CONGRESSIONAL OVERSIGHT PANEL

NOVEMBER OVERSIGHT REPORT *

GUARANTEES AND CONTINGENT PAYMENTS IN TARP AND RELATED PROGRAMS

NOVEMBER 6, 2009.—Ordered to be printed

*Submitted under Section 125(b)(1) of Title 1 of the Emergency Economic Stabilization Act of 2008, Pub. L. No. 110–343

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EXECUTIVE SUMMARY *

In creating the Troubled Asset Relief Program (TARP) in late 2008, Congress provided Treasury with a wide range of tools to combat the financial crisis. In addition to purchasing assets directly from financial institutions, Treasury was also authorized to support the value of assets indirectly by issuing guarantees.

In the legal sense, a guarantee is simply a promise by one party to stand behind a second party's obligation to a third. For example, when a worker deposits his paychecks in an account at his local bank, his money is guaranteed by the U.S. government through the Federal Deposit Insurance Corporation (FDIC). If a bank fails—that is, if the bank cannot give the worker his money later, when he needs it—then the FDIC will step in to fill in the gap. The FDIC guarantees the bank's debt to its customer.

During the financial crisis of late 2008 and early 2009, the federal government dramatically expanded its role as a guarantor. Congress raised the maximum guaranteed value of FDIC-insured accounts from $100,000 to $250,000 per account, and the FDIC also established the Debt Guarantee Program (DGP), standing behind the debt that banks issued in order to raise funds that they could use to lend to customers. Treasury reassured anxious investors by guaranteeing that money market funds would not fall below $1.00 per share, and Treasury, the FDIC, and the Federal Reserve Board together negotiated to secure hundreds of billions of dollars in assets belonging to Citigroup and Bank of America. All told, the federal government's guarantees have exceeded the total value of

* The Panel adopted this report with a 5–0 vote on November 5, 2009. Additional views are available in Section Two of this report.

TARP, making guarantees the single largest element of the government's response to the financial crisis.

From the taxpayers' perspective, guarantees carry several advantages over the direct purchases of bank assets. Most significantly, guarantees bear no upfront price tag. When government agencies agreed to guarantee $300 billion in Citigroup assets in late 2008, taxpayers paid no immediate price—and now appear likely to earn a profit from fees assuming economic conditions do not deteriorate further.

The low upfront cost of guarantees also allowed Treasury, in coordination with other federal agencies, to leverage a limited pool of TARP resources to guarantee a much larger pool of assets. The enormous scale of these guarantees played a significant role in calming the financial markets last year. Lenders who were unwilling to risk their money in distressed and uncertain markets became much more willing to participate after the U.S. government promised to backstop any losses.

Despite these advantages, guarantees also carry considerable risk to taxpayers. In many cases, the American taxpayer stood behind guarantees of high-risk assets held by potentially insolvent institutions. It was possible that, if the guaranteed assets had radically declined in value, taxpayers could have suffered enormous losses.

At its high point, the federal government was guaranteeing or insuring $4.3 trillion in face value of financial assets under the three guarantee programs discussed in this report. (The majority of that exposure came from Treasury's guarantee of money market accounts that held high concentrations of government debt in the form of Treasury securities. Therefore, the total exposure is less than the full face value guaranteed because government debt is already backed by the full faith and credit of the United States.) Despite the likelihood that the U.S. government will receive more revenue in fees than will ultimately be paid out under the guarantees, the taxpayers bore a significant amount of risk.

Just as significantly, guarantees carry moral hazard. By limiting how much money investors can lose in a deal, a guarantee creates price distortion and can lead lenders to engage in riskier behavior than they otherwise would. In addition to the explicit guarantees offered by Treasury, the FDIC, and the Federal Reserve, the government's broader economic stabilization effort may have signaled an implicit guarantee to the marketplace: the American taxpayer would bear any price, and absorb any loss, to avert a financial meltdown. To the degree that lenders and borrowers believe that such an implicit guarantee remains in effect, moral hazard will continue to distort the market in the future. The cost of moral hazard is not as easily measured as the price of guarantee payouts or the income from guarantee fees, but it remains a real and significant force influencing the financial system today. As Treasury contemplates an exit strategy for TARP and similar financial stability efforts such as these explicit guarantees, unwinding the implicit guarantee of government support is critical to ensuring an efficiently functioning marketplace.

After a wide-ranging review of TARP and related guarantees, the Panel has not identified significant flaws in Treasury's implementation of the programs. To the contrary, the Panel has noted a trend towards a more aggressive and commercial stance on the part of Treasury in safeguarding the taxpayers' money. Nonetheless, in light of these guarantees' extraordinary scale and their risk to taxpayers, the Panel believes that these programs should be subject to extraordinary transparency. The Panel urges Treasury to disclose greater detail about the rationale behind guarantee programs, the alternatives that may have been available and why they were not chosen, and whether these programs have achieved their objectives.

Finally, the Panel recommends that Treasury provide regular disclosures relating to Citigroup's asset guarantee—the single largest TARP guarantee offered to date. These disclosures should be detailed enough to provide a clear picture of what is happening, including information on the status of the final composition of the asset pool and total asset pool losses to date, as well as what the projected losses of the pool are and how they have been calculated.

The following table summarizes the principal elements of the programs that the Panel has examined for the purposes of this report:

Agency	Program	Authority	Who is protected?	What is guaranteed?	Sum currently guaranteed	Fees earned	Losses to date
Treasury	Asset Guarantee Program (AGP).	Emergency Economic Stabilization Act of 2008 (EESA).	Citigroup (Bank of America—never used).	Specified asset classes of Citigroup.	Up to $5 billion	$3.8 billion	$0
Treasury	Temporary Guarantee Program for Money Market Funds (TGPMMF).	Gold Reserve Act of 1934, as amended EESA, § 131.	Money market fund investors.	Investors' holdings in participating funds as of September 19, 2008.	$0 (current) ($3.22 trillion peak commitment).	$1.2 billion	$0
Federal Reserve Board	Asset Guarantee Program (AGP).	Federal Reserve Act, § 13(3).	Citigroup (Bank of America—never used).	Specified assets of Citigroup.	Undetermined; non-recourse loans to be made available.	$57 million	$0
Federal Deposit Insurance Corporation (FDIC).	Temporary Liquidity Guarantee Program (TLGP)—includes Debt Guarantee Program (DGP).	Federal Deposit Insurance Act.	Holders of debt issued by banks and other financial institutions issuing debt.	Debt issued by banks and other financial institutions.	$307 billion principal, plus interest.	$9.6 billion	$2 million [1]
FDIC	Asset Guarantee Program (AGP).	Federal Deposit Insurance Act.	Citigroup (Bank of America—never used).	Specified assets of Citigroup.	Up to $10 billion	$2.7 billion	$0

[1] According to the Federal Deposit Insurance Corporation, as of October 22, 2009, there has been one failure of a Temporary Liquidity Guarantee Program-participating institution, an affiliate of which had issued guaranteed debt. While the FDIC anticipates up to a $2 million loss on that issuance, no losses have been paid out yet with respect to the Debt Guarantee Program.

SECTION ONE:

A. Overview

Guarantees of the assets and liabilities of banks and bank holding companies (BHCs) form an essential part of the Troubled Asset Relief Program (TARP) and broader financial stabilization efforts. Unlike direct payments or purchases, guarantees do not require the immediate outlay of cash (and if the guarantees expire without having been triggered, cash may never be needed), but they expose taxpayer funds to potential risk—in some cases, a great deal of risk. This report examines the role played by guarantees and other contingent payments under TARP and related programs.

The Emergency Economic Stabilization Act of 2008 (EESA), the legislation that established TARP, authorized Treasury not only to purchase assets of financial institutions,[2] but also to guarantee existing troubled assets.[3] Under EESA and TARP, Treasury participates with the Federal Reserve Board and the FDIC in the Asset Guarantee Program (AGP), which includes a three-way guarantee of Citigroup assets. In addition to $45 billion in direct investment under two separate TARP programs and an FDIC guarantee of $37.3 billion of Citigroup obligations, Treasury, the Federal Reserve Board, and the FDIC have guaranteed a pool of Citigroup assets valued at approximately $301 billion. A similar guarantee under the AGP was arranged for Bank of America but never finalized.

EESA directed Treasury to reimburse the Exchange Stabilization Fund (ESF) for any funds that are used for Treasury's guarantee of money market funds through the Temporary Guarantee Program for Money Market Funds (TGPMMF).[4] At the program's height, it guaranteed $3.2174 trillion in money market funds.[5]

The FDIC created its Temporary Liquidity Guarantee Program (TLGP) less than two weeks after the enactment of EESA, under authority of the Federal Deposit Insurance Act.[6] The Debt Guarantee Program portion of the TLGP (DGP) guarantees debt issued by banks and BHCs.[7] The FDIC currently guarantees approximately $307 billion in outstanding financial institution obligations, and has the authority to guarantee an additional $312 billion

[2] *See* Emergency Economic Stabilization Act of 2008 (EESA), Pub. L. No. 110–343, § 101 (authorizing the Treasury Secretary to purchase troubled assets from financial institutions).

[3] *See* EESA § 102 (authorizing the Treasury Secretary to establish "a program to guarantee troubled assets originated or issued prior to March 14, 2008, including mortgage-backed securities" if a troubled asset purchase program is created).

[4] *See* EESA § 131(a) (stating that the required EESA reimbursement of the ESF for any funds that are used for the TGPMMF is to be made "from funds under this Act," meaning that it is funded by EESA, but not out of the $700 billion appropriated to TARP). *See* Section D(2)(a), *infra*, for a discussion of issues relating to the legal authority for TGP.

[5] This raw number overstates the true amount at risk; a large proportion of money market funds are invested in Treasury securities. *See* discussion of the "real" amount at risk in Section E.

[6] *See* Federal Deposit Insurance Act of 1950, Pub. L. No. 81–797, § 13(c)(4)(G) (authorizing the FDIC, upon the determination of systemic risk, to take actions "to avoid or mitigate serious adverse effects on economic conditions or financial stability").

[7] The TLGP has a second program, the Transaction Guarantee Program, which provides temporary full guarantees for funds held at FDIC-insured depository institutions in noninterest-bearing transaction accounts. This guarantee is in addition to and separate from the $250,000 coverage provided under the FDIC's general deposit insurance regulations through June 30, 2010. Unless stated otherwise, discussion of TLGP in this report refers to the DGP aspect of the program.

under the DGP.[8] Through both the TLGP and its deposit insurance program, the FDIC has increased insurance for bank guarantees.[9]

Treasury has committed the vast majority of its EESA funds for purchases under Section 101, and the Panel's reports to date have focused on that particular use of funds. Examining the relatively smaller amounts committed under Section 102, however, reveals several important findings.

First, guaranteeing liabilities or backstopping losses on assets can play as important a role in establishing financial stability as purchasing assets.

Second, despite the guarantees' significant impact, the contingent nature of guarantees, coupled with the limited transparency in implementing these programs, means that the total amount of money that is being placed at risk is not always readily apparent. Some financial stabilization initiatives outside of TARP, such as the FDIC's DGP and Treasury's TGPMMF, carry greater potential for exposure of taxpayer funds than TARP itself. The U.S. government was at risk for a considerable amount of money while these programs were in full effect and some of that exposure continues.

Finally, the programs examined in this report raise substantial moral hazard concerns. Explicit guarantees incentivize managers and investors to ignore or downplay risk. More broadly, stabilization initiatives as a whole risk implicitly signaling that the government will provide extraordinary support whenever economic conditions deteriorate in the future.

This report will examine in detail the TARP programs that have guaranteed rather than purchased assets (the Citigroup and Bank of America guarantees under the AGP), as well as Treasury's money market fund guarantee, the TGPMMF, and the FDIC's DGP, which significantly benefited many of the financial institutions that were the recipients of TARP funds.

Some of these guarantees will extend beyond the end of TARP and will continue to serve as government backstops to the financial system. By devoting a report to the way the guarantees work, the way they relate to the health of the financial institutions involved, and their potential cost, the Panel examines another important part of TARP strategy and implementation. This topic touches on the Panel's mandate to examine the Secretary of the Treasury's authority under the TARP, the impact of the TARP on the markets, the protection of taxpayers' money and transparency issues.

B. The Nature of a Guarantee

1. Legal Aspects of Guarantees

A guarantee is an agreement by one person to satisfy another person's obligation if the latter person does not do so. A guarantee involves three parties: the person who owes the original obligation

[8] See Federal Deposit Insurance Corporation, *Monthly Reports on Debt Issuance Under the Temporary Liquidity Guarantee Program* (as of Sept. 30, 2009) (online at www.fdic.gov/regulations/resources/TLGP/total_issuance9_09.html) (hereinafter "FDIC, September Monthly TLGP Report") (while as of September 30, 2009, $307 billion was outstanding under the program, the FDIC's current cap is $620 billion).

[9] Congress has temporarily increased the deposit insurance program to insure accounts up to $250,000. In addition, banks that choose to participate in the TLGP's Transaction Account Guarantee will have the entirety of their customers' non-interest bearing deposit accounts insured.

(the debtor or obligor), the person to whom that obligation is owed (the creditor), and the guarantor.[10] Guarantees can be absolute—meaning that the guarantor is immediately liable—or they can require that other conditions are met before they take effect. Guarantees may also be limited to less than 100 percent of the original liability.[11]

General contract rules govern guarantees.[12] For example, guarantees are usually required to be instruments,[13] and are construed with the aid of a number of substantive rules protecting guarantors.[14] A guarantor who makes good on a guarantee is normally entitled to collect the amount it paid (or whatever part it can) from the original debtor[15] unless the guarantor waived that right in the guarantee agreement.[16] This is known as "subrogation."

A two-party agreement that one party will pay the other a defined amount under certain circumstances (e.g., if a pool of assets does not prove to be worth a defined amount) is not technically a guarantee contract. The party entitled to payment cannot look to a third party to obtain the promised amount, so no additional assets exist to protect the former's ability to obtain what it is owed.[17] All the same, such agreements are sometimes called guarantees.

