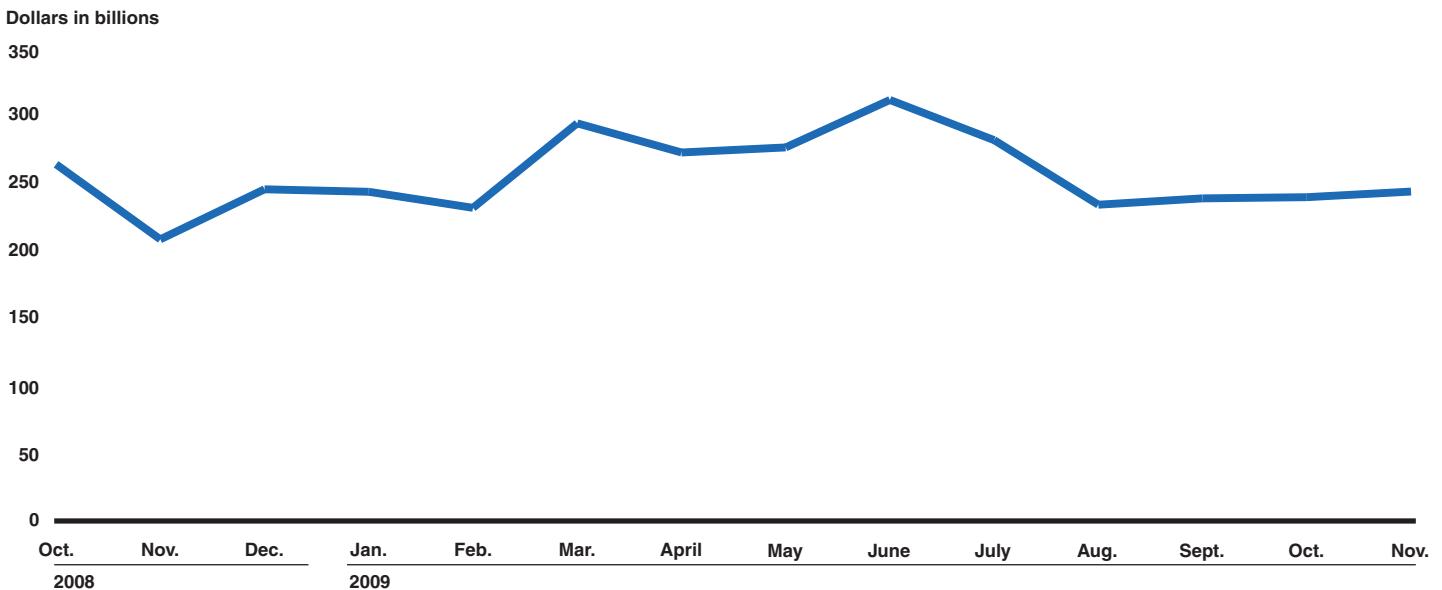
Source: GAO analysis of data from Thomson Reuters.

The impact of CPP on lending is difficult to determine because data on loan originations are limited, and how much lending would have occurred in the absence of CPP is not known.³⁸ We have noted in previous reports

³⁸In identifying performance metrics for fiscal year 2010, Treasury noted that it will evaluate changes in capital ratios and lending of the SCAP BHCs versus control banks with similar characteristics.

that some tension exists between the goals of improving banks' capital positions and promoting lending—that is, the more capital banks use for lending, the less their overall capital positions will improve.³⁹ Treasury collects data monthly on new lending from the largest participants in CPP, which included for a time as many as 22 institutions.⁴⁰ As a result, more is known about recent loan originations by large banks than small banks. Ten institutions that repaid CPP in June 2009 stopped submitting data after November 2009. New lending by the largest CPP recipients was \$244 billion in November 2009, up 2 percent from the prior month and 17 percent from the year before. However, lending in the third quarter of 2009 was down 12 percent from the second quarter (see fig. 6).

Figure 6: New Lending at Largest CPP Recipients, October 2008 to November 2009



Source: GAO analysis of Treasury loan survey.

³⁹See GAO, *Troubled Asset Relief Program: Status of Efforts to Address Transparency and Accountability Issues*, GAO-09-296 (Washington, D.C.: Jan. 30, 2009).

⁴⁰New lending includes new home equity lines of credit; mortgage, credit card, and other consumer originations; new or renewed commercial and industrial loans; and commercial real estate loans, but not other important activities that these institutions may undertake to facilitate credit intermediation, including underwriting and purchasing MBS and ABS. Because the origination data collected by Treasury are unique, we were not able to benchmark the origination levels against historical lending or seasonal patterns at these institutions.

Support to securitization markets through TALF. With underwriters finding increasing success in bringing issuances to the ABS market and decreasing their utilization of TALF, Federal Reserve and Treasury decided not to extend TALF further. TALF expired on March 31, 2010, for loans backed by ABS and legacy CMBS, and is scheduled to terminate at the end of June 2010 for loans backed by newly-issued CMBS.⁴¹ The program was designed to increase liquidity and reopen the asset-backed securitization markets in an effort to improve access to credit for consumers and small businesses after the decrease in issuances and the refusal of market participants to purchase potential offerings at rates that were acceptable to issuers. TALF-assisted issuances began in March 2009 after an initial announcement in late 2008. Officials from the Federal Reserve and Treasury highlighted that TALF was designed to attract investors when market conditions were stressful, but lose its appeal as conditions improved and spreads tightened to the point that the rate on ABS bonds were lower than the cost of borrowing from the program.

