Testimony of Professor Elizabeth Warren
Chair, Congressional Oversight Panel
Submitted to the
Senate Finance Committee
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Thank you, Chairman Baucus, Ranking Member Grassley and members of the Committee, for inviting me to testify regarding oversight of the Troubled Asset Relief Program. We share a desire to bring accountability and transparency to the TARP program, and I am pleased to assist your efforts in any way that I can.

From the outset I would like to stress that although I am Chair of the Congressional Oversight Panel, I do not have a pre-approved script. The views I express today are my own and do not necessarily represent those of the entire panel.

The Oversight Panel was created as part of the TARP in last year's Emergency Economic Stabilization Act. The job of the Panel is to "review the current state of the financial markets and the financial regulatory system" and report to Congress every 30 days. The Panel has submitted reports to Congress on December 10, January 9, February 6, and March 6, and it is preparing its fifth TARP oversight report for submission next week. The Panel also submitted a special report on regulatory reform to Congress, as required by the legislation, at the end of January.

The Oversight Panel is one of three organizations to which the TARP legislation gives oversight responsibilities. In my capacity as Panel chair, I have been pleased to work alongside my colleagues Gene Dodaro, the Acting Comptroller General of the United States, and Neil Barofsky, the Special Inspector General for the Troubled Assets Relief Program. Together we are charged with ensuring that the tax dollars of the American people are used prudently and effectively to ameliorate and ultimately reverse the deepening financial crisis in which our country – and much of the world – now finds itself.

The Special Inspector General for the TARP has a broad responsibility, and matching authority, to audit and investigate any part of the Program. GAO is given an even more detailed set of instructions for "ongoing oversight of the activities and performance of the TARP," as well as responsibility for an annual audit of the TARP's financial statements. Between the Oversight Panel's obligation to report to Congress every 30 days, the GAO's obligation to report every 60 days, and the obligation of the Special Inspector General to report every 90 days, Congress will receive an average of two TARP oversight reports every month.

The three oversight organizations are working to complement, not duplicate, one another. We hold regular meetings with the office of the Special Inspector General and with GAO senior staff responsible for TARP oversight. We share information and discuss possible lines of inquiry. We have also shared, where possible, preliminary work product. If GAO or the SIGTARP identify questions for the Oversight Panel, they will pass them to us and give us access to data that we can synthesize to inform our work; similarly, when our analysis or information indicates a significant instance of non-compliance with the terms or spirit of the TARP legislation, we will inform GAO, the SIGTARP, or both. We all want to make the whole of our work greater than the sum of its parts.

The Oversight Panel is the smallest of the three organizations. We see our contribution as fact-based analysis designed to raise issues about the operation and direction of the TARP and about the broader effort to restore stability to the financial system. In the Emergency Economic Stabilization Act, Congress specifically asked that the Oversight Panel conduct oversight on: the use of Treasury authority under the TARP; the Program's effect on the financial markets, financial institutions, and market transparency; the effectiveness of foreclosure mitigation efforts; and the TARP's effectiveness in minimizing long-term costs and maximizing long-term benefits for the nation's taxpayers. Our ultimate question is whether the TARP is operating to benefit the American family and the American economy. If we believe the answer is no, we will ask "why not," and try to suggest alternatives.

The Panel's first report back in December 2008 asked whether the public was receiving a "fair deal" when Treasury used TARP funds to make capital infusions into financial institutions. After that report came out, we worked with recognized independent experts to develop multiple valuation models to determine whether the securities Treasury received had a fair market value equal to the dollar amount of the infusions. With minimal variation, the models all demonstrated that Treasury made its infusions at a substantial discount. Treasury received securities that were worth substantially less than the amounts it had paid in return, given the financial institutions involved. In all, as we documented in our February report, Treasury had overpaid by an estimated $78 billion. For each $100 Treasury invested in these financial institutions, it received on average stock and warrants worth only about $66. We believe this is an important issue.

Our report does not draw a conclusion about whether such discounts may – or may not – have been appropriate as a matter of policy. The Panel continues to examine the matter, and Congress may decide to keep it in mind as well as it responds to new Treasury initiatives. Thus far, Treasury has not given the public an explanation, so that the appropriateness of the overpayment remains, at best, unresolved.

The most important lesson we draw from our analysis is that without a clearer explanation from Treasury about its overall plan for each capital infusion, and without more transparency and accountability for how that plan was carried out, it is not possible to exercise meaningful oversight over Treasury's actions. Congress has given Treasury substantial discretion, as befits this fast-moving crisis. But that discretion carries with it an equivalent obligation to explain, in real time, why the discretion is exercised as it is. Congress and the American people need to understand Treasury's conception of the problems in the financial system, the comprehensive strategy to address those problems, and metrics to measure success toward meeting those goals. Our collective financial security is on the line, and we all have a stake in the outcome.

The Oversight Panel has also focused on mortgage foreclosure mitigation, with particular regard to impediments to mitigation efforts. The March report offers a checklist of items to evaluate the likely effectiveness of any proposal to halt the cascade of mortgage foreclosures.

- Will the plan result in modifications that create affordable monthly payments?
- Does the plan deal with negative equity?
- Does the plan address junior mortgages?
- Does the plan overcome obstacles in existing pooling and servicing agreements that may prevent modifications?
- Does the plan counteract mortgage servicer incentives not to engage in modifications?

- Does the plan provide adequate outreach to homeowners?
- Can the plan be scaled up quickly to deal with millions of mortgages?
- Will the plan have widespread participation by lenders and servicers?