The FDIC's obligations under its TLGP are true guarantees. Treasury's TGPMMF, on the other hand, does not technically create a guarantee relationship, nor do the agreements between Treasury, the Federal Reserve, and the FDIC, in one regard, or Citigroup and Bank of America, respectively, in another.[18] But these are minor distinctions, given the fact that the obligations of the three government agencies are backed by the full faith and credit of the United States. While the government agencies and the beneficiaries of the arrangements refer to the government sup-

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[10] A guarantee is a form of suretyship. The Restatement (Third) of Suretyship and Guaranty provides a formal description:

1. [A] secondary obligor has suretyship status whenever:

(a) pursuant to contract (the "secondary obligation"), an obligee has recourse against a person (the "secondary obligor") or that person's property with respect to the obligation (the "underlying obligation") of another person (the "principal obligor") to that obligee.

2. An obligee has recourse against a secondary obligor or its property with respect to an underlying obligation:

(a) whenever the principal obligor owes performance of the underlying obligation; and

(b) pursuant to the secondary obligation, either:

(i) the secondary obligor has a duty to effect, in whole or in part, the performance that is the subject of the underlying obligation; or

(ii) the obligee has recourse against the secondary obligor or its property in the event of the failure of the principal obligor to perform the underlying obligation; or

(iii) the obligee may subsequently require the secondary obligor to either purchase the underlying obligation from the obligee or incur the duties described in subparagraph (i) or (ii).

Restatement (Third) of Suretyship and Guaranty § 1 (1996).

[11] *See* Restatement (Third) of Suretyship and Guaranty § 1 cmt. k (1996). As indicated in the text, a guarantee may contain many additional conditions and limitations about triggers for the guarantor's obligation and precise definitions of the liabilities to which that obligation applies. *See id*. at § 1 cmt. j.

[12] *See* Restatement (Third) of Suretyship and Guaranty § 5 (1996); *Louis Dreyfus Energy Corp*. v. *MG Refining & Marketing, Inc.*, 812 N.E.2d 936, 939 (N.Y. 2004).

[13] Restatement (Third) of Suretyship and Guaranty § 11 (1996).

[14] *See, e.g.*, Restatement (Third) of Suretyship and Guaranty §§ 37–49 (1996).

[15] Restatement (Third) of Suretyship and Guaranty § 27 (1996); *see Chemical Bank* v. *Meltzer*, 712 N.E.2d 656, 661 (N.Y. 1999) (explaining the guarantor is technically said to have been "subrogated" to the rights of the obligee).

[16] *See* Restatement (Third) of Suretyship and Guaranty § 6 (1996).

[17] Again, more than one party may be involved on either side of such a direct agreement. For example, A, B, and C may promise directly to pay D (or D, E, and F) under certain conditions.

[18] The TGPMMF is perhaps better understood as an insurance program designed to protect MMF investors and, in so doing, support the commercial paper market.

port by several different terms, including "loss-sharing" and "ring-fencing," this report refers to these contingent arrangements as guarantees.

Typical provisions in guarantee contracts include: [19]

- the nature of the obligation;
- the conditions for its performance (e.g., whether a guarantee can be enforced if payment obligations on the underlying debt are accelerated);
- the proportionate obligations and rights of multiple parties (for example, whether obligations to pay are proportionate or any party can be required to pay the entire amount owed);
- ongoing responsibilities of the obligor or obligors, including provision of security for performance;
- whether the obligation is continuing or terminable;
- the terms on which subrogation (in the case either of a true guarantee or a direct agreement) can occur;
- the terms of any waivers, by one or more parties, of contract, statutes of limitation, or other defenses that might otherwise be asserted;
- allocation of expenses (of enforcement, protecting collateral, etc.); and
- costs of bankruptcy proceedings of one or more parties to the arrangement.

2. How Guarantees Are Treated on Government Agencies' Books

a. Standard Accounting Treatment

The Financial Accounting Standards Board (FASB) specifies accounting rules for guarantees issued by institutions that follow generally accepted accounting principles (GAAP) in the United States. FASB provides guidance on how to account for the initial liability that the guarantor (issuer) records to recognize fair value of the guarantee, as well as on how to address any liability exposure created over the course of the guarantee.

The issuance of a guarantee obligates the guarantor in two respects: (1) the guarantor undertakes an obligation to stand ready to perform over the term of the guarantee in the event that the specified triggering events or conditions occur [20] and (2) the guarantor undertakes a contingent obligation to make future payments if those triggering events or conditions occur.

According to the rules as part of accrual accounting,[21] fees received and not yet earned are recorded as deferred revenue which is a liability and is reduced over the life of the guarantee as revenue is earned. This deferred revenue for guarantee purposes is called an "initial stand-ready liability," which reflects the fair value of the guarantee (expected cash flows over the life of the guarantee). If losses are expected on the guaranteed assets, guarantee expense must be accrued as a charge to the guarantor's income if both of the following conditions are met: (1) it is probable the asset

[19] *Cf.* Langdon Owen, *Real Property Lender Security, Lease, and Other Downside Concerns* (June 5, 2008) (online at www.bankerresource.com/articles/view.php?article_id=624#) (discussing lender security provisions for real property transactions). The list is non-exhaustive.
[20] U.S. GAAP Codification of Accounting Standards: Codification Topic 460—Guarantees.
[21] U.S. GAAP Codification of Accounting Standards: Codification Topic 450—Contingencies.

guaranteed is impaired or the liability guaranteed had been incurred; and (2) the amount of loss is estimable.

The initial stand-ready liability for the fee received for the guarantee but not yet earned, reflecting the fair value of the guarantee of the loan, is recorded even when it is not probable that payments will be required under that guarantee, as that may change over the term of the loan.

b. Accounting Practices of Federal Agencies

The Federal Reserve and the FDIC follow GAAP accounting rules in preparing their accounting statements while Treasury follows similar Government Accounting Standards. FASB issues guidance for adapting GAAP for use by government agencies. Treasury and the FDIC submit audited financial statements to the Office of Management and Budget (OMB), and Treasury subsequently consolidates these statements into a government-wide financial report. While this report attempts to provide a balance sheet for the federal government, it is not the federal budget, and it is not a forecasting document. The financial report also includes a modified version of an income statement for the federal government. The federal budget is on a cash basis and thus provides cash flow information.

From a consolidated, government-wide perspective, the federal budget treats the guarantee transactions of the three agencies in three different ways:

- Treasury/TARP. Section 123 of EESA requires that TARP transactions, including asset guarantees undertaken pursuant to Section 102, be recorded on a "credit reform" basis. This means that the cost of the program measures the discounted present value of the cash flows involved. For most federal direct loan and guarantee programs, the discount rate used in the credit reform subsidy calculation is simply the government's cost of funds. However, EESA requires that the discount rate used for TARP be the government cost of funds modified to reflect market risk.
- Federal Reserve. The Federal Reserve is excluded from the federal budget except that its net earnings are paid to Treasury at the end of each year and are recorded as a budget receipt. Hence, the only impact of the Federal Reserve's guarantee activities on the federal budget would be in reducing its net earnings should the Federal Reserve absorb any losses on its guarantees.
- FDIC. Only the cash flows associated with the FDIC guarantees are reflected in the federal budget, not the discounted present value of those flows. This means that no "cost" is recorded for the FDIC guarantees under the AGP and the TLGP unless there is an actual default and payment of a guarantee claim, in which case the full, undiscounted amount of that claim is included in the budget.

The following table shows the amounts that each individual agency and the federal budget have recorded so far for the three major guarantee programs. Note that the differences between the Congressional Budget Office (CBO) and OMB budget estimates for the AGP are not as large as they first appear because CBO does not include the guarantee fees received in the cash flows used to calculate the credit reform subsidy figure, whereas OMB does.

FIGURE 1: SUMMARY OF AGENCY AND FEDERAL BUDGET TREATMENT OF GUARANTEE PROGRAMS

	Treasury/TARP		Federal Reserve		FDIC	
	Agency accounts	Federal budget	Agency accounts	Federal budget	Agency accounts	Federal budget
AGP	Receipts of $1,028 million.[22]	Receipts of $1,028 million.[23]	Receipts of $57 million.	Not included ...	Receipts of $2.7 billion.	Receipts of $2.7 billion.
TGPMMF	Receipts of $1.2 billion.	Receipts of $1.2 billion.	—	—	—	—
TLGP	—	—	—	—	Receipts of $9.6 billion; 2 million disbursement.[24]	Receipts of 9.6 billion; $2 million disbursement.[25]

[22] Represents initial credit reform estimate of $752 million in receipts for the AGP transactions in FY 2009, which is subject to end of year reestimate, plus receipts for the Bank of America termination fee of $276 million.
[23] *Id.*
[24] According to the FDIC, as of October 22, 2009 there has been one failure of a TLGP-participating institution, an affiliate of which had issued guaranteed debt. While the FDIC anticipates up to a $2 million loss on that issuance, no losses have been paid out yet with respect to the DGP.
[25] *Id.*

3. How Guarantees Are Treated on the Books of the Entity Benefitted

a. Guarantee of Assets

For the institutions that receive a guarantee, the fair value of the guarantee (the fee paid) is recorded as an initial asset (as a prepaid expense equivalent to the initial liability recorded by the guarantor) adjusted (through the income statement as an other operating expense) over the life of the guarantee to reflect the reduced risk. If and when cumulative losses (impairment) based on GAAP for the covered assets exceed an agreed amount or deductible, an asset is recorded (reflecting expected receipt of payment for the claim) that is equal to the losses recorded in the relevant period.

b. Guarantee of Liabilities

When a bank issues debt (a liability to the bank) that has been guaranteed by a third party, the guarantee benefits the holder of the bank's debt (the lender) rather than the bank. The bank pays a guarantee premium to the guarantor at the time of issuance of the debt which is carried as part of the carrying basis of the underlying debt. This premium is recognized as an asset and amortized over the life of the guaranteed debt as an interest expense.

The guarantee in such a case is in effect a debt discount (i.e., it lowers the borrowing cost). If the bank defaults, a payment from the guarantor goes directly to the lender, bypassing the bank. Unlike an asset guarantee, in the case of a liability guarantee, the bank is not the guaranteed party and hence it does not record an asset if it defaults on the guaranteed debt. Rather, the guarantor is liable to the holder of the underlying debt of the bank.[26]

Though the accounting of the guaranteed party is similar to that of the guarantor in terms of the initial recording of the guarantees, there is significant difference in the treatment of guarantees of as-

[26] *See* discussion of asset guarantees and liability guarantees *supra* Section B(1).

sets versus guarantees of liabilities when a payment is due from the guarantor. For guarantees of assets, the guarantor pays the guaranteed party according to the loss agreement. For guarantees of liabilities, the guarantor pays the creditor directly (bypassing the obligor).

C. The Programs

1. The Asset Guarantee Program

By the fall of 2008, financial markets were in significant turmoil. In October 2008, Treasury provided $125 billion in Capital Purchase Program (CPP) funds—half of the TARP funds then available—to nine financial institutions selected due to their perceived importance to the capital markets and the greater financial system.[27] At the time, the nine financial institutions held, in aggregate, approximately 55 percent of all assets held by U.S.-owned banks.[28] Treasury maintained that these institutions were "healthy" and that the infusion of capital was intended primarily to restore market confidence and stimulate the economy by helping banks increase lending to consumers and businesses.[29]

The continuation of significant disruptions in the capital markets and the banking industry experiencing "one of the most financially devastating earnings quarters in recent history"[30] during the fourth quarter of 2008, meant that CPP infusions were not enough for some institutions. In a matter of weeks, two of the nine institutions—Citigroup and Bank of America—needed additional support.

Some of this support was provided through the Asset Guarantee Program (AGP). On December 31, 2008, Treasury issued a report detailing its Asset Guarantee Program (AGP),[31] which Treasury

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[27] Bank of America, Citigroup, Wells Fargo, JPMorgan Chase, Goldman Sachs, Morgan Stanley, Merrill Lynch, State Street Corporation, and the Bank of New York Mellon were the nine initial financial institutions to receive the first government capital injections. Settlement with Merrill Lynch was deferred pending its merger with Bank of America. The purchase of Merrill Lynch by Bank of America was completed on January 1, 2009, and this transaction under the CPP was funded on January 9, 2009. U.S. Department of the Treasury, *Troubled Asset Relief Program Transactions Report for Period Ending October 30, 2009*, at 5 (Nov. 3, 2009) (online at www.financialstability.gov/docs/transaction-reports/11-3-09%20Transactions%20 Report%20as%20of%2010-30-09.pdf) (hereinafter "October 30 TARP Transactions Report").

[28] U.S. Department of the Treasury, *Remarks by Secretary Henry M. Paulson, Jr. on Financial Rescue Package and Economic Update* (Nov. 12, 2008) (online at www.financialstability.gov/latest/hp1265.html) (stating that "nine of the largest U.S. financial institutions, holding approximately 55 percent of U.S. banking assets . . . .").

[29] *See* U.S. Department of the Treasury, *Statement by Secretary Henry M. Paulson, Jr., on Actions to Protect the U.S. Economy* (Oct. 14, 2008) (online at www.treasury.gov/press/releases/hp1205.htm) (stating that the financial institutions receiving emergency injections of capital, including Citigroup and Bank of America, were "healthy institutions," and that they were accepting federal assistance "for the good of the U.S. economy").

[30] SIGTARP, *Emergency Capital Injections Provided to Support the Viability of Bank of America, Other Major Banks, and the U.S. Financial System*, at 1 (Oct. 5, 2009) (online at www.sigtarp.gov/reports/audit/ 2009/Emergency_Capital_Injections_Provided_to_Support_the_Viability_of_Bank_of_America..._100509.pdf) (hereinafter "Emergency Capital Injections").