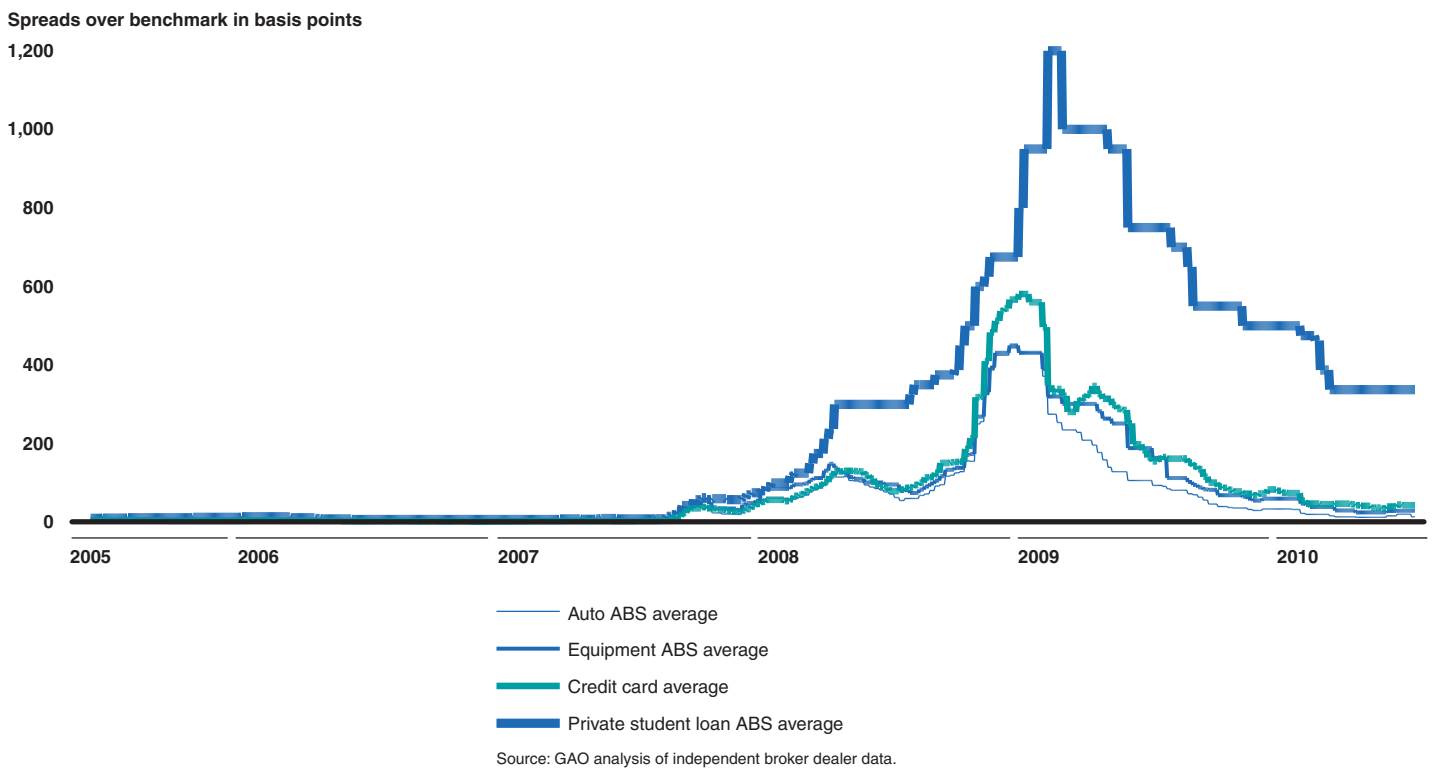
Federal Reserve and Treasury officials have also cited declining asset spreads in the ABS market as justification for not making new commitments under TALF (see fig. 7).⁴² While not at precrisis levels, spreads have tightened significantly from their heights at the beginning of 2009. Considering the excesses during the recent credit expansion, the desirability of a return to precrisis levels in many areas of the securitization markets is debatable. However, for most TALF-eligible assets, spreads have tightened significantly. For instance, average auto ABS spreads peaked at more than 400 basis points over the benchmark in late 2009, but have since returned to less than 100 basis points over the benchmark in early 2010. Private student loans ABS, however, have maintained spreads above precrisis levels. According to Federal Reserve officials this is partly due to the performance of the underlying student loans and because some of the securities were not structured well. Nevertheless, the contraction in spreads for most TALF-eligible ABS can be seen as normalization of the securitization markets as participants view new and existing issuances as less risky. Some of the decline in spreads and the perceptions of risk in recent securitizations may be attributable to

⁴¹Eligible TALF ABS includes credit cards; auto, student, and equipment loans and leases; insurance premiums finance loans; mortgage servicer advance; and floorplan loans, as well as SBA 7a and SBA 504 securities.

⁴²Asset spreads are the difference between the yield on an asset and a benchmark yield. Asset spreads are expressed in basis points or percentage points.

the products themselves. Since the crisis, new securitizations have generally been structured with more credit protections through enhancements such as greater levels of subordination and overcollateralization.⁴³

Figure 7: TALF Eligible Asset Class ABS Spreads Since 2005



The Federal Reserve structured TALF to reduce the rate of utilization of the facility as the market returned to normalcy through relatively high pricing of TALF loans. As we noted in a previous GAO report, during 2009, returns generally decreased for select classes of TALF-eligible collateral between the first TALF operation in March 2009 and the latter part of the year, with limited exceptions.⁴⁴ The report notes that as these returns