President Obama's announcement of the Administration's Homeowner Affordability and Stability Plan last month addressed many of these issues. The Plan focuses on payment affordability through an expanded refinancing program involving Fannie Mae and Freddie Mac and a modification program targeting a wide range of borrowers at risk. The Plan also includes financial incentives to encourage both lenders and borrowers to strive for sustainable outcomes. It also encourages servicers to modify mortgages for at risk homeowners before they are delinquent. There are additional incentives available to extinguish junior mortgages. The Administration estimates that the Plan's expanded refinancing opportunities could assist four to five million responsible homeowners, some of whom otherwise would likely have ended up in foreclosure.

While these projections are encouraging, the Panel noted areas of serious concern that are not addressed in the plan. In particular, the Plan does not include a safe harbor for servicers operating under pooling and servicing agreements to address the potential litigation risk that may be an impediment to voluntary modifications. It is also important that the Plan more directly address second mortgages, lest they otherwise continue to contribute substantially to the rise in foreclosures. And, while the modification aspects of the Plan will be mandatory for banks receiving TARP funds going forward, Treasury has not made it clear how the federal regulators will enforce these new standards industry-wide to reach the needed level of participation.

The Plan also supports permitting bankruptcy judges to restructure underwater mortgages in certain situations. Such statutory changes would expand the impact of the Plan. Without the bankruptcy piece, however, the Plan does not deal with mortgages that substantially exceed the value of the home. Such a failure could sharply limit the relief it provides, particularly in parts of the country that have experienced the greatest price declines.

It is also critical for the federal government to collect and analyze loan performance and loss mitigation data. Without adequate data, measuring the success or failure of mitigation efforts is, at best, a hit-or-miss proposition. Reliable data will demonstrate whether TARP funds used for foreclosure mitigation efforts are achieving their intended purpose and whether such programs require modification or termination.

Recently, the Oversight Board has also opened an inquiry into the Term Asset-Backed Loan Facility (TALF). Specifically, the Oversight Panel is concerned that the TALF appears to involved substantial downside risk and high costs for the American taxpayer, while offering substantial rewards to a small number of private parties. Equally important, the TALF appears to subsidize the continuation of financial instruments and arrangements whose failure was a primary cause of the current economic crisis. The Panel is further concerned because the documents posted on Treasury's website describing the terms of operation of the TALF and press reports about the content of those terms as they are to be implemented by the Federal Reserve Bank of New York are contradictory, promoting substantial confusion.

To clarify the questions surrounding TALF, the Panel has asked Treasury for more information. Generally, the Panel is seeking information on a number of points to better understand what Treasury intends to accomplish with TALF and why the TALF structure is the most effective way to accomplish that goal. We have not received answers to this inquiry, but have been told we can expect a response tomorrow. Until we receive detailed and accurate information, the Panel cannot perform its oversight function. Moreover, it is difficult for Congress and the American public to have confidence in an initiative for which so much money is at stake and so little key information is available.

The Oversight Panel has also launched an inquiry into Treasury and Fed actions to provide continued capital infusions and other assistance to the American International Group, Inc. (AIG). The Panel has raised a number of important questions. These include the basis for deciding that AIG posed systemic risk, the economic consequences of the assistance provided to AIG, the ultimate beneficiaries of this assistance, and the manner in which Treasury and the Board have monitored the recipients of taxpayer dollars. The Panel is particularly concerned that the opaque nature of the relationship among AIG, its counterparties, the Treasury, and the Federal Reserve Banks, particularly the Federal Reserve Bank of New York, has substantially hampered oversight of the TARP program by Congress and, equally important, has impaired the understanding of that program by the American people.

The Panel has requested information from Treasury and the Fed on a number of points related to AIG, including how the assistance was requested and need was analyzed, the assessment of risk to the national and international financial system, any conditions placed on the assistance, and information about counterparties and credit default swaps. We await the requested information from Treasury. Again, it is not surprising that Congressional and public outrage have been stoked on issues such as bonuses for AIG executives when there is no information or basic explanation as to why substantial taxpayer-funded assistance is necessary and what that money is accomplishing.

The TARP legislation is now six months old, and according to Secretary Geithner, Treasury has spent or committed $565 billion. However, when calculating based on the maximum program levels as announced, the amount swells to $667 billion. The Oversight Panel has repeatedly called on Treasury to articulate a clear strategy for its use of TARP funds; the absence of such a vision hampers effective oversight. In fact, our first report outlined a series of ten basic questions, starting with the question, "What is Treasury's strategy?" Months later, Congress and the American public have no clear answer to that question. The ongoing uncertainty has hindered recovery efforts.

I have sent two letters to Treasury Secretary Geithner asking for clarification on this specific point. I am disappointed to report that the Oversight Panel has not received a substantive response. We have concerns in other areas as well. Although the initiatives announced over recent weeks describe a commitment to transparency and accountability, the general frameworks do not provide an adequate foundation to oversee Treasury's activities or to measure the success of the TARP or the Stability Plan.

As part of its April report, the Oversight Panel will further analyze the evolving strategy of Treasury. The Panel has focused in recent weeks on the lessons from previous financial crises, both foreign and domestic, to help inform our analysis of the current situation. Our report will examine four case studies of particular relevance: the Japanese "Lost Decade" of the 1990s; the Swedish experience with bank nationalization in the 1990s; the establishment of the Resolution Trust Corporation (RTC) in response the American savings and loan collapse in the late-1980s; and the actions taken to stabilize the financial and housing sectors during the Great Depression. In each case we can learn from the steps taken—or not taken—as policymakers tried to cope with failing financial institutions.

What have we learned thus far? In a crisis, transparency, accountability and a coherent plan with clearly delineated goals are necessary to maintain public confidence and the confidence of the capital markets. Sophisticated metrics to measure the success and failure of program initiatives are also critical. Assuring that the TARP reflects these elements underlies all of our oversight efforts.

Thank you again for the opportunity to explain the work of the Congressional Oversight Panel.