[31] U.S. Department of the Treasury, *Report to Congress Pursuant to Section 102 of the Emergency Economic Stabilization Act, at 2* (Dec. 31, 2008) (online at www.financialstability.gov/docs/AGP/sec102ReportToCongress.pdf) (hereinafter "Treasury AGP Report"). For practical purposes, the AGP was created when the government agreed, in November 2008, to guarantee certain Citigroup assets. *See* U.S. Department of the Treasury, *U.S. Government Finalizes Terms of Citi Guarantee Announced In November* (Jan. 16, 2009) (online at www.treas.gov/press/releases/hp1358.htm) (hereinafter "Treasury AGP Terms Release"). (announcing the federal government's intention to guarantee Citigroup assets, without specifying AGP as the programmatic source of the guarantee). There is no evidence that AGP existed prior to that announcement as a program, but funds were allocated to Citigroup that were later attributed to AGP. It was not until Treasury issued its report to Congress in December 2008, however, that it formally linked the

Continued

created pursuant to Section 102 of EESA. Under the AGP, Treasury may guarantee [32] certain distressed or illiquid assets that are held by systemically significant financial institutions.[33] In exchange, participating financial institutions pay premiums to Treasury, which are supposed to cover any losses under the program.[34] Participating financial institutions also agree to manage the guaranteed assets according to certain guidelines.[35] Treasury's stated objective for the AGP is to bolster confidence in participating institutions and to stabilize financial markets,[36] thereby strengthening the broader economy.[37]

From the beginning, Treasury stated that AGP assistance would not be "widely available." [38] To date, Treasury has offered AGP assistance to only two institutions: Citigroup and Bank of America. In both cases, Treasury offered this assistance in coordination with the Federal Reserve and the FDIC, both of which, like Treasury, agreed to absorb certain losses arising from the guaranteed assets.

Although the AGP program was jointly announced by Treasury, the Federal Reserve, and the FDIC, Treasury is the only agency that refers to this tripartite initiative as AGP. (The latter two agencies instead refer to this agreement as "a package of guarantees, liquidity access and capital.") [39] Treasury is also the only

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agreement with Citigroup to the AGP. *See* Treasury AGP Report, *supra* note 31, at 1 (announcing that Treasury intended to "explor[e] use of the Asset Guarantee Program to address the guarantee provisions of the agreement with Citigroup announced on November 23, 2008").

[32] Treasury guarantees assets under the AGP by "assum[ing] a loss position with specified attachment and detachment points on certain assets held by [a] qualifying financial institution[.]" Treasury AGP Report, *supra* note 31, at 1. The insured assets are selected by the financial institution receiving the guarantee and reviewed for eligibility by Treasury. *Id*.

[33] Treasury AGP Report, *supra* note 31. Treasury regards a financial institution as "systemically significant" if its "failure would impose significant losses on creditors and counterparties, call into question the financial strength of other similarly situated financial institutions, disrupt financial markets, raise borrowing costs for households and businesses, and reduce household wealth." U.S. Department of the Treasury, *Decoder* (Sept. 18, 2009) (online at www.financialstability.gov/roadtostability/decoder.htm) (hereinafter "Treasury Decoder"). Treasury has stated that, in determining whether to provide aid under the AGP, it will consider the following factors, among others:

1. The extent to which destabilization of the institution could threaten the viability of creditors and counterparties exposed to the institution, whether directly or indirectly;
2. The extent to which an institution is at risk of a loss of confidence and the degree to which that stress is caused by a distressed or illiquid portfolio of assets;
3. The number and size of financial institutions that are similarly situated, or that would be likely to be affected by destabilization of the institution being considered for the program;
4. Whether the institution is sufficiently important to the nation's financial and economic system that a loss of confidence in the firm's financial position could potentially cause major disruptions to credit markets or payments and settlement systems, destabilize asset prices, significantly increase uncertainty, or lead to similar losses of confidence or financial market stability that could materially weaken overall economic performance;
5. The extent to which the institution has access to alternative sources of capital and liquidity, whether from the private sector or from other sources of government funds.

Treasury AGP Report, *supra* note 31.

[34] U.S. Department of the Treasury, *Asset Guarantee Program* (Mar. 2, 2009) (online at www.financialstability.gov/roadtostability/assetguaranteeprogram.htm) (hereinafter "AGP Overview").

[35] Treasury AGP Report, *supra* note 31, at 1; see, e.g., Master Agreement Among Citigroup Inc., Certain Affiliates of Citigroup Inc. Identified Herein, Department of the Treasury, Federal Deposit Insurance Corporation and Federal Reserve Bank of New York at Exhibit B, *Governance and Asset Management Guidelines* (Jan. 15, 2009) (online at www.sec.gov/Archives/edgar/data/831001/000095010309000098/dp12291_ex1001.htm) (hereinafter "Citigroup Master Agreement") (guidelines governing Citigroup's management of the covered assets).

[36] Treasury stated that AGP and its Targeted Investment Program, discussed below, were components of a coordinated effort to counteract any potential systemic risks. Treasury conversations with Panel staff (Oct. 22, 2009).

[37] Treasury AGP Report, *supra* note 31, at 2.

[38] Treasury AGP Report, *supra* note 31, at 1.

[39] *See, e.g.*, AGP Overview, *supra* note 34; U.S. Department of the Treasury, *Joint Statement by Treasury, Federal Reserve and FDIC on Citigroup* (Nov. 23, 2008) (online at

agency whose authority to participate in the initiative emanates from EESA[40]—an issue discussed in greater depth in section D of this report.

a. Citigroup

i. Background

On October 28, 2008, Treasury purchased Citigroup preferred shares and warrants valued at $25 billion under its CPP.[41] As discussed above, at the time, Treasury maintained that CPP recipients were "healthy."[42]

On Friday, November 21, 2008, Citigroup approached the federal government and requested assistance over and above the $25 billion direct capital infusion it had received in November under the CPP. In response to rapidly deteriorating market conditions and Citigroup's position,[43] the federal government announced that it would provide additional aid to Citigroup.

This second wave of aid took two forms. First, Treasury agreed to purchase an additional $20 billion in Citigroup preferred stock under its Targeted Investment Program (TIP).[44] Second, three gov-

financialstability.gov/latest/hp1287.html); Board of Governors of the Federal Reserve System, *Joint Statement by Treasury, Federal Reserve, and the FDIC on Citigroup* (Nov. 23, 2008) (online at www.federalreserve.gov/newsevents/press/bcreg/20081123a.htm); Federal Deposit Insurance Corporation, *Joint Statement by Treasury, Federal Reserve and the FDIC on Citigroup* (Nov. 23, 2008) (online at www.fdic.gov/news/news/press/2008/pr08125.html).

[40] The Federal Reserve states its authority derives from § 13(3) of the Federal Reserve Act of 1913, Pub. L. No. 63–43, § 13(3); see also Board of Governors of the Federal Reserve System, *Report Pursuant to Section 129 of the Emergency Economic Stabilization Act of 2008: Authorization to Provide Residual Financing to Bank of America Corporation Relating to a Designated Asset Pool* (online at www.federalreserve.gov/monetarypolicy/files/129BofA.pdf) (accessed Nov. 2, 2009) (referencing § 13(3) of the Federal Reserve Act as the source of the Federal Reserve's authority to act).

[41] U.S. Department of the Treasury, *Capital Purchase Program Transaction Report* (Nov. 17, 2008) (online at www.financialstability.gov/docs/transaction-reports/TransactionReport-11172008.pdf).

[42] Notwithstanding these statements that the nine financial institutions were healthy, a recent SIGTARP audit suggests that there were concerns about the health of at least several of the institutions at that time, and that "their overall selection was far more a result of the officials' belief in their importance to a system that was viewed as being vulnerable to collapse than concerns about their individual health and viability." SIGTARP, *SIGTARP Survey Demonstrates that Banks Can Provide Meaningful Information On Their Use of TARP Funds*, at 17 (July 20, 2009) (online at www.sigtarp.gov/reports/audit/2009/SIGTARP_Survey_ Demonstrates_That_ Banks_Can_Provide_Meaningfu_%20Information_On_ Their_Use_Of_TARP_Funds.pdf) (hereinafter "SIGTARP Bank Audit").

[43] See, e.g., Vikram Pandit, Chief Executive Officer of Citigroup, *Citi Reports Fourth Quarter Net Loss of $8.29 Billion, Loss Per Share of $1.72* (Jan. 16, 2009) (online at www.citibank.com/citi/press/2009/090116a.htm); Bradley Keoun & Mark Pittman, *Citigroup's Asset Guarantees to be Audited by TARP*, Bloomberg (Aug. 19, 2009) (online at www.bloomberg.com/apps/news?pid=20601087&sid=aiWZXE5RKSCc) (reporting that Citigroup's shares fell below $5 in November 2008, raising concerns of a destabilizing run on the bank).

[44] 44 U.S. Department of the Treasury, *Treasury Releases Guidelines for Targeted Investment Program* (Jan. 2, 2009) (online at www.treasury.gov/press/releases/hp1338.htm) (hereinafter "Treasury TIP Guidelines"). The TIP "was created to stabilize the financial system by making investments in institutions that are critical to the functioning of the financial system. Investments made through the TIP seek to avoid significant market disruptions resulting from the deterioration of one financial institution that can threaten other financial institutions and impair broader financial markets and pose a threat to the overall economy." U.S. Department of the Treasury, *Decoder*, supra note 34. As the Panel has before noted, there is no evidence that the TIP existed as a program prior to that announcement, but funds were disbursed to Citigroup that were later attributed to the TIP. *See* Congressional Oversight Panel, *February Oversight Report:Valuing Treasury's Acquisitions*, at 5 (Feb. 6, 2009) (online at cop.senate.gov/documents/cop-020609-report.pdf).

Treasury states, "[t]his program description is required by Section 101(d) of the Emergency Economic Stabilization Act," but does not provide the date TIP was created. TIP is not referred to by name in EESA. Treasury asserts its authority for this program arises from Section 101, which authorizes Treasury to purchase troubled assets. *See* Treasury TIP Guidelines, *supra* note 44; *see also* EESA § 101.

ernment agencies (Treasury, the Federal Reserve, and the FDIC) agreed to share with Citigroup potential losses on a pool of Citigroup assets that Citigroup identified as some of its riskiest and most high-profile assets.[45] Initially, that pool was valued at up to $306 billion.[46]

ii. Structure of the Guarantee

The structure of Citigroup's asset guarantee is relatively simple. According to the Citigroup Master Agreement,[47] Citigroup will absorb initial losses arising from the covered pool up to $39.5 billion.[48] Citigroup will then absorb 10 percent of any losses in excess of that amount, while the federal government will absorb the remainder of the losses. Treasury will absorb the first $5 billion in federal liability, the FDIC will absorb the second $10 billion in federal liability, and the Federal Reserve will cover any further federal liability by way of a non-recourse loan to Citigroup.[49] The

[45] Generally speaking, the assets in the guarantee pool are loans and securities backed by residential and commercial real estate and other such assets, which will remain on Citigroup's balance sheet. U.S. Dept. of the Treasury, Press Release, *Joint Statement by Treasury, Federal Reserve and the FDIC on Citigroup* (Nov. 23, 2008) (online at www.treas.gov/press/releases/hp1287.htm) (hereinafter "Treasury Citigroup Press Release"). For a more detailed breakdown of the asset pool, see Figure 2, *infra*. Citigroup, Treasury and the Federal Reserve have indicated that the assets were valued at the amounts shown on Citigroup's books at the date of the agreement (or January 15, 2009 for assets added later). The whole loans within the asset pool are carried at face value and adjusted for permanent impairments (write-downs) and any repayments of principal. The securities within the asset pool are carried at their mark-to-market value. This was confirmed by Citigroup. (In the notes to its financial statements, Citigroup, as a BHC, is required to show the market value of these assets, which includes mark-to-market valuation.) As shown in Figure 2, most of the assets covered were in the form of whole loans. Citigroup uses the same valuation principles it uses in its financial statements for the calculation of losses under the guarantee. See Congressional Oversight Panel, *August Oversight Report, The Continued Risk of Troubled Assets* at Section B (Aug. 11, 2009) (hereinafter "COP August Oversight Report") (online at financialservices.house.gov/cop-081109-report.pdf) (discussing the changes in accounting rules that move away from mark-to-market accounting).

[46] The terms of the asset guarantee agreement were finalized in January 2009, at which time the size of the guaranteed pool was reduced to $301 billion. Treasury AGP Terms Release, *supra* note 31. The reason for this reduction was largely the result of certain accounting corrections as well as the exclusion from the pool of certain asset-backed collateralized debt obligations. As discussed below, the asset pool has since shrunk even further due to sales of assets, principal amortization, and charge-offs. It now stands at approximately $266 billion.

[47] Citigroup Master Agreement, *supra* note 35 (setting forth the agreement by Treasury, the FDIC, and FRBNY to protect Citigroup and certain of its affiliates from certain losses on an asset pool, as originally announced on November 23, 2008).

[48] Citigroup Master Agreement, *supra* note 35, at 2, 28. Citigroup's so-called "deductible" was "determined using (i) an agreed-upon $29 billion of first losses [on the asset pool], (ii) Citigroup's then-existing reserve with respect to the portfolio of approximately $9.5 billion, and (iii) an additional $1.0 billion as an agreed-upon amount in exchange for excluding the effects of certain hedge positions from the portfolio." U.S. Securities and Exchange Commission, *Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for Citigroup Inc.* (Aug. 7, 2009), at 35 (online at www.sec.gov/Archives/edgar/data/831001/000104746909007400/a2193853z10-q.htm) (hereinafter "Citigroup Second Quarter 2009 Report"). When the guarantee was first announced on November 23, 2008, it was announced that the deductible would be $29 billion "plus reserves." When these reserves and the $1 billion for the hedge position are factored in, the amount becomes the $39.5 billion reflected in the final agreement signed in January.

During a call with Panel staff, Citigroup stated there was disagreement between the federal government and Citigroup as to the value of certain hedge positions during negotiations of the deductible. Since determining which assets were a hedge for other assets to some degree of precision was extremely difficult, if at all possible, Citigroup and the government settled on the figure of $1 billion to account for the existence of these hedges in calculating the deductible. Citigroup conversations with Panel staff (Oct. 26, 2009).

[49] Citigroup Master Agreement, *supra* note 35, at 6–8, 28–30; see also U.S. Department of the Treasury, *The Next Phase of Government Financial Stabilization and Rehabilitation Policies*, at 44 (Sept. 2009) (online at www.treas.gov/press/releases/docs/Next%20Phase%20of%20Financial%20Policy,%20Final,%202009-09-14.pdf) (hereinafter "Next Phase Report").

guarantee runs for up to ten years for residential assets and five years for non-residential assets.