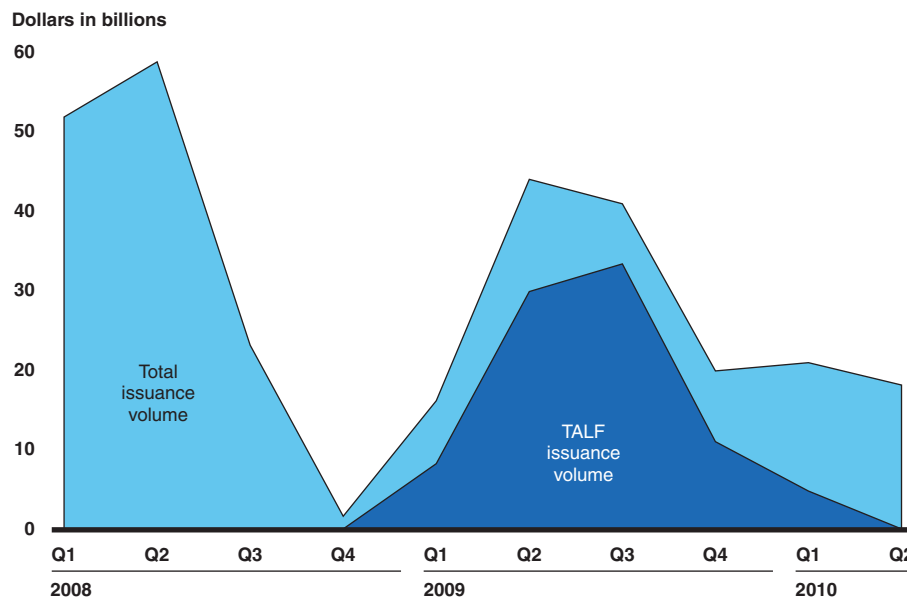
⁴³Subordination helps ensure that highly rated tranches in a security receive priority of payment and overcollateralization provides better assurance that sufficient funds are available even when some of the underlying loans default because the securities are issued in an amount that are more than covered by the collateral.

⁴⁴See [GAO-10-25](#).

generally became increasingly negative through the year, participants would have essentially locked in losses with certain issuances. To avoid this, many participants instead chose to forego TALF financing for these issuances and instead finance their own investments.

ABS markets began to show signs of health as 2009 quarterly issuances were above their lows in 2008 and utilization of TALF began decreasing in mid-2009. ABS issuances experienced a significant decline in 2008, but stabilized in 2009 (see fig. 8). TALF issuance dollar volume peaked in the third quarter of 2009, but by the fourth quarter TALF volume decreased significantly and at a faster rate than the total decrease in ABS volume. Further, there has been one CMBS new issuance that utilized TALF financing although the commercial real estate market continues to experience stresses and there has been little activity in the sector as a whole. Partly as a result of the continuing difficulties in this market, TALF loans backed by newly issued CMBS will be allowed through June 2010 even though the rest of the program closed at the end of March.

Figure 8: Credit Card, Auto, and Student Loan ABS and CMBS Issuance and TALF Utilization



Source: GAO analysis of Thomson Reuters data.

Addressing “troubled” (legacy) securities through PPIP. Initially announced at up to \$100 billion, Treasury reduced the amount available for commitment under PPIP based on improvements in the prices for

certain legacy assets. Announced in March 2009, Treasury offered equity and debt financing to nine private fund managers, however, no further commitments to new funds are planned. The Legacy Securities Public-Private Investment Program (S-PPIP) is a program whereby Treasury and private sector fund managers and investors partnered to purchase eligible securities from banks, insurance companies, mutual funds, pension funds, and other sellers defined as eligible under EESA.⁴⁵ Treasury indicated that this process was designed to allow financial institutions to repair their balance sheets by removing troubled assets and allow for renewed lending to households. Treasury participates by providing matching equity financing and debt financing up to 100 percent of the total equity of the fund. A related program, L-PPIP, was also announced at the same time by Treasury and FDIC but never operated as a TARP program. This program, however, suspended its planned sale of legacy assets held by banks in order to focus its use in the sale of receivership assets in bank failures.⁴⁶ Treasury did not include PPIP in its plans for new commitments in 2010, but has tracked the performance of each individual fund since inception.

Treasury stated that a recovery in asset prices in the RMBS and CMBS markets was one indicator that PPIP was effective and achieved its stated purpose. The return of market confidence can be seen in the general recovery or stabilization of asset prices. PPIP and the TARP programs to support bank capital were both intended to improve bank balance sheets. As we noted previously, banks have already been able to raise large amounts of private capital and perceptions of risk in the banking system have declined markedly since the onset of the crisis. PPIP and various other programs and initiatives may have to some extent addressed concerns about bank balance sheets.⁴⁷ An indication of the reduction in