On a quarterly basis, Citigroup is required to calculate a number of figures, including the adjusted baseline value of each asset, the aggregate losses incurred by asset class, and the aggregate recoveries and gains recognized by the ring-fenced portfolio.[50] The losses reported are equal to the amount of any charge-offs or other realized losses (such as sales at a loss) taken on covered assets over the quarterly period. These losses generally count against Citigroup's deductible under the agreement.[51] If assets in the pool have increased in value, then upon their sale or disposition gain offsets the losses, and the amount the federal government is liable for decreases. On a monthly basis, Citigroup prepares an AGP report for senior management and the audit committee that includes updates on the current value of the ring-fenced assets and provides a month-to-month change as well as a year-to-date change (since the inception of the AGP). These monthly reports also describe the drivers of the change in the value of the ring-fenced assets and include Citigroup's stress test on these assets projecting the expected losses over the life of the guarantee. Citigroup submits this report to Treasury. Net losses, if any, on the portfolio after Citigroup's losses exceed its deductible will be paid out by the U.S. government in a specified manner. If Citigroup's recoveries or gains on the asset pool exceed its losses, then certain clawback provisions within the Master Agreement require it to reimburse the U.S. government for any outstanding advances on a quarterly basis.

As consideration for this asset guarantee, Citigroup agreed to issue to Treasury $4.034 billion of perpetual preferred stock, which pays dividends at 8 percent, and warrants to purchase 66,531,728 shares of common stock at a strike price of $10.61.[52] Citigroup also issued to the FDIC $3.025 billion of the same perpetual preferred stock issued to Treasury.[53] (Citigroup was required to reimburse

[50] Federal Reserve conversations with Panel staff (Oct. 22, 2009); Citigroup Master Agreement, *supra* note 35, at 20–21.

[51] As the FDIC has noted, "the specific requirements for claims under the agreement result in some differences between GAAP charge-offs and recognition of losses under the agreement which would be covered (first going against Citigroup's deductible and then as an allowed claim)." Federal Deposit Insurance Corporation, Responses to Panel Questions on AGP (Oct. 30, 2009).

[52] Citigroup accounts for the loss-sharing program as an indemnification agreement; it was recorded on Citigroup's Consolidated Financial Statements as follows:

Per U.S. Generally Accepted Accounting Principles (GAAP), an asset of $3.617 billion (equal to the initial fair value of the consideration issued to Treasury) was recorded as "Other Assets" on the Consolidated Balance Sheet and, correspondingly, the issuance of preferred stock and warrants resulted in an increase of stockholder's equity by $3.617 billion during the first quarter of 2009.

During the 3rd quarter of 2009, the preferred stock was subsequently exchanged for "Trust Preferred Securities" as part of the "Exchange Offer." Accordingly, the "Trust Preferred Securities" were classified as debt and the Preferred Stock issued in Q1 2009 was derecognized.

The initially recorded asset will be amortized as an "Other Operating Expense" in the Consolidated Income Statement on a straight-line basis over the coverage periods (i.e., 10 years for residential assets and 5 years for non-residential assets) based on the initial principal amounts of each group.

If cumulative losses in the covered asset pool exceed $39.5 billion, any recoveries on the guarantee will be recorded as an asset (on the loss sharing program) equal to the losses recorded in the relevant period.

U.S. Securities and Exchange Commission, *Citigroup Inc, Form 10-Q for the Quarterly Period Ended March 31, 2009* (online at www.sec.gov/Archives/edgar/data/831001/000104746909005290/a2192899z10-q.htm) (accessed Nov. 2, 2009).

[53] U.S. Securities and Exchange Commission, *Summary of Terms of USG/Citigroup Loss Sharing Program* at 1–2 (Jan. 15, 2009) (hereinafter "Citigroup Summary") (online at

Continued

the government for expenses incurred in negotiating the guarantees.)[54] Should Citigroup draw on the Federal Reserve's non-recourse loan facility, the funds will be subject to a floating Overnight Index Swap Rate plus 300 basis points.[55]

The Citigroup Master Agreement also addresses certain governance issues. For example, it provides that Citigroup may not pay common stock dividends in excess of $.01 per share per quarter until November 20, 2011, except with the government's consent; that Citigroup will follow certain government-approved executive compensation guidelines; that Citigroup will follow certain government-approved asset management guidelines for the covered pool; and that the federal government may demand a change in management of the pool if losses in the pool exceed $27 billion.[56]

iii. The Guaranteed Pool

The Master Agreement does not specify the precise value or composition of the guaranteed asset pool; rather, it sets forth the criteria for covered assets[57] and a post-signing process for negotiating and finalizing those details.

Pursuant to the terms of the Master Agreement, the composition of the asset pool is subject to final confirmation by the U.S. government.[58] Citigroup submitted its proposed asset pool to the U.S. government on April 15, 2009 in compliance with the Master Agreement,[59] and the three agencies had 120 days—until August 13, 2009—to complete their review.[60] Treasury, the Federal Reserve,

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www.sec.gov/Archives/edgar/data/831001/000095010309000098/dp12291_8k.htm). Should Citigroup draw on the Federal Reserve's non-recourse loan facility, the funds will be subject to a floating Overnight Index Swap Rate plus 300 basis points. *Id.*

According to Citigroup, "the approximately $7.1 billion of preferred stock issued to the [Treasury] and FDIC in consideration for the loss-sharing agreement was [subsequently] exchanged for newly issued 8 percent trust preferred securities." Citigroup Second Quarter 2009 Report, *supra* note 48, at 35.

[54] Treasury has informed the Panel that no such expenses were incurred by TARP. However, the Federal Reserve Bank of New York did incur expenses in connection with the Citigroup ring fence, including contracts for outside legal counsel and financial advisory services. See Federal Reserve Bank of New York, *Citigroup Ringfencing Arrangement, Blackrock Contract* (Dec. 14, 2008) (online at www.newyorkfed.org/aboutthefed/Blackrock_Redacted.PDF); Federal Reserve Bank of New York, "Citigroup Ringfencing Arrangement," PricewaterhouseCoopers Contract (online at www.newyorkfed.org/aboutthefed/pricewaterhousecoopers_redacted.pdf); Federal Reserve Bank of New York, "Citigroup Ringfencing Arrangement," Cleary Gottlieb Stein & Hamilton Contract, at 13–21 (online at www.newyorkfed.org/aboutthefed/ClearlyGottliebSteinHamilton_LLP.pdf). According to the FRBNY, Citigroup has repaid all expenses incurred by these contracts in connection with the Citigroup AGP.

[55] Citigroup Summary, *supra* note 53, at 1–2.

[56] *See* Citigroup Master Agreement, *supra* note 35, at 30, Exhibit B, *Governance and Asset Management Guidelines,* Exhibit C, *Executive Compensation;* Section D of this report below, which discusses the creation and structure of the guarantee programs.

[57] The requirements include: (1) that each asset was owned by a Citigroup affiliate and included on its balance sheet as of the agreement date (January 15, 2009); (2) that no foreign assets are to be included; (3) that no equity securities or derivatives of such equity securities are to be included; (4) that all assets in the pool must have been issued or originated prior to March 14, 2008; (5) that Citigroup or any of its affiliates would not serve as an obligor of any of the assets; and (6) that the assets are not guaranteed by any governmental authority pursuant to another agreement. The Panel has confirmed with Treasury and Citigroup that all assets were originally on the balance sheet of Citigroup.

Citigroup stated during a conversation with Panel staff that in determining the assets to be guaranteed, it included mainly "high headline exposure" categories of assets, not necessarily the technically riskiest, but the types of assets that the markets were most worried about and the guarantee of which would attract the most market attention. Citigroup also stated that it included in its initial proposal all of the assets in each of these categories in an effort to demonstrate it was not "cherry-picking" assets and to reflect moral hazard concerns. Citigroup conversations with Panel staff, October 26, 2009.

[58] *See* Citigroup Master Agreement, *supra* note 35, at 17.

[59] *See* Citigroup Master Agreement, *supra* note 35, at 17.

[60] *See* Citigroup Master Agreement, *supra* note 35, at 17.

and the FDIC have 90 days after completing their review of the asset pool (i.e., until November 11, 2009) to finalize the pool's composition.[61] Treasury expects that the asset pool will be finalized by early November, after the review of the remaining $2 billion, or roughly one percent of covered assets, is completed.

According to Citigroup, the covered asset pool currently includes approximately $99 billion of assets considered "replacement" assets—that is, assets that were added to the pool to replace assets that were determined not to meet the criteria set forth in the Master Agreement.[62] When the idea of a guarantee of assets was first proposed, the government agencies agreed to the guarantee in principle, but required that the assets meet specified criteria. The parties agreed to these criteria, also referred to as "filters," and started a due diligence review[63] to ascertain whether the initial assets proposed for the pool passed the filters. Many of the assets in the initial pool were rejected as a result of the filtering process. As a result of this process (as well as voluntary exclusions, accounting corrections, and confirmation of covered asset balances), the total value of the asset pool fell below the $306 (adjusted to $301) billion amount that was agreed to initially. Thus, new asset classes (not among the asset classes initially proposed) were added, such as certain corporate loans.[64] This "swapping" process is governed by the terms of the Master Agreement.[65]

The most recent description of the asset pool appears in Citigroup's second quarter 2009 earnings report. According to that report, the value of assets in the guaranteed pool has declined from $301 billion to $266.4 billion as a result of principal repayments and charge-offs. The following table describes the composition of the asset pool (as of June 30, 2009), including replacement assets,

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[61] *See* Citigroup Master Agreement, *supra* note 35, at 17.

[62] Citigroup Master Agreement, supra note 35, at 36. For further discussion on the criteria for assets in the covered pool, see Section C(a)(ii), *infra*.

[63] The FRBNY, along with PricewaterhouseCoopers (PwC) and Blackrock, analyzed Citigroup's books (not available to the market) including the models and assumptions used to value these assets. FRBNY looked at non-public information relating to Citigroup's assets. The valuation question also requires the assumption of discount rates and interest rate levels (on which the value of many of the pool assets are likely, in part, to depend).

[64] Citigroup conversations with Panel staff (Oct. 22, 2009); Treasury conversations with Panel staff (Oct. 19, 2009); Federal Reserve Bank of New York conversations with Panel staff (Oct. 22, 2009).

[65] The definitions of "covered assets" and "replacement covered assets" are both included in the definitions section of the Master Agreement. Section 5 of the agreement sets forth detailed guidelines for how each of the assets must be "mutually agreed to by each of the U.S. Federal Parties." In particular, Section 5.1(d) sets out the swapping process. See Citigroup Master Agreement, supra note 35, at 17 ("Citigroup shall have the right to substitute or add, as the case may be, new assets that qualify as Covered Assets up to the amount of any such decrease; provided such assets are acceptable to the U.S. Federal Parties acting in good faith . . . following any such substitution or addition of new assets, such assets shall be subject to this Master Agreement and shall be deemed to be 'Covered Assets' in all respects."). On July 23, 2009 SIGTARP announced it is initiating an audit of the Citigroup asset guarantee to determine: "(1) the basis on which the decision was made to provide asset guarantees to Citigroup, and the process for selecting the loans and securities to be guaranteed; (2) what were the characteristics of the assets deemed to be eligible to be 'ring-fenced', i.e., covered under the program, how do they compare with other such assets on Citigroup's books, and what risk assessment measures were considered in their acquisition; (3) whether effective risk management and internal controls and related oversight processes and procedures are in place to mitigate risks to the government under this guarantee program with Citigroup; and (4) what safeguards exist to protect the taxpayer's [sic] interests in the government's investment in the asset guarantees provided to Citigroup, and the extent of losses to date." See SIGTARP, *Engagement Memo—Review of Citigroup's Participation in the Asset Guarantee Program* (July 23, 2009) (online at www.sigtarp.gov/reports/audit/2009/EM_Review_of_Citigroup's_Participation_in_the_Asset_Guarantee_Program.pdf).

and reflects decreases by reason of amortization, charge-offs or asset sales.

FIGURE 2: ASSETS COVERED BY CITIGROUP AGP

[Dollars in billions]

	June 30, 2009	November 21, 2008
Loans:		
First mortgages	$ 86.0	$ 98.0
Second mortgages	52.0	55.4
Retail auto loans	12.9	16.2
Other consumer loans	18.4	19.7
Total consumer loans	169.3	189.3
Commercial real estate loans	11.4	12.0
Highly leveraged loans	1.3	2.0
Other corporate loans	12.2	14.0
Total corporate loans	24.9	28.0
Securities:		
"Alt-A" mortgage securities	9.5	11.4
Special investment vehicles	5.9	6.1
Commercial real estate	1.6	1.4
Other	9.0	11.2
Total securities	26.0	30.1
Unfunded Lending Commitments:		
Second mortgages	19.6	22.4
Other consumer loans	2.6	3.6
Highly leveraged finance	0	0.1
Commercial real estate	4.2	5.5
Other commitments	19.8	22.0
Total unfunded lending commitments	46.2	53.6
Total covered assets	266.4	301.0

As of June 30, 2009, Citigroup had announced approximately $5.3 billion in losses on the guaranteed asset pool—far short of the $39.5 billion in losses required to trigger any obligation on the part of the government.[66] Even though the final composition of the pool has not yet been determined, the government considers itself committed to cover any losses specified by the agreement that occurred after November 23, 2008. Whether a specific loss would be eligible for coverage, however, cannot be determined until the asset pool is finalized.

While the size of the asset pool will diminish over time as the assets are amortized or sold, the "deductible" means that losses on the pool will not result in losses to Treasury, if at all, until later in the term of the guarantee.

b. Bank of America

i. Background

Like Citigroup, Bank of America was one of the first financial institutions to receive substantial infusions of government capital. Treasury invested $15 billion in the company under the CPP on

[66] *See* Citigroup Second Quarter 2009 Report, supra note 48, at 10, 36; see also Section E, infra, which discusses financial projections for Citigroup made by the Federal Reserve and Citigroup.

October 28, 2008 and another $10 billion under the same program on January 9, 2009.[67]

On September 15, 2008, Bank of America announced plans to buy Merrill Lynch. At the time, Merrill Lynch was already experiencing significant losses.[68] Those losses continued to mount, largely due to declining asset prices.[69]

Despite apparent misgivings,[70] Bank of America chose to complete the merger, which was finalized in January 2009. Soon thereafter, CEO Kenneth Lewis requested further federal assistance in order to cope with larger-than-expected losses at both Merrill Lynch and Bank of America.[71] Federal officials agreed and, as they had done with Citigroup, they decided to offer Bank of America two additional forms of aid.[72] First, Treasury agreed to purchase $20 billion of preferred stock from Bank of America under the TIP.[73] Second, Treasury, the Federal Reserve, and the FDIC agreed to guarantee "an asset pool of approximately $118 billion of loans, securities backed by residential and commercial real estate loans, and other such assets[.]"[74] Most of these assets were acquired by Bank of America in the Merrill Lynch acquisition.

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[67] *See* October 30 TARP Transactions Report, *supra* note 27.

[68] See Emergency Capital Injections, *supra* note 30, at 7–8.

[69] Public Broadcasting Service, *Interview: John Thain* (Apr. 17, 2009) (online at www.pbs.org/wgbh/pages/frontline/breakingthebank/interviews/thain.html) (former CEO of Merrill Lynch stating Merrill's "operating losses were almost entirely from existing positions and from the market dislocations that were occurring in that environment.").

[70] On December 17, 2008, Bank of America CEO Kenneth Lewis informed Treasury and the Federal Reserve that, in his view, the substantial losses suffered by Merrill Lynch could justify invocation of the "material adverse change" clause in the merger agreement between Bank of America and Merrill Lynch. In response, federal officials told Mr. Lewis that such action would be "ill advised, would likely be unsuccessful, and could potentially destabilize Merrill Lynch, Bank of America, and the broader financial markets." Then-Treasury Secretary Paulson asked Mr. Lewis to take no action immediately and to allow the government to consider its options. On December 21, 2008, Mr. Lewis reiterated his view that Bank of America would be justified in invoking the material adverse change clause. House Oversight and Government Reform Committee, Subcommittee on Domestic Policy. Testimony of Mr. Kenneth D. Lewis, *Bank of America and Merrill Lynch: How Did a Private Deal Turn Into a Federal Bailout?*, 111th Cong., (June 11, 2009) (online at oversight.house.gov/story.asp?ID=2474); Emergency Capital Injections, *supra* note 30.

The Panel notes that there has been widespread speculation as to the possibility of a "deal" between Bank of America and the U.S. government, under which the bank would acquire Merrill Lynch and instead receive the opportunity to obtain the guarantee. This speculation also includes numerous questions about the acquisition and whether government officials exerted pressure on Bank of America to complete the acquisition. While they raise interesting policy questions, these issues are beyond the scope of the Panel's report. These issues are, however, the subject of investigations by the House Oversight and Government Reform Committee, the Securities and Exchange Commission, and the Office of New York State Attorney General Andrew Cuomo. On Thursday, April 23, 2009, Attorney General Cuomo sent a letter to congressional leaders, including Chair Elizabeth Warren of the Congressional Oversight Panel, discussing legal issues relating to corporate governance and disclosure practices at Bank of America. In addition, SIGTARP released a recent audit discussing the basis for the decision by Treasury, the Federal Reserve Board, and FDIC to provide Bank of America with additional assistance. *See* Emergency Capital Injections, *supra* note 30.

[71] *See* Emergency Capital Injections, *supra* note 30, at 26–28.

[72] *See* Emergency Capital Injections, *supra* note 30, at 30 (reporting that federal officials decided to offer additional assistance to Bank of America to "help ensure that the bank remained a viable financial institution after the merger and to avert what they thought could be another market-destabilizing event").

[73] Board of Governors of the Federal Reserve System, *Treasury, Federal Reserve, and the FDIC Provide Assistance to Bank of America* (Jan. 16, 2009) (online at www.federalreserve.gov/newsevents/press/bcreg/20090116a.htm).

[74] *Id.* In contrast to the Citigroup pool of assets, much of Bank of America's asset pool was derivatives, a different type of security which was very difficult to value and which made efforts to reach a definitive agreement more challenging.

ii. Structure of the Guarantee

A Provisional Term Sheet was drafted reflecting the outlines of Bank of America's asset guarantee agreement.[75] The Bank of America guarantee resembled the Citigroup guarantee in many ways and the parties acknowledge that this was the intention. According to the Provisional Term Sheet, Bank of America would absorb initial losses in the guaranteed pool up to $10 billion. Bank of America would then absorb 10 percent of any losses in excess of that amount, while the federal government would absorb the remainder of the losses.[76] Specifically, Treasury's AGP Program and the FDIC would absorb the first $10 billion in federal liability (with Treasury absorbing 75 percent and the FDIC absorbing 25 percent of that $10 billion loss), while the Federal Reserve would cover any further federal liability by way of a non-recourse loan to Bank of America.[77] The guarantee would run for up to 10 years for residential assets and five years for non-residential assets. Bank of America, however, could terminate the guarantee at any time subject only to the consent of the government and "an appropriate fee or rebate in connection with any permitted termination." [78]

In exchange for this guarantee, the Federal Reserve would receive a commitment fee, while Treasury and the FDIC collectively would receive (1) $4 billion of preferred stock paying dividends at 8 percent; and (2) warrants to purchase Bank of America stock in an amount equal to 10 percent of the total amount of preferred shares (i.e., $400 million).[79] The Provisional Term Sheet explicitly acknowledged that this fee arrangement could be revised in light of any later modifications to the guaranteed pool.[80]

The parties never agreed upon a finalized term sheet.

iii. The Guaranteed Pool

According to Treasury, the pool of Bank of America assets that the federal government agreed in principle to guarantee consisted primarily of derivatives—specifically, credit default swaps—most of which Bank of America acquired when it merged with Merrill Lynch. Bank of America proposed a list of assets to be covered by the guarantee, and the agencies and Pacific Investment Management Company (PIMCO) performed an initial loss estimate on the assets. The Federal Reserve Board hired Ernst & Young to "filter" the assets. The asset pool also included (in descending order of value) commercial real estate loans, corporate loans, residential loans, certain investment securities, and collateralized debt obligations.[81] Treasury estimated on a preliminary basis that the asset

[75] *See generally* U.S. Department of the Treasury, *Summary of Terms: Eligible Asset Guarantee* (Jan. 15, 2009) (online at www.treas.gov/press/releases/reports/011508BofAtermsheet.pdf) (hereinafter "Bank of America Provisional Term Sheet").

[76] This is different from the Citigroup guarantee structure. In particular, Citibank must first absorb $39.5 billion in losses compared to $10 billion by Bank of America.

[77] *See* Bank of America Provisional Term Sheet, *supra* note 75, at 2; *see also* Congressional Oversight Panel, *June Oversight Report: Stress Testing and Shoring Up Bank Capital,* at 15 n.41 (June 9, 2009) (hereinafter "COP June Oversight Report").

[78] Bank of America Provisional Term Sheet, *supra* note 75, at 1.

[79] The Bank of America Provisional Term Sheet also appeared to contemplate that Bank of America, like Citigroup, would be subject to guidelines related to corporate governance, asset management, dividend disbursement and executive compensation. *See* Bank of America Provisional Term Sheet, *supra* note 75, at 2–3.

[80] *See* Bank of America Provisional Term Sheet, *supra* note 75, at 3.

[81] Treasury conversations with Panel staff (Oct. 22, 2009).

pool comprised 72 percent derivatives (including credit default swaps), 15 percent loans and 13 percent securities.[82] This pool conforms to the description of eligible assets as contained in the January 15, 2009 term sheet.[83]

iv. Termination of the Guarantee

On May 6, 2009, Bank of America notified the federal government that it wished to terminate ongoing negotiations surrounding the as-yet-unfinalized guarantee, stating the market conditions had improved such that the guarantee agreement was no longer necessary.[84] The parties proceeded to negotiate a fee to compensate the government.[85]

Initially, Bank of America maintained that it owed the government only its fees and expenses because the government suffered no losses, Bank of America received no quantifiable benefit, and the agreement was never finalized. The government disagreed, asserting that it should be reimbursed for the fees contemplated by the Provisional Term Sheet, including the value of the preferred shares, the warrants, the dividends, and the commitment fee.[86] The government conceded, however, that the fee should be adjusted to reflect (1) the parties' agreement to set the value of the guaranteed asset pool at $83 billion as opposed to $118 billion;[87] and (2) the abbreviated time period between the announcement of the guarantee and Bank of America's decision to terminate the guarantee.

One key issue in determining the amount of the fee was determining what would constitute the full duration of the anticipated guarantee, since it would have run 10 years for residential assets and five years for non-residential assets. The parties eventually agreed to base the fee on a 5.7 year duration for the full guar-

[82] *Id.*

[83] Bank of America Provisional Term Sheet, *supra* note 75, at 1 (describing the eligible assets as "financial instruments consisting of securities backed by residential and commercial real estate loans and corporate debt, derivative transactions that reference such securities, loans, and associated hedges, as agreed, and such other financial instruments as the U.S. government has agreed to guarantee or lend against (the Pool)").

[84] *See* House Committee on Oversight and Government Reform, Testimony of Federal Reserve Chairman Ben S. Bernanke, *Acquisition of Merrill Lynch by Bank of America,* at 3 (June 25, 2009) (online at oversight.house.gov/documents/20090624185603.pdf) (explaining that Bank of America chose to terminate the guarantee agreement because "Bank of America now believes that, in light of the general improvement in the markets, this protection is no longer needed").

[85] Even though no agreement had been memorialized in writing and the parties were still negotiating certain terms (i.e., there was no explicit guarantee) both Bank of America and the government issued press releases stating the intent to enter such agreement.

[86] Treasury conversations with Panel staff (Sept. 30, 2009).

[87] The pool was reduced for two reasons. First, the parties agreed to reduce the pool by $14 billion after the Provisional Term Sheet was signed to account for assets that were already insured and which Bank of America believed were being undervalued. Treasury conversations with Panel staff (Oct. 19, 2009). Second, at the time Bank of America decided to terminate, the parties had not yet reached agreement regarding the eligibility of losses on other assets worth approximately $42 billion. Thus, the parties accounted for the uncertainty surrounding the latter assets by reducing the size of the pool by an additional $21 billion (that is, 50 percent of $42 billion). As a result, for purposes of the Termination Agreement, the parties agreed that the guaranteed asset pool stood at $83 billion ($118 billion − $14 billion − $21 billion = $83 billion). *See* Termination Agreement By and Among Bank of America Corporation, the United States Department of the Treasury, the Board of Governors of the Federal Reserve System, On its Own Behalf and on Behalf of the Federal Reserve System, and the Federal Deposit Insurance Corporation, Schedule A, at 2 (Sept. 21, 2009) (hereinafter "Termination Agreement") (online at online.wsj.com/public/resources/documents/BofA092109.pdf).

antee,[88] reflecting the fact that a large proportion of the asset pool was non-residential assets.

Ultimately, Bank of America agreed to pay $425 million to terminate the guarantee,[89] broken down as follows:

- $159 million for the preferred shares, $119 million of which was allocated to Treasury and $40 million of which was allocated to the FDIC.[90]
- $140 million for the warrants, $105 million of which was allocated to Treasury and $35 million of which was allocated to the FDIC.[91]
- $69 million for foregone dividends on the preferred shares, $52 million of which was allocated to Treasury and $17 million of which was allocated to the FDIC.[92]
- $57 million to the Federal Reserve for the commitment fee contemplated by the Provisional Term Sheet.[93]

All told, Treasury received $276 million, the Federal Reserve received $57 million, and the FDIC received $92 million from Bank of America.

2. Treasury's Temporary Guarantee Program for Money Market Funds

a. Background

A money market fund (MMF) is a type of mutual fund that invests only in highly-rated, short-term debt instruments.[94] Government funds invest primarily in government securities such as U.S. Treasuries, while prime funds invest primarily in non-government securities such as the commercial paper (i.e., short-term debt) of businesses. Investors use MMFs as a safe place to hold short-term funds that may pay higher interest rates than a bank account. Unlike bank deposits, however, MMFs traditionally have not been insured, nor is a fund's sponsor legally obligated to provide support.[95]

MMFs are structured to be highly liquid and protect principal by maintaining a stable net asset value (NAV) of $1.00 per share.[96] If the securities that a fund holds decrease in value, the MMF's

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[88] Treasury stated it anticipated losses would increase during the later part of the program, thereby increasing its risk exposure over time. Thus, Treasury believes that 5.7 years was a fair term for the time based proration. Treasury conversations with Panel staff (Oct. 22, 2009).

[89] Termination Agreement, *supra* note 87, at 2.

[90] Termination Agreement, *supra* note 87, at 2.

[91] The value of the warrants was calculated using the Black-Scholes method on the basis of a $13.30 strike price, which was the price of Bank of America shares on the day it received TIP funds. Termination Agreement, *supra* note 87, at 2.

[92] Termination Agreement, *supra* note 87, at 2.

[93] Termination Agreement, *supra* note 87, at 1.

[94] According to SEC regulations, MMFs may invest in debt instruments including government securities, certificates of deposit, commercial paper of companies, Eurodollar deposits, and repurchase agreements. 17 C.F.R. 270.2a–7 (2008) (SEC Rule 2a–7).

[95] To preserve its business interests, a fund's sponsor may seek SEC approval to purchase underperforming securities at par or provide guarantees agreeing to cover that security at par. This is sometimes referred to as "parental support." Since July 2007, around one-third of the top U.S. MMFs have received sponsor support to shore up their operations. *See* Bank for International Settlements, *US Dollar Money Market Funds and Non-US Banks,* BIS Quarterly Review, at 68–69 (Mar. 2009) (hereinafter "BIS, US Dollar Money Market Funds and Non-US Banks") (online at www.bis.org/publ/qtrpdf/r_qt0903.pdf); *see also* Mercer Bullard, *Federally Insured Money Market Funds and Narrow Banks the Path of Least Insurance* (Mar. 2, 2009) (online at papers.ssrn.com/sol3/papers.cfm?abstract_id=1351987) (hereinafter "Bullard, Federally-Insured Money Market Funds").