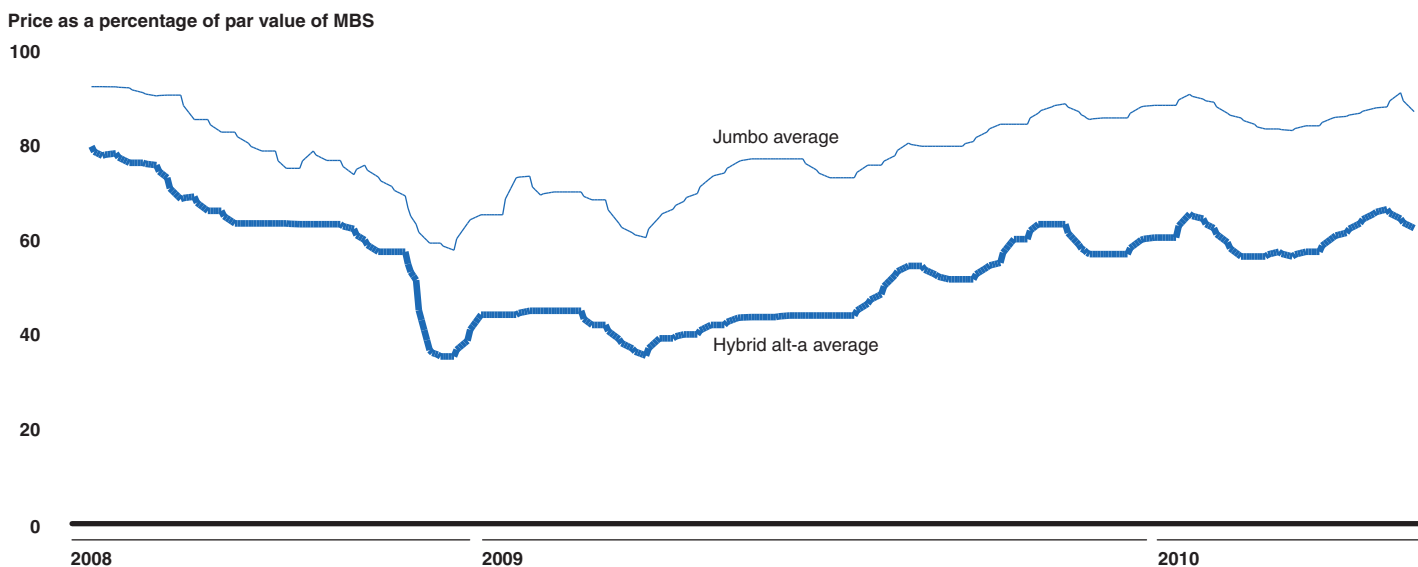
⁴⁵Eligible securities are defined as troubled real estate-related securities issued prior to January 1, 2009, and originally rated AAA—or an equivalent rating by two or more nationally recognized statistical rating organizations—without rating enhancement, such as RMBS and CMBS, and in which at least 90 percent of the assets underlying the security must be situated in the United States.

⁴⁶L-PPIP was suspended and the FDIC now uses the program concept in the sale of receivership assets, which draws upon concepts employed in the 1990s by the Resolution Trust Corporation. L-PPIP will now offer financing when a receivership transfers a portfolio of loans to a limited liability company in exchange for an ownership interest. An equity ownership interest will be sold to a qualified investor, who will be responsible for managing the portfolio of loans.

⁴⁷The SCAP results were announced subsequent to PPIP and required participant banks that needed to augment their capital to design a detailed plan to raise sufficient amounts of new equity capital in order to prevent failure in the event of further economic distress.

perceptions of risk is the general recovery in prices of legacy securities is the pricing of Jumbo and Alt-A RMBS securities (see fig. 9).⁴⁸

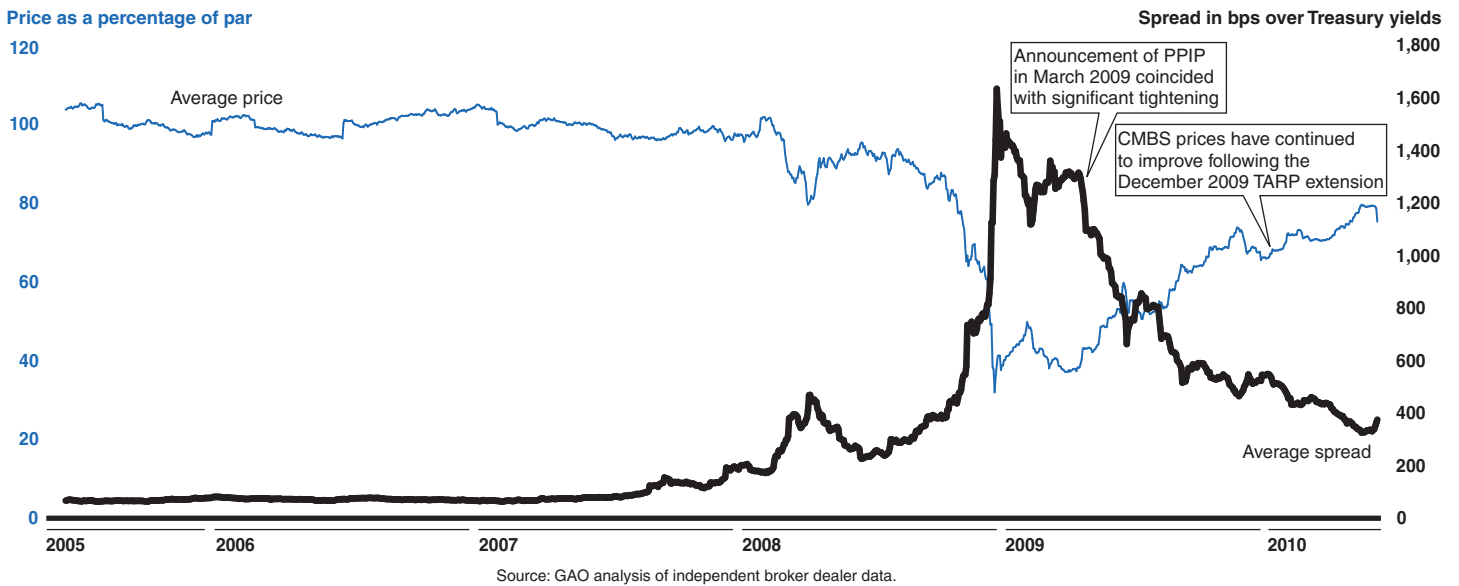
Figure 9: Jumbo and Alt-A RMBS Price Indices Since May 2008



Highly-rated CMBS prices also confirm that parts of the ABS and MBS markets have stabilized since PPIP was announced. Specifically, highly-rated CMBS prices have rebounded from their lows in late-2008, and we note that average spreads have also tightened in the same time period (see fig. 10). This, however, does not reflect the continuing troubles in the broader commercial real estate market as delinquencies have continued to increase.