[96] U.S. Securities and Exchange Commission, *Net Asset Value* (Mar. 26, 2009) (online at www.sec.gov/answers/nav.htm).

NAV may drop below $1.00.[97] In this case, the MMF is said to have "broken the buck," a "rare and significant event" given the widespread perception of the safety of these funds.[98]

Leading into July 2007, as the credit crisis intensified, investment managers reallocated their portfolios away from riskier pooled investment funds and into MMFs.[99] Between July 2007 and August 2008, more than $800 billion in new capital poured into MMFs.[100] Inflows largely came from institutional investors who favored government funds over prime funds.[101] Both prime funds and government funds generally shifted their holdings away from higher risk investments (e.g., commercial paper) and into lower risk investments, (e.g., Treasury and agency securities).[102]

Stress in the money markets began to emerge by mid-2007 as indicated by spreads between yields on one-month commercial paper of financial companies and Treasury bills. These spreads widened substantially, climbing to nearly 400 basis points at one time.[103] Despite those strains, MMFs continued to maintain stable NAVs of $1.00 per share and honor redemption requests within the seven days in which they must return funds to investors. That changed on September 16, 2008, when the Reserve Primary Fund broke the buck. A day earlier, Lehman Brothers had filed for bankruptcy. Because of the Reserve Primary Fund's exposure to Lehman's short-term debt, its NAV fell to $0.97 per share.[104] This event quickly triggered a broad-based run of investor redemptions in prime funds and the reinvestment of capital into government funds.[105] On September 15, 2008, redemption orders for the Reserve Primary Fund totaled $25 billion. Over the next two days, contagion spread. Although no other fund's NAV dipped below $1.00 per share, investors liquidated $169 billion from prime funds and reinvested $89

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[97] *See* Bullard, Federally-Insured Money Market Funds, *supra* note 95, at 8 ("A decline of 0.51 percent in the value of an MMF's holdings lowers its per share value to $0.9949, which rounds down to a per share price of $0.99.").

[98] *See* Emergency Capital Injections, *supra* note 30. Sponsor support has historically prevented MMFs from "breaking the buck." Prior to the Reserve Primary Fund event discussed *infra*, only one other fund in 30 years had done so. *See, e.g.,* BIS, US Dollar Money Market Funds and Non-US Banks, *supra* note 95. In 1994, the Community Bankers US Government Fund (US Government Fund) became the first MMF in history to "break the buck." *See* Investment Company Institute, *Report of the Money Market Working Group,* at 39 (Mar. 17, 2009) (online at www.ici.org/pdf/ppr_09_mmwg.pdf) (hereinafter "ICI Money Market Working Group Report"). US Government Fund had invested a large percentage of its assets in risky derivatives. *See* Saul S. Cohen, *The Challenge of Derivatives,* 63 Fordham L. Rev. 1993, 1995 n.15 (1995) (internal citations omitted). The fund's "breaking the buck" caused widespread concern by anxious investors. Sharon R. King, *After Fund's Death, Managers Reassure Municipal Investors* (Oct. 3, 1994) (online at www.americanbanker.com/issues/159_115/-47018-1.html). Many fund executives took defensive measures such as sending investors flyers explaining the company's guidelines on monitoring derivatives investments and education brochures on derivatives. *Id.* Although they assured investors US Government Fund was an "isolated incident," executives nevertheless declined to comment on the record for fear of publicity causing heightened concern among investors. Investors ultimately received $0.96 per share. *Id.*

[99] *See* ICI Money Market Working Group Report, *supra* note 98 (this partly reflects industry trends whereby, "institutional share classes of money market funds typically see strong inflows when the Federal Reserve lowers short-term interest rates, as they did after July 2007.").

[100] ICI Money Market Working Group Report, *supra* note 98.

[101] See BIS, US Dollar Money Market Funds and Non-US Banks, *supra* note 95, at 70.

[102] *See* BIS, US Dollar Money Market Funds and Non-US Banks, *supra* note 95, at 70.

[103] *See* ICI Money Market Working Group Report, *supra* note 98, at 50.

[104] *See* Emergency Capital Injections, *supra* note 30, at 9; BIS, US Dollar Money Market Funds and Non-US Banks, *supra* note 95. Primary held $785 million in Lehman short-term debt, meaning that 1.2 percent of its assets were in Lehman debt.

[105] *See* BIS, US Dollar Money Market Funds and Non-US Banks, *supra* note 95, at 72 (reflecting the events set off "broad-based but selective shareholder redemptions, like a bank run . . .").

billion into government funds.[106] By September 19, 2008, withdrawal requests had climbed to 95 percent of the Reserve Primary Fund's $62 billion portfolio, necessitating approval from the SEC to delay redemption payments beyond the seven-day requirement.[107]

In normal markets, MMFs can liquidate their holdings to meet investors' withdrawal requests. The events of the previous days, however, had brought the commercial paper market to a virtual standstill.[108] Credit spreads on commercial paper relative to U.S. Treasuries rose significantly.[109] In the distressed market, MMFs could not sell their commercial paper to meet investor redemptions, nor could corporations and financial institutions easily access the market for their financing needs.[110]

On September 19, 2008, two weeks before EESA was signed into law, Treasury announced the TGPMMF. Treasury relied on the Exchange Stabilization Fund (ESF) to fund the TGPMMF.[111] The program's stated purpose was to "enhance market confidence by alleviating investors' concerns about the ability of money market mutual funds to absorb losses."[112] According to Treasury, the TGPMMF was intended specifically to "stop a run on money market mutual funds in the wake of the failure of Lehman Brothers" and to alleviate concerns regarding the industry because MMFs "are an important investment vehicle for many Americans and a fundamental source of financing for our capital markets and financial institutions. Maintaining confidence in the money market mutual fund industry is critical to protecting the integrity and stability of the global financial system."[113]

After two extensions, the TGPMMF expired on September 18, 2009.[114]

Treasury's launch of the TGPMMF was coordinated with Federal Reserve Board initiatives focused on preventing the collapse of, and restoring health to, the commercial paper market. These efforts in-

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[106] *See* Appendix, Figure 12; *see* BIS, US Dollar Money Market Funds and Non-US Banks, *supra* note 95, at 72.

[107] Securities and Exchange Commission, *In the Matter of The Reserve Fund, On Behalf of Two of Its Series, the Primary Fund and the U.S. Government Fund* (Sept. 22, 2008) (online at www.sec.gov/rules/ic/2008/ic-28386.pdf).

[108] Collectively, MMFs carry a concentrated share of the commercial paper market. Consequently, when MMFs shift away from these securities and into safer ones (as discussed *infra*), funding liquidity for commercial paper issuers can be affected and their cost of capital can rise. *See* BIS, US Dollar Money Market Funds and Non-US Banks, *supra* note 95, at 69 ("MMFs held nearly 40% of the outstanding volume of CP in the first half of 2008."); *see* also Senior Supervisors Group, *Risk Management Lessons from the Global Banking Crisis of 2008,* at 13 (Oct. 2009) (hereinafter "Senior Supervisors Group") (online at www.occ.treas.gov/ftp/release/2009-125b.pdf) ("Firms indicated that most of the [MMF] sector would not invest in unsecured commercial paper of financial institutions and would provide funds only rarely, on an overnight basis and at extremely high cost.").

[109] *See* Appendix, Figure 14.

[110] *See* Senior Supervisors Group, *supra* note 108, at 12–13.

[111] The ESF, which is controlled by the Secretary of the Treasury, holds U.S. dollars, foreign currencies, and Special Drawing Rights (SDR). It is typically used to purchase or sell foreign currencies, to hold U.S. foreign exchange and SDR assets, and to provide financing to foreign governments pursuant to the requirements of 31 U.S.C. § 5302. *See* U.S. Department of the Treasury, *Exchange Stabilization Fund: Introduction* (Aug. 6, 2007) (online at www.treas.gov/offices/international-affairs/esf/). Treasury's legal authority to use the ESF in this way is discussed *supra* in section H.

[112] Next Phase Report, *supra* note 49, at 46.

[113] Next Phase Report, *supra* note 49, at 46.

[114] *See* Next Phase Report, *supra* note 49, at 46; U.S. Department of the Treasury, *Treasury Announces Extension of Temporary Guarantee Program for Money Market Funds* (Nov. 24, 2008) (online at www.treas.gov/press/releases/hp1290.htm); U.S. Department of the Treasury, *Treasury Announces Extension of Temporary Guarantee Program for Money Market Funds* (Mar. 31, 2009) (online at www.treas.gov/press/releases/tg76.htm).

cluded the launch of the Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility (AMLF), which grants non-recourse loans to financial institutions to purchase asset-backed commercial paper from MMFs,[115] and the Commercial Paper Funding Facility (CPFF), which purchases three-month unsecured commercial paper directly from eligible issuers.[116]

One Treasury intervention in the MMF market occurred outside the TGPMMF.[117] On November 20, 2008, Treasury announced that it would serve as the buyer of last resort to facilitate an "orderly and timely" liquidation of the Reserve Fund's U.S. Government Fund (USGF).[118] Contagion caused by the Reserve Primary Fund led investors to request redemptions equaling 60 percent of USGF's $10 billion portfolio.[119] The SEC had permitted Reserve Fund to suspend share redemptions in the USGF.[120] A November 19, 2008 letter agreement between Treasury and Reserve Fund granted USGF a 45-day window to continue to sell its assets, at or above their amortized cost, to raise capital for investor redemptions.[121] At the conclusion of this period, Treasury agreed to purchase from its ESF "any remaining securities at amortized cost, up to an amount required to ensure that each shareholder receives $1 for every share they own." [122] A sizeable portion of USGF's assets consisted of variable- and floating-rate agency securities,[123] which compounded the difficulty in meeting investor redemption requests. In the constrained market, "borrowings with variable interest rates [were] particularly unattractive" to investors, and Treasury was reportedly concerned that the problems with the USGF "could tip the market for agency debt into an even worse condition if it sold its assets at steep discounts." [124]

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[115] Board of Governors of the Federal Reserve System, *Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility* (Sept. 2, 2009) (online at www.federalreserve.gov/monetarypolicy/abcpmmmf.htm).

[116] Federal Reserve Board of New York, *Commercial Paper Funding Facility* (online at www.federalreserve.gov/monetarypolicy/20081021a.htm) (accessed Oct. 29, 2009). The Federal Reserve also announced the creation of the Money Market Investor Funding Facility (MMIFF), which was designed to provide senior secured funding to facilitate the private-sector purchase of eligible assets from eligible investors, but was never used and terminated on October 30, 2009. *See* Federal Reserve Bank of New York, *Money Market Investor Funding Facility: Program Terms and Conditions* (online at www.newyorkfed.org/markets/mmiff_terms.html) (accessed Oct. 29, 2009); Board of Governors of the *Federal Reserve System, Federal Reserve Statistical Release* (online at www.federalreserve.gov/releases/h41/) (accessed Oct. 29, 2009) (weekly H.4.1 releases showing zero balances for MMIFF).

[117] Treasury's position with respect to this point is discussed below. *See infra* note 2(c).

[118] U.S. Department of the Treasury, *Treasury Enters Into Agreement To Assist the Reserve Fund's US Government Money Market Fund* (Nov. 20, 2008) (online at www.treas.gov/press/releases/hp1286.htm) (hereinafter "Treasury Reserve Fund Release").

[119] *See* Diya Gullapalli, *Treasury Will Help Liquidate Reserve Fund,* Wall Street Journal (Nov. 21, 2008) (online at online.wsj.com/article/SB122722728577846211.html).

[120] *See* U.S. Securities and Exchange Commission, *Investment Company Act of 1940 Release No. 28386* (Sept. 22, 2008) (online at www.sec.gov/rules/ic/2008/ic-28386.pdf).

[121] *See* Treasury Reserve Fund Release, *supra* note 118.

[122] *See id.*

[123] *See* U.S. Department of the Treasury, *Letter Agreement Relating to the Guarantee Agreement, Dated as of September 19, 2008, Between the Treasury and The Reserve Fund,* at 25–26 (Nov. 19, 2008) (online at www.treas.gov/press/releases/reports/reservefundletteragreement.pdf) (hereinafter "Treasury-Reserve Fund Letter Agreement") (listing USGF portfolio investments in Fannie Mae, Federal Farm Credit Bank, Federal Home Loan Bank, and Federal Home Mortgage Corp.).

[124] *See* Diya Gullapalli, *Treasury Will Help Liquidate Reserve Fund* (Nov. 21, 2008) (online at online.wsj.com/article/SB122722728577846211.html). The presence of a substantial number of illiquid assets with relatively long maturities in a government MMF is attributable to an SEC provision that allows a fund to use the interest rate reset date of variable- and floating-rate securities (VROs), rather than the security's final maturity or demand date in calculating a fund's maximum dollar-weighted average portfolio maturity (WAM), which must be less than

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On January 15, 2009, Treasury purchased the remaining $3.6 billion of securities from the USGF pursuant to the letter agreement.[125] Although the USGF participated in the TGPMMF, and, while this asset purchase did not represent a claim under the TGPMMF, it appears Treasury provided support to this fund in order to prevent a TGPMMF claim. At the time Treasury purchased USGF securities in January, the market value was below the purchase price due to market illiquidity.[126] Because Treasury likely purchased the USGF assets at an amount above their market value, it provided a subsidy to the Reserve Fund equivalent to the difference. Treasury has informed Panel staff that the assets were all highly-rated GSE securities, posing a very low risk of default, and that the last of the assets are expected to reach maturity in November 2009 without incurring any losses to Treasury.

b. Structure of the Guarantee

The TGPMMF was a voluntary program; Treasury allowed all publicly offered MMFs meeting certain criteria to participate.[127] Participating MMFs were required to sign guarantee agreements with the federal government and to pay fees, as discussed below. Under the guarantee, payments would be triggered by a "guarantee event," which occurred if the NAV of an MMF fell below $0.995, unless promptly cured.[128] If a guarantee event did occur, Treasury would use the ESF to ensure that investors in that MMF would receive $1.00 per covered MMF share up to the extent of their holdings in that MMF on September 19, 2008.[129] A guarantee event would result in the liquidation of the MMF.

Coverage under the TGPMMF was capped at an investor's holding in a participating MMF account on September 19, 2008.[130] Thus, if an investor had purchased additional interests in a partici-

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90 days. SEC Rule 2a–7(c)(2) & (d)(1). The SEC has proposed amendments to this rule. See Money Market Fund Reform, 74 Fed. Reg. 32688 at 32701, 32738–39 (proposed July 8, 2009) (to be codified at 17 C.F.R. pts. 270 & 274) (online at www.sec.gov/rules/proposed/2009/ic-28807fr.pdf) (hereinafter "SEC Proposed Money Market Fund Reform Rule") (applying maturity/demand date for long-term (397 days or less) variable and long-term floating rate securities but preserving reset date rule for comparable short-term securities).

[125] *See also* U.S. *Department of the Treasury, Department of Treasury Fiscal Year 2010 Budget Request,* at 975–76 (online at www.whitehouse.gov/omb/budget/fy2010/assets/tre.pdf) (accessed Oct. 22, 2009); U.S. Department of the Treasury, *Exchange Stabilization Fund Policy and Operations Statements Fiscal Year 2008,* at 27 (online at www.treas.gov/offices/international-affairs/esf/congress_reports/final_22509wdc_combined_esf_auditreports.pdf) (accessed Nov. 2, 2009).

[126] Treasury has provided Panel staff with a list of the securities purchased by Treasury from the USGF, which includes their market value ($3,618,533,450), amortized cost ($3,625,000,000), and purchase price as of January 14, 2009 ($3,629,795,815). See Treasury-Reserve Fund Letter Agreement, *supra* note 123, at 25 (showing similar narrow spreads (about 0.2 percent) as of November 14, 2008, between market value and amortized cost for a pool of USGF securities including securities later purchased by Treasury). The difference between the purchase price and amortized cost is attributable to $4.795 million of interest received on the securities as of that date.

[127] Specifically, the TGP was open to all money market funds: (1) registered under the Investment Company Act of 1940; (2) offering securities registered under the Securities Act of 1933; (3) operating under a policy of maintaining a stable NAV or share price of $1.00 per share; and (4) operating in compliance with Rule 2a–7 under the Investment Company Act of 1940. In addition, any MMF wishing to participate in the Program was required to have a market-based NAV of at least $0.995 per share on September 19, 2008. U.S. Department of the Treasury, *Summary of Terms for the Temporary Guaranty Program for Money Market Funds,* at 1 (online at www.treas.gov/offices/domestic-finance/key-initiatives/money-market-docs/TermSheet.pdf) (accessed Nov. 2, 2009) (hereinafter "TGP Term Sheet").

[128] *See* TGP Term Sheet, *supra* note 127 at 1; U.S. Department of Treasury, *Guarantee Agreement*, at 4 (Sept. 19, 2008) (hereinafter "Treasury Guarantee Form Agreement") (accessed Nov. 2, 2009) (online at www.treas.gov/offices/domestic-finance/key-initiatives/money-market-docs/Guarantee-Agreement_form.pdf).

[129] *See* Section D; *see generally* TGP Term Sheet, *supra* note 127.

[130] *See generally* TGP Term Sheet, *supra* note 127.

pating MMF after September 19, 2008, those interests would not be insured by the MMF.[131] Similarly, if an investor subsequently sold shares in a participating MMF and owned a lesser amount at the time of a guarantee event, the lesser amount would be covered.[132]

Additionally, the guarantee agreements specifically limited aggregate coverage to the amount of funds available in the ESF on the date of a guarantee event, with investor claims in excess of available funds subject to pro-ration.[133]

c. Participation Fees

Funds participating in the program paid fees based on their NAV as of September 19, 2008.

• For the period between September 19, 2008 and December 18, 2008, funds whose NAV per share was greater than or equal to $0.9975 paid a fee equal to the number of outstanding shares multiplied by 0.00010.[134] For funds whose NAV per share was less than $0.9975, the fee was the number of outstanding shares multiplied by 0.00015.[135]

• For the period between December 19, 2008 and April 30, 2009, the fee for funds with NAV per share greater than or equal to $0.9975 equaled the number of outstanding shares multiplied by

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[131] *See* U.S. Department of the Treasury, *Frequently Asked Questions About Treasury's Temporary Guarantee Program for Money Market Funds* (Sept. 29, 2009) (online at www.ustreas.gov/press/releases/hp1163.htm) (hereinafter, "Treasury TGP FAQ"). The MMF trade association, the Investment Company Institute (ICI), stated that Treasury originally proposed to impose a broader guarantee of the industry, and the ICI successfully urged Treasury to limit coverage to the amount in investors' shareholder accounts as of September 19, 2008 to reduce opportunities for arbitrage and to prevent the possibility of large flows in and out of MMFs upon implementation and expiration of the TGP. *See* Paul Schott Stevens, President and CEO, ICI, *Remarks at ICI's 2008 Equity, Fixed-Income & Derivatives Markets Conference* (Oct. 6, 2008) (online at www.ici.org/policy/regulation/products/mutual/08_equity_stevens_spch); Investment Company Institute, 2009 *Annual Report to Members* (forthcoming).

[132] *See* Treasury TGP FAQ, *supra* note 131. Treasury's implementation of the TGP goes beyond the scope of any insurance offered by the private market for MMFs. In 1998, the ICI Mutual Insurance Company, a captive insurance company, offered its members a limited insurance product designed to protect participating funds against default risk arising from issuer payment default, insolvencies, and other credit-related events but not against interest rate risk or market illiquidity. *See* U.S. Securities and Exchange Commission, Division of Investment Management (July 27, 1998), Ref No. 98–441–CC, ICI Mutual Insurance Company, File No. 132–3 (online at www.sec.gov/divisions/investment/noaction/1998/icimutual072798.pdf). According to an industry source, its insurance coverage was limited to $50 million with premiums set by portfolio risk, and a similar limited insurance product was offered by non-captive insurance providers. Industry participation in private insurance arrangements was never extensive, and the products were discontinued after several years because relatively high premiums in a low interest rate environment made use economically unattractive.

[133] *See* TGP Term Sheet, *supra* note 127; see Section D, *infra.* Because the balance of the ESF hovered around $50 billion, a relatively large cascading set of fund failures—precisely the sort that the program was designed to prevent—would have to occur before otherwise eligible claimants would be subject to pro-rationing of claims. And this possibility was further mitigated when Section 131 of EESA compelled Treasury to replenish the ESF when it was depleted by program claims. EESA § 131(a). According to Treasury, it would not have been permitted to replenish the ESF with TARP funds because TARP funds can only be used to purchase or guarantee "troubled assets." COP August Oversight Report, *supra* note 45, at 127–129 (reprinting "Letter from Treasury Secretary Timothy Geithner to COP Chair Elizabeth Warren" dated July 21, 2009 (hereinafter "Geithner Letter to Warren")); EESA § 115. Thus, according to Treasury, had it been required to replenish ESF funds, it would have had to do so pursuant to Section 118 of EESA, which authorizes Treasury to sell "any securities issued under chapter 31 of title 31" for the purpose of carrying out "the authorities granted in this Act." EESA § 118. Thus, in Treasury's view, the TGP could not and did not involve the use of TARP funds; rather, it involved ESF funds backstopped by other, non-TARP Treasury funds, which were available as "in effect a permanent, indefinite appropriation." Geithner Letter to Warren, *supra* note 133 at 129.

[134] U.S. Department of the Treasury, *Summary of Terms for the Temporary Guaranty Program for Money Market Funds* (online at www.treas.gov/offices/domestic-finance/key-initiatives/money-market-docs/TermSheet.pdf) (accessed Nov. 3, 2009).

[135] *Id.*

0.00015.[136] For funds with NAV per share less than $0.9975, the fee was the number of outstanding shares multiplied by 0.00022.[137]

- For the period between May 1, 2009 and September 18, 2009, the fee was the number of outstanding shares multiplied by 0.00015 for funds whose NAV was greater than or equal to $0.9975.[138] For funds with NAV per share less than $0.9975, the fee was the number of outstanding shares multiplied by 0.00023.[139]

Treasury has explained that the two-tiered fee structure reflects the higher risk of MMFs with NAVs below $0.9975 triggering a TGPMMF claim and that the variation in basis points among program periods indicates a stable fee of 4 or 6 basis points on an annualized basis, the nominal differences of fees reflecting the unequal lengths of the program periods.[140]

d. Scope of the Program

In the initial phase of the TGPMMF, 1,486 MMFs participated, representing over $3.2 trillion or 93 percent of the assets in the MMF market as of September 19, 2008.[141] As liquidity returned to the market and MMFs held less risky commercial paper, fewer funds chose to participate. These figures, however, inflate Treasury's true exposure under the TGPMMF in each program phase because the guarantee is specific to investor accounts in participating funds as of September 19, 2008. There is no exact correlation between a MMF's participation in the TPGMMF and the coverage of its assets by TPGMMF. If an investor sold its shares in the MMF to a new investor (or even transferred his shares between accounts) after September 19, 2008, Treasury was not obligated to guarantee the NAV of the new shareholder's shares even if the MMF continued to participate in the program.[142] It is unclear whether later investors truly understood this important coverage limitation despite a Treasury FAQ on point.[143] Given the cycling in and out of MMF accounts, it is possible that Treasury's exposure was well under $2 trillion by the second extension. Finally, Treasury's practical exposure was even more limited because a majority of the assets in covered accounts were not subject to real credit risk, including Treasury securities and GSE securities, which both had implicit or explicit federal government backing.

[136] U.S. Department of the Treasury, *Temporary Money Market Fund Guarantee Program Extension Announcement,* at 1 (online at treas.gov/press/releases/reports/moneymarketextension.pdf) (accessed Nov. 3, 2009).
[137] *Id.*
[138] U.S. Department of the Treasury, *Temporary Money Market Fund Guarantee Program Extension Announcement,* at 1 (online at www.treas.gov/press/releases/reports/03312009ExtensionAnnouncement.pdf).
[139] *Id.*
[140] Treasury information provided to Panel staff (Nov. 2, 2009). Treasury staff explained that agency officials involved in the initial fee setting were no longer available, and that they were unaware of any memoranda on the topic. *See id.*
[141] *See* Next Phase Report, *supra* note 49, at 46.
[142] *See* Treasury TGP FAQ, *supra* note 131.
[143] *Id.*

FIGURE 3: TGPMMF PARTICIPATION AND PREMIUMS [144]

[Dollars in billions]

Program phase	Participating investment companies [145]	Assets of participating funds	Participating funds' assets as % of MMF market	Premiums collected
Initial phase (9/19/08–12/18/08)	366	$3,217.4	93	$0.3316
First extension (12/19/08–4/30/09)	352	3,118.0	83	0.4817
Second extension (5/1/09–9/18/09)	296	2,470.0	68	0.3865

[144] This chart is based on information provided by Treasury to Panel staff and the Next Phase Report, *supra* note 49, at 46.
[145] 1,486 individual funds participated in the initial phase with many investment companies enrolling multiple MMFs. *See* Next Phase Report, *supra* note 49, at 46.

3. FDIC Guarantees Under the Temporary Liquidity Guarantee Program

The TLGP is an FDIC program intended to promote liquidity in the interbank lending market and confidence in financial institutions. It has two aspects. The DGP guarantees newly issued senior unsecured debt of insured depository institutions and most U.S. holding companies, and the Transaction Account Guarantee Program (TAG) guarantees certain noninterest-bearing transaction accounts at insured depository institutions.[146]

Announced on October 14, 2008, the program was authorized by Section 13(c)(4)(G) of the Federal Deposit Insurance Act, which gives the FDIC the authority to provide assistance following the determination of systemic risk by the Secretary of the Treasury (in consultation with the President), with the recommendation of the Board of Directors of the FDIC and the Federal Reserve Board of Governors.[147]

The DGP automatically enrolled all institutions that were eligible to participate. Institutions had until December 5, 2008 to opt out if they did not want to participate. "Eligible institutions" are FDIC-insured depository institutions, U.S. bank holding companies, U.S. financial holding companies, U.S. savings and loan holding companies, and affiliates of insured depository institutions. The FDIC-insured branches of foreign banks were not included.[148]

Under the terms of the DGP, on the uncured failure of a participating institution to make a scheduled payment of principal or interest, the FDIC will pay the unpaid amount.[149] The FDIC will then make the scheduled payments of principal and interest through maturity. Under the terms of the DGP Master Agreement, the FDIC is subrogated to the rights of the debt holders in any claims against the issuer.[150]

Fees for the program vary by the term of the debt:

- Debt with a maturity of 31 to 80 days carries a fee of 50 basis points annualized.

[146] Final Rule: Temporary Liquidity Guarantee Program, 12 C.F.R. § 370, 73 Fed. Reg. 72244 (Nov. 26, 2008) (online at www.fdic.gov/news/board/08BODtlgp.pdf) (hereinafter "TLGP Final Rule").
[147] *See* Federal Deposit Insurance Act of 1950, Pub. L. No. 81–797, § 13(c)(4)(G); TLGP Final Rule, *supra* note 146. Though the statute can be read as only authorizing assistance to a single institution, the FDIC believes that it is drafted broadly and supports the TLGP.
[148] 12 C.F.R. § 370.2(a)(1). The statutory authority of the program is broad, allowing it to provide guarantees to non-bank financial institutions that are affiliates of insured depository institutions, with the approval of the FDIC.
[149] 12 C.F.R. § 370.3(a).
[150] Federal Deposit Insurance Corporation, *Master Agreement,* at Annex A (online at www.fdic.gov/regulations/resources/TLGP/master.pdf) (accessed Nov. 2, 2009).

• Debt with a maturity of 181 to 364 days carries a fee of 75 basis points annualized.

• Debt maturing in more than one year carries a fee of 100 basis points.