⁴⁸Jumbo refers to loans made to borrowers with an original balance larger than the conforming limits. Alt-A refers to borrow with good credit but include more aggressive underwriting than conforming or jumbo loans.

Figure 10: CMBS AAA Tranche Average Prices and Spreads Since 2005



Treasury Can Strengthen Its Analytical Framework to Improve Its Usefulness for Future Decisions

Treasury could strengthen its analytical framework by identifying clear objectives for small business programs and explaining how relevant indicators motivated TARP program decisions. As noted above, Treasury identified four public documents that represented its rationale and decision-making process for the decision to extend TARP. Our understanding of Treasury’s decision-making process was also informed by reading FinSOB quarterly reports and through our interviews with Treasury and other officials. Treasury often directly or indirectly linked program decisions to a variety of quantitative indicators, including surveys, financial market prices and quantities, and measures of program utilization, among others. As discussed previously, all of these factors played an important role in the decision to extend TARP, expand some programs, and end others. As noted in our October 2009 report, indicators are an important step toward providing a credible foundation for TARP decision making. However, how the performance of an indicator affected a program decision, or if and when that indicator would signal a program had or had not met its goals was not always clear. Balancing the costs and benefits of TARP programs effectively will require making objectives explicit, assessing the impact of any commitments under TARP programs, and accounting for the fiscal and other costs of continuing to support markets. Again, a set of indicators, although imperfect, might inform the

proper timing for winding down the remaining programs and liquidating of investments.⁴⁹

Treasury has yet to identify clear program objectives for small business lending, which raises questions about when Treasury will know that government assistance can be removed. Without a strong analytic framework that includes clear objectives and meaningful measures, Treasury will be challenged in determining whether the program is achieving its desired goals. Given the scale of TARP and importance of the government's entry and exit from financial market interventions, decisions to allocate remaining resources should be subject to rigorous analysis. Because Treasury may decide to commit additional resources to problem areas before the expiration of TARP, or scale back commitments in others, it needs to be able to estimate the effect of program resources on meeting its objectives. Wherever possible Treasury should use quantitative factors in its decision making, but we recognize that qualitative factors are also important. While HAMP continues to face implementation challenges, the small business initiatives are challenged by a lack of data needed to clarify the root of the problem which may limit Treasury's ability to effectively address it. For example, without data and analysis to determine the extent to which access to small business credit is being restricted by limited capital at institutions engaged in small business lending, Treasury will not have a sufficient basis to address the underlying issues that may be affecting small business lending. With a better understanding of the problem, Treasury can set clear, achievable goals to address it.

Conclusions

The crisis and consequent interventions temporarily changed the U.S. financial system from one primarily reliant on markets and market discipline to one more reliant on government assistance and public capital. With the recovery underway, financial regulators in the United States have begun to shift focus from stabilizing the economy to exiting from crisis-driven interventions and transferring risk back into the hands of the private sector. Many TARP recipients have repaid loans and repurchased shares and warrants. A recent Federal Open Market Committee meeting

⁴⁹In general, timing of the exit from TARP should be determined by the efficacy of the various programs, the degree to which they distort markets, and by the fiscal costs—including the contingent liabilities to the government. Although the presence of a program alone can improve market conditions, in general, ineffective, underutilized, or highly distortionary programs should be exited early along with those that have reached their intended goals or are longer necessary.

focused on how the Federal Reserve should sell off assets acquired during the financial crisis. However, weaknesses in residential housing, commercial real estate, and labor markets, as well as risk from more global economic forces, limit the ability to withdraw rapidly and completely. For example, the Federal Reserve dollar liquidity swap lines were re-established with some central banks in response to the re-emergence of strains in short-term U.S. dollar funding markets as a result of European debt and currency issues.

While the Secretary, in consultation with the Federal Reserve and FDIC, elected to extend TARP to address perceived weaknesses in the economy and respond to unanticipated shocks, Treasury still faces remaining decisions about allocating any additional funds to MHA and CBLI before its ability to take actions authorized by EESA expires on October 3, 2010. Moreover, ongoing decisions will need to be made related to the general exit strategy, including unwinding the equity investments and scaling back commitments in an environment where (1) other regulators are unwinding their programs, (2) the economy is still coping with the legacy of the crisis, (3) market distortion and moral hazard concerns are pressing, and (4) the long-term fiscal challenges facing the United States have become more urgent. While the level of consultation with the Federal Reserve was generally robust, broad coordination could be enhanced and formalized for future judgments. Similarly, decisions to allocate remaining resources and the timing of exits should be subject to rigorous analysis. By strengthening its framework for decision making, Treasury can better ensure that competing priorities are properly weighed and the next phase of the program is effectively executed.

Although the economy is still fragile, a key priority will be to develop, coordinate, and communicate exit strategies to unwind the remaining programs and investments resulting from the extraordinary crisis-driven interventions. Because TARP will be unwinding concurrently with other important interventions by federal regulators, decisions about the sequencing of the exits from various federal programs will require bringing a larger body of regulators to the table to plan and sequence the continued unwinding of federal support. Similar to the need for a coordinated course of action to stabilize the financial system and re-establish investor confidence, the general exit from the government interventions will require careful coordination to avoid upsetting the recovery and help

ensure the proper sequencing of the exits.⁵⁰ Beyond the immediate costs of financial crises, these episodes can have longer term consequences for fiscal balances and government debt especially if the policy responses exacerbate the situation, lack coherency and effectiveness, or the exit strategy undermines the recovery because it occurs too soon or not soon enough. Moreover, as we discussed earlier in this report, the financial crisis and response has contributed to an already challenging fiscal legacy. As a result, the administration and Congress will need to apply the same level of intensity to the nation's long-term fiscal challenge as they have to the recent economic and financial market issues.⁵¹ Coherent and effectively carried out exit strategies are the first step in beginning to address these challenges.

Recommendations for Executive Actions

We are making two recommendations to the Secretary of the Treasury:

1. To effectively conduct a coordinated exit from TARP and other government financial assistance, we recommend that the Secretary of Treasury formalize and document coordination with the Chairman of the FDIC for decisions associated with the expiration of TARP (1) by including the Chairman at relevant FinSOB meetings, (2) through formal bilateral meetings, or (3) by utilizing other forums that accommodate more structured dialogue.
2. To improve the transparency and analytical basis for program decisions made before TARP's expiration, we recommend that the Secretary of the Treasury publicly identify clear program objectives, the expected impact of programs, and the level of additional resources needed to meet those objectives. In particular, Treasury should set quantitative program objectives for its small business lending programs and identify any additional data needed to make program decisions.

Agency Comments and Our Evaluation

We provided a draft of this report to Treasury for its review and comment. We also provided the draft report to the Federal Reserve and FDIC for their review. Treasury provided written comments that we have reprinted

⁵⁰These points were emphasized in a recent IMF report. See Global Financial Stability Report, October 2009.

⁵¹[GAO-10-483T](#).

in appendix III. Treasury, the Federal Reserve, and the FDIC also provided technical comments that have been incorporated as appropriate.

In its comments, Treasury generally agreed with our recommendations and noted that it would continue to consult extensively with the Federal Reserve and FDIC. Treasury agreed that publicly identifying clear program objectives was important and pledged to continue its efforts to do so.

In commenting, the Federal Reserve questioned the use of FinSOB as a coordination mechanism for the next phase of the TARP program. We have amended our recommendation to clarify that we are not advocating an expansion of FinSOB membership or to otherwise change its structure or purpose. We continue to believe FinSOB is a potential forum for more formal interaction between agencies by including nonmembers at relevant meetings, not by expanding membership. Moreover, leveraging FinSOB is just one option for formalizing and documenting coordination between Treasury and FDIC. Bilateral meetings or using other forums that accommodate structured dialogue would be consistent with our recommendation.

We are sending copies of this report to the Congressional Oversight Panel, Financial Stability Oversight Board, Special Inspector General for TARP, interested congressional committees and members, Treasury, the federal banking regulators, and others. In addition, the report will be available at no charge on the GAO Web site at <http://www.gao.gov>.

If you or your staff have any questions about this report, please contact Richard J. Hillman at (202) 512-8678 or hillmanr@gao.gov; Thomas J. McCool at (202) 512-2642 or mccoolt@gao.gov; or Orice Williams Brown at (202) 512-8678 or williamso@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. GAO staff who made major contributions to this report are listed in appendix IV.

A handwritten signature in black ink that reads "Gene L. Dodaro". The signature is written in a cursive style with a large, prominent initial "D".

Gene L. Dodaro
Acting Comptroller General
of the United States

List of Committees

The Honorable Daniel K. Inouye
Chairman
The Honorable Thad Cochran
Vice Chairman
Committee on Appropriations
United States Senate

The Honorable Christopher J. Dodd
Chairman
The Honorable Richard C. Shelby
Ranking Member
Committee on Banking, Housing, and Urban Affairs
United States Senate

The Honorable Kent Conrad
Chairman
The Honorable Judd Gregg
Ranking Member
Committee on the Budget
United States Senate

The Honorable Max Baucus
Chairman
The Honorable Charles E. Grassley
Ranking Member
Committee on Finance
United States Senate

The Honorable David R. Obey
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The Honorable Jerry Lewis
Ranking Member
Committee on Appropriations
House of Representatives

The Honorable John M. Spratt, Jr.
Chairman
The Honorable Paul Ryan
Ranking Member
Committee on the Budget
House of Representatives

The Honorable Barney Frank
Chairman
The Honorable Spencer Bachus
Ranking Member
Committee on Financial Services
House of Representatives

The Honorable Sander M. Levin
Acting Chairman
The Honorable Dave Camp
Ranking Member
Committee on Ways and Means
House of Representatives

Appendix I: Scope and Methodology

The objectives of this report are to determine (1) the process the Department of the Treasury (Treasury) used to decide to extend the Troubled Asset Relief Program (TARP) and the extent of coordination with relevant agencies and (2) the analytical framework and quantitative indicators Treasury used to decide to extend TARP.

To determine the process Treasury used to decide to extend TARP and the extent of coordination with relevant agencies, we interviewed officials from Treasury and the Board of Governors of the Federal Reserve System (Federal Reserve), and received official responses to our questions from the Federal Deposit Insurance Corporation (FDIC). In addition, we reviewed Treasury documents and analyses, Financial Stability Oversight Board (FinSOB) reports, and previous GAO reports. In particular, we reviewed four public documents Treasury identified as central to its efforts to describe and communicate the framework it used to make decisions related to the extension of TARP to Congress and the public (1) the September 2009 report “The Next Phase of Government Financial Stabilization and Rehabilitation Policies”; (2) the December 9, 2009, letter to Congressional leadership certifying the extension of TARP; (3) Secretary Geithner’s December 10 testimony to the Congressional Oversight Panel; and (4) the “Management Discussion and Analysis” portion of the fiscal year 2009 Office Financial Stability Agency Financial Report.