The program did not guarantee debt of less than 30 days' maturity or debt maturing after June 30, 2012.[151] Debt issued after April 1, 2009 carries an annualized surcharge of 10 basis points for insured depository institutions and 20 basis points for other participating entities. There was a cap on the amount of guaranteed debt that an institution could issue.[152]

The program was designed such that it would be funded entirely from its own fees [153] and would require no expenditure of the FDIC or other government funds. As of September 30, 2009, the FDIC had collected $9.64 billion in fees.[154]

The DGP has proved popular among larger financial institutions.[155] Approximately 6,500 institutions, mostly smaller institutions, chose to opt-out.[156] As of September 30, 2009, a total of 89 institutions have $307 billion in outstanding debt under the program.[157] Six issuers raised almost 82 percent of this debt: General Electric Capital, Citigroup, Bank of America, J.P. Morgan, Morgan Stanley, and Goldman Sachs. The research firm SNL Financial (SNL) also found that the DGP saved issuers 39 percent in interest costs: non-TLGP debt carried a weighted average coupon of 3.9 percent, compared to 2.374 percent for TLGP debt.[158] These savings of approximately 1.53 percent, on average, or 153 basis points, are greater than even the highest fees under the current program, 120 basis points. This study evaluated senior debt issued between November 21, 2008 and November 4, 2009. During this time period, $7.1 billion of non-DGP debt was issued, compared to $303.8 billion of DGP debt. All of this non-DGP debt was issued by DGP partici-

[151] Debt maturing after June 30, 2012 was considered long-term non-guaranteed debt. Institutions issuing such debt during the program were required to pay a fee of 37.5 basis points on the maximum debt limit. The FDIC explained that it needed to limit non-guaranteed debt because, "[f]irst, and most importantly, limiting a participating entity's ability to issue non-guaranteed debt reduces the risk of adverse selection—the risk that the participating entity will issue only the riskiest debt with the guarantee . . . [In addition,] limiting a participating entity's ability to issue non-guaranteed debt reduces the possibility of confusion over whether debt is, or is not, guaranteed." TLGP Final Rule, *supra* note 146, at 72255.

[152] *See* 12 C.F.R. § 370.3(b)(1). In general, the cap is set at 125 percent of the institution's unsecured debt outstanding on September 30, 2008 that will mature before June 30, 2009. *See id.*

[153] A guarantee premium is paid each time debt issued by the bank is guaranteed under the TLGP program. The guarantee premium is recorded as a prepaid expense and amortized over the life of the debt into interest expense. Unlike the loss-sharing agreement discussed, *infra,* if the bank defaults on TLGP guaranteed debt, the bank will not record an asset on its books because the FDIC will send the funds for the default amount directly to the holder of the underlying debt (i.e., the creditor to which the debt was issued). Financial Accounting Standards Board, *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others,* FASB Interpretation No. 45 (Nov. 2002) (online at www.fasb.org/cs/ BlobServer?blobcol= urldata&blobtable= MungoBlobs&blobkey= id&blobwhere= 1175818750722&blobheader= application%2Fpdf).

[154] *See* FDIC, September Monthly TLGP Report, *supra* note 8.

[155] See Federal Deposit Insurance Corporation, *Monthly Reports on Debt Issuance Under the Temporary Liquidity Guarantee Program* (May 31, 2009) (online at www.fdic.gov/regulations/resources/tlgp/total_issuance5-09.html). See list of issuers using DGP at Annex A of this report.

[156] Smaller banks do not typically issue debt, so they would have less interest in the program. *See, e.g.,* Federal Deposit Insurance Corporation, *List of Entities Opting Out of the Debt Guarantee Program* (online at www.fdic.gov/regulations/resources/TLGP/optout.html) (accessed on Nov. 2, 2009).

[157] *See* FDIC, September Monthly TLGP Report, *supra* note 8; FDIC written responses to Panel questions (Oct. 30, 2009).

[158] *See* Matt Herb, *Turning off the TLGP Tap: FDIC Says 'Last Call' For Cheap Debt;* SNL Financial (Sept. 18, 2009) (hereinafter "Last Call for TLGP Debt") (online at www2.snl.com/Interactivex/article.aspx?CDID=A-10036796-12080).

pants.[159] According to SNL, no debt was issued by eligible institutions that did not participate in the DGP.[160] Debt issued under the DGP is heavily weighted towards medium term debt. Of the $307 billion currently outstanding under the program, $304 billion has a term of one to three years. Participating institutions issued more medium term and less long term debt than in prior periods, reflecting the attractiveness of the guarantee and the difficulty of raising capital, through either debt or equity, during this time period.[161]

The DGP closed to new issuances of debt on October 31, 2009. The FDIC will continue to guarantee debt issued prior to that date until the earlier of its maturity or June 30, 2012. As discussed in further detail below, the FDIC has established a six-month emergency guarantee facility to be made available to insured institutions and other participants in the DGP.[162] This facility will be available only to institutions that cannot issue debt without the guarantee, and will carry significantly higher fees of at least 300 basis points.[163]

The other part of the TLGP was the TAG. Under the FDIC's deposit insurance program, the FDIC insures deposit accounts up to $100,000. EESA temporarily increased this limit to $250,000.[164] This increase was enacted to improve confidence in the banks as well as to provide additional liquidity to FDIC-insured institutions.[165] Separately, the TAG insures deposits in non-interest bearing accounts to an unlimited amount.[166] Though it covers all depository accounts, this program was intended to benefit business payment processing accounts, such as payroll accounts.[167] Unlike the FDIC deposit insurance program, banks' participation in TAG is voluntary. To participate, banks pay a fee of 10 basis points

[159] *See id.*
[160] *See id.*
[161] Compared to the approximately $308 billion of medium and long term debt issued from 4Q 2008 through 3Q 2009, DGP participants issued:

Time period	**Medium and long term debt**	**Medium term debt**
4Q 2004 through 3Q 2005	$196 billion	$36 billion
4Q 2005 through 3Q 2006	$243 billion	$55 billion
4Q 2006 through 3Q 2007	$227 billion	$108 billion
4Q 2007 through 3Q 2008	$242 billion	$84 billion

These figures are slightly over inclusive, as they include senior debt issued by subsidiaries that would not have been eligible for the TLGP DGP.

[162] The DGP was originally set to expire on June 30, 2009, but the FDIC extended it to October 31, 2009. See Federal Deposit Insurance Corporation, *Extension of Temporary Liquidity Guarantee Program* (Mar. 18, 2009) (hereinafter "TLGP Extension Notice") (online at www.fdic.gov/news/news/financial/2009/fil09014.html); Federal Deposit Insurance Corporation, *Expiration of the Issuance Period for the Debt Guarantee Program, Establishment of Emergency Guarantee Facility* (hereinafter "DGP Expiration Notice") (online at www.fdic.gov/news/board/NoticeSept9no6.pdf) (accessed Nov. 2, 2009).
[163] *See* DGP Expiration Notice, *supra* note 162.
[164] EESA increased the insured limit through December 31, 2009. EESA § 136(a). The increase has since been extended through December 31, 2013. Helping Families Save Their Homes Act of 2009, Pub. L. No. 111–22, § 204.
[165] House Committee on Financial Services, Testimony of Sheila Bair, Chairman, Federal Deposit Insurance Corporation, *Oversight of Implementation of the Emergency Economic Stabilization Act of 2008 and Of Government Lending and Insurance Facilities,* 110th Cong. (Nov. 18, 2008) (online at www.fdic.gov/news/news/speeches/archives/2008/chairman/spnov1808.html).
[166] 12 C.F.R. § 370.4(a).
[167] *See* Federal Deposit Insurance Corporation, *Interim Rule, Temporary Liquidity Guarantee Program* (Oct. 29, 2008) (hereinafter "TLGP Interim Rule") (online at www.fdic.gov/news/board/TLGPreg.pdf) ("The FDIC anticipates that these accounts will include payment-processing accounts, such as payroll accounts, frequently used by an insured depository institution's business customers, and further anticipates that the Transaction Account Guarantee Program will stabilize these and other similar accounts.").

annualized for deposits over $250,000.[168] Though originally scheduled to end on December 31, 2009, TAG has been extended until June 30, 2010. Coverage after December 31, 2009 will carry higher fees; banks must have opted out of the extended coverage by November 2, 2009.[169]

4. Other Programs That Have "Guarantee" Aspects

As discussed above, the federal government designed all of its financial stabilization programs to work together, and the guarantee programs can only be examined in this joint context. Effectively, the entire stabilization program has functioned as a "guarantee" in that the combined efforts of several government entities signaled to the markets and the broader economy that there would be no large-scale failure of the financial system, and that further support would be available to large private financial institutions if necessary. The actions taken to ensure the continued viability of American International Group are just one example.

The Federal Reserve Bank of New York's (FRBNY) Term Asset-Backed Securities Loan Facility (TALF), which was announced on November 25, 2008, is another. It provides non-recourse loans to any participating institution pledging eligible asset-backed securities (ABS) as collateral.[170] This program was designed to stimulate the origination of new ABS at a time when the credit markets were almost entirely frozen.[171] TALF encourages new ABS originations by shifting the risk of declining ABS values to the U.S. government. Although TALF is not a direct guarantee of any financial institution, market, or class of securities, it functions as a guarantee by permitting participating ABS owners to default on their TALF loans without further recourse from the lender, the government. Thus, the FRBNY serves as a quasi-guarantor of the newly issued ABS under TALF.

Another program that had the same effect is the Public-Private Investment Program (PPIP), announced on March 23, 2009 by Treasury in conjunction with the Federal Reserve and the FDIC.[172] PPIP is designed to provide liquidity for legacy assets and assist financial institutions in raising capital.[173] PPIP, as originally envisioned, would address two components: legacy loans and legacy securities. Although the legacy loans program has been postponed,[174]

[168] 12 C.F.R. § 1A370.7(c).

[169] Federal Deposit Insurance Corporation, *Final Rule regarding Limited Amendment of the Temporary Liquidity Guarantee Program to Extend the Transaction Account Guarantee Program with Modified Fee Structure* (Aug. 26, 2009) (online at www.fdic.gov/news/board/aug26no4.pdf).

[170] Board of Governors of the Federal Reserve System, *Press Release for Release at 8:15 a.m. EST* (Nov. 25, 2008) (online at www.federalreserve.gov/newsevents/press/monetary/20081125a.htm).

[171] Federal Reserve Bank of New York, *Term Asset-Backed Securities Loan Facility: Frequently Asked Questions* (online at www.newyorkfed.org/markets/talf_faq.html) (accessed Oct. 30, 2009).

[172] U.S. Department of the Treasury, *Treasury Department Releases Details on Public Private Partnership Investment Program* (Mar. 23, 2009) (online at www.treasury.gov/press/releases/tg65.htm).

[173] *Id.* (stating the goal of PPIP is "to repair balance sheets throughout our financial system and ensure that credit is available to the households and businesses, large and small, that will help drive us toward recovery.").

[174] Federal Deposit Insurance Corporation, *FDIC Statement on the Status of the Legacy Loans Program* (June 3, 2009) (online at www.fdic.gov/news/news/press/2009/pr09084.html). The Legacy Loans Program creates Public-Private Investment Funds (PPIFs) comprised of private equity, public equity, and FDIC-guaranteed debt, and allows participating banks to sell certain existing assets, typically whole loans or pools of loans, into the program. U.S. Department of the Treasury, *Public-Private Investment Program, $500 Billion to $1 Trillion Plan to Purchase*

the legacy securities program continues to move forward. To restart the market for legacy securities, the government provides debt financing from the Federal Reserve under TALF and through matching private capital raised for dedicated funds targeting legacy securities.[175] Although the FDIC provided debt guarantees for investors purchasing legacy loans, the bulk of the government's initiatives under PPIP do not explicitly guarantee legacy assets. Instead, like TALF, PPIP provides a quasi-guarantee to the markets by demonstrating the U.S. government's willingness to subsidize private investments and implement measures to encourage market liquidity.

D. Analysis of the Creation and Structure of the Guarantee Programs

1. AGP Guarantees for Citigroup and Bank of America

a. Treasury's Authority to Create the AGP

Treasury created the Citigroup AGP under Section 102 of EESA, which requires the Secretary, if he creates the TARP, also to "establish a program to guarantee troubled assets originated or issued prior to March 14, 2008, including mortgage-backed securities."[176] The Citigroup AGP raises three questions.[177]

The first is whether the term "guarantee" in Section 102 embraces the AGP. The section prominently and repeatedly uses that term,[178] with no additional definition.[179] The Citigroup AGP is not a classic guarantee; instead it is an insurance contract, a two-way agreement under which Treasury will reimburse Citigroup up to a certain amount if assets within a defined pool lose value.[180]

Section 102 can be read to authorize only classic guarantees[181] or both classic guarantees and insurance-like arrangements. Either would allow an institution to hold real estate-based obligations on its books rather than forcing it to dispose of them at greatly reduced prices, and it is noteworthy that Section 102(c) refers to

Legacy Assets (online at www.treas.gov/press/releases/reports/ppip_whitepaper_032309.pdf) (accessed Nov. 5, 2009).

[175] The Legacy Securities Program pre-selects investment fund managers, who then raise private equity to fund purchases of mortgage backed securities. These managers receive matching TARP money for any amount they raise privately, and are eligible to seek additional TARP funding. *Id.*

[176] EESA § 102(a)(1).

[177] During a discussion with Panel staff, Treasury stated that the Bank of America asset guarantee would have been assigned to the AGP had it been finalized. Treasury conversations with Panel staff (Nov. 4, 2009). Thus, it is reasonable to assume that the Bank of America arrangement would have taken roughly the same form as the Citigroup arrangement, and therefore been subject to the analysis set forth here.

[178] EESA, §§ 102(a)(1), 102(a)(2), 102(a)(3), 102(c)(2), 102(c)(4), 102(d)(3).

[179] As noted in Section B(1), *infra*, a true guarantee involves three parties: the one to whom the original obligation is owed, the person who owes the original obligation, and the guarantor.

[180] Treasury AGP Report, *supra* note 31 at 1.

[181] The only part of the section to speak in terms of a traditional guarantee is section 102(a)(3), which authorizes the Secretary "[u]pon the