To determine the analytical framework and quantitative indicators Treasury used to decide to extend TARP, we similarly interviewed Treasury and the Federal Reserve and received official responses to our questions from FDIC. We also reviewed Treasury documents and analyses, FinSOB reports, and previous GAO reports. Based on the four key documents that Treasury identified and interviews with Treasury officials, we determined the key factors that motivated Treasury’s program-specific decisions associated with the extension of TARP and quantitative indicators that to some extent captured those factors. We furthermore analyzed data from Thomson Reuters, Treasury, the Federal Reserve, the National Federation of Independent Businesses, SNL Financial, and a broker-dealer to assess the state of the economy and financial markets. These data may also be suggestive of the performance and effectiveness of TARP. We believe that these data, considered as a whole, are sufficiently reliable for the purpose of summarizing TARP activity and Treasury’s decision-making process, and presenting and analyzing trends in the economy and financial markets. We identified some limitations of the data on credit conditions for small businesses, including the fact that the National Federation of Independent Business survey over-

represents certain industries, and therefore may not represent the credit experiences of all small firms. Moreover, there are no consistent historical data on lending to small businesses. In addition, the data from Treasury's survey of lending by the largest Capital Purchase Program (CPP) recipients (as of November 30, 2009, the last month in which all of the largest CPP recipients participated) are based on internal reporting from participating institutions, and the definitions of loan categories may vary across banks. Because these data are unique, we are not able to benchmark the origination levels against historical lending or seasonal patterns at the institutions.

We conducted our audit from March 2010 through June 2010 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Appendix II: Selected Interventions by Federal Financial Regulators in the United States

The financial crisis prompted an extraordinary response from financial regulators in the United States. As table 3 shows, the crisis-driven interventions—both within and outside of TARP—can be roughly categorized into programs that: 1) provided capital directly to financial institutions, 2) enhanced financial institution’s access to liquid assets through collateralized lending or other credit facilities to 3) purchased nonperforming or illiquid assets, 4) guaranteed liabilities, 5) intervened in specific financial markets, and 6) mitigated home foreclosures. Some programs involved exceptional assistance to particular institutions, such as American International Group (AIG), because of its systemic importance or supported particular markets while others involved assistance to individuals through refinance or loan modification programs. Table 3 does not include interventions or programs that existed prior to the financial crisis, such as the Federal Reserve’s loan program through the discount window, FDIC receivership of failed banks, or interventions that did not expose the intervening bodies to risks or involve federal outlays such as the Securities and Exchange Commission’s temporary ban on short selling in financial stocks.

Table 3: Selected Interventions by the Federal Reserve, Treasury, and other Federal Financial Regulators in the United States

Program or intervention	Type of support	Announcement date	Status
Federal Reserve			
Term Auction Facility	Short-term liquidity to financial institutions	December 2007	No auctions announced since March 8, 2010
Swap Lines ^a	Short-term liquidity to financial institutions through central banks	December 2007	Closed on February 1, 2010; reopened May 2010 until 2011
Term Securities Lending Facility	Short-term liquidity to financial institutions	March 2008	Closed on February 1, 2010
Exceptional Assistance Bear Stearns	Loan; purchases of troubled assets	March 2008	Securities Held Long-term
Primary Dealer Credit Facility	Short-term liquidity to financial institutions	March 2008	Closed on February 1, 2010
Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility	Liquidity directly to borrowers and investors	September 2008	Closed on February 1, 2010
Commercial Paper Funding Facility	Liquidity directly to borrowers and investors	October 2008	Closed on February 1, 2010
Money Market Investor Funding Facility	Liquidity directly to borrowers and investors	October 2008	Closed October 30, 2009
Long-term securities purchases	Direct purchases of Fannie Mae and Freddie Mac mortgage-backed securities (MBS) and debt	November 2008	Closed March 2010
Long-term securities purchases	Direct purchases of Treasury securities	March 2009	Closed October 2009

**Appendix II: Selected Interventions by
Federal Financial Regulators in the United
States**

Program or intervention	Type of support	Announcement date	Status
Federal Reserve and Treasury			
Term Asset-Backed Securities Loan Facility ^b	Liquidity directly to borrowers and investors; support to securitization markets	November 2009	Closed March 31, 2010 for ABS and MBS. Extended to June 30, 2010 for CMBS
Exceptional Assistance AIG ^b	Liquidity and capital; purchases of troubled assets	September 2008; November 2008	TARP portion Closed October 2009; Loan from Federal Reserve expires September 2013
Treasury			
Long-term securities purchases	Direct purchases of Fannie Mae and Freddie Mac MBS	September 2008	Closed December 31, 2009
Supplementary Financing Program	Treasury bill issuance to finance Federal Reserve initiatives	September 2008	Ongoing
Temporary Guarantee Program for Money Market Mutual Funds	Guarantees	September 2008	Closed September 18, 2009
TARP	Liquidity and capital to institutions; stress tests for large banks; direct loans; asset purchases; loan modifications; guarantees	October 2008	Ongoing for some programs; Extended to October 3, 2010 (see table 1)
Treasury, FDIC, and Federal Reserve			
Exceptional Assistance to Citigroup ^b	Guarantees, liquidity and capital	November 2008	Closed December 2009
Exceptional Assistance to Bank of America ^b	Guarantees, liquidity and capital	January 2009	Closed December 2009
Treasury and FDIC			
Public Private Investment Partnership ^{bc}	Equity and debt investment to facilitate purchases of troubled-assets (loans and MBS)	March 2009 (July 2009)	Closed December 2009 for program using TARP funds
Treasury and FHFA			
Preferred Stock Purchase Agreements	Equity Investments in the GSEs (Fannie Mae, Freddie Mac, and Federal Home Loan Banks); lending facility	September 2008	Ongoing
Increasing Size of Fannie Mae and Freddie Mac Portfolios	Mortgage Purchases; Liquidity to Secondary Market	February 2009	Ongoing
FDIC			
Deposit Insurance Increase	Guarantee of deposits	October 2008	Closes on January 1, 2014
Temporary Liquidity Guarantee Program	Debt Guarantee; Transaction Account Guarantee	October 2008	Closed on October 31, 2010 for debt; Extended to December 31, 2010 for transaction accounts.

**Appendix II: Selected Interventions by
Federal Financial Regulators in the United
States**

Program or intervention	Type of support	Announcement date	Status
Department of Housing and Urban Development and Federal Housing Administration (FHA)			
FHA Secure	Refinance program	September 2007	Closed December 31, 2008
HOPE for Homeowners	Loan modification	October 2008	Closes September 30, 2011
FHFA			
GSE Conservatorship	Various actions to promote solvency	September 2008	Ongoing
Home Affordable Refinance Program	Refinance program	February 2009	Closes June 30, 2011
Streamlined Modification Program (with GSEs and Hope Now)	Loan modification	November 2008	Closed March 4, 2009

Source: GAO analysis, Treasury, the Federal Reserve Bank of St. Louis, and the Congressional Research Service.

Notes: Includes new programs launched in response to the crisis and does not include programs that existed prior to the financial crisis or those that involved no outlays by, or risk to, the intervening agencies. Also, some initiatives that were announced but never used are not included.

Closed means no new agreements to undertake transactions occurred or will occur through the program after the expiration date, but does not necessarily imply no activity is occurring.

As we discussed, many of the programs have resulted in equity investments, loans, and lines of credit that remain outstanding.

^aA currency swap is a transaction where two parties exchange an agreed amount of two currencies while at the same time agreeing to unwind the currency exchange at a future date.

^bPrograms using TARP funds through the Asset Guarantee Program, the Systemically Significant Failing Institutions Program, the Consumer & Business Lending Initiative, the Home Affordable Modification Program, and the Public Private Investment Program (PPIP).

^cSince announcing PPIP as a joint partnership, the Legacy Loans Public-Private Investment Program was developed by FDIC while Treasury operated the legacy security portion of the program. Neither component of PPIP operated jointly.

Appendix III: Comments from the Department of the Treasury



DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

June 25, 2010

Thomas J. McCool
Director, Center for Economics
Applied Research and Methods
U.S. Government Accountability Office
441 G Street, N.W.
Washington, D.C. 20548

Dear Mr. McCool:

The Department of the Treasury ("Treasury") appreciates the opportunity to review the GAO's latest report on the Troubled Asset Relief Program ("TARP"), titled *Treasury's Framework for Deciding to Extend TARP Was Sufficient, but Could be Strengthened for Future Decisions* ("Draft Report"). As Assistant Secretary Allison is travelling, he has asked me to respond on his behalf.

We are pleased that the Draft Report finds that Treasury acted in a manner that largely fulfilled the recommendations made by the GAO in October 2009 regarding the decision to extend TARP. We appreciate the GAO's general approval of the process followed by Treasury in deciding whether to extend. As the GAO notes, the process involved "significant deliberation and interagency coordination and consultation" and was coupled with an extensive effort to explain the decision and rationale to the Congress and the public.

The Draft Report makes two recommendations. First, the Draft Report suggests that upcoming decisions regarding the exit phase of TARP "would benefit from continued collaboration and communication with other agencies." In this regard, the Draft Report praises Treasury's consultation with the Federal Reserve as "the type of collaboration necessary for the next stage of the government response to the crisis." The Draft Report also notes that the Financial Stability Oversight Board ("FinSOB") has been an effective vehicle for formalized consultations among agencies and suggests that the Chairman of the FDIC be included in FinSOB meetings.

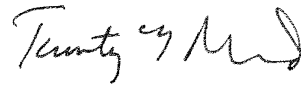
While the membership of FinSOB was set by statute and is chaired by the Chairman of the Board of Governors of the Federal Reserve System, Treasury has consulted and will continue to consult extensively on TARP matters with the FDIC as well as with other agencies where appropriate. Among other things, Treasury has consulted with the FDIC in designing the structure and process for approval in the bank assistance programs, the stress tests and standards for exiting TARP, as well as situations involving particular institutions that have received assistance. This consultation will continue.

We also agree with GAO on the importance of publicly identifying clear program objectives, which was the substance of the second recommendation. We will continue to publicly identify clear program objectives and to address the related suggestions made in this recommendation.

**Appendix III: Comments from the Department
of the Treasury**

Treasury appreciates the opportunity to review the Draft Report. We will review the final audit report and provide any further comments regarding the GAO's recommendations within the statutory period. We look forward to continuing this constructive dialogue.

Sincerely,



Timothy G. Massad
Chief Reporting Officer
Office of Financial Stability

Appendix VI: Contacts and Staff Acknowledgments

Contacts

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Staff Acknowledgments

In addition to the contacts named above, Lawrance Evans Jr. (lead Assistant Director), Benjamin Bolitzer, Timothy Carr, Emily Chalmers, William Chatlos, Rachel DeMarcus, Michael Hoffman, Steven Koons, Matthew Keeler, Robert Lee, Matt McDonald, Sarah McGrath, Harry Medina, Marc Molino, Joseph O'Neill, Jose Oyola, Rhiannon Patterson, Omyra Ramsingh, Matt Scire, Karen Tremba, and Winnie Tsen have made significant contributions to this report.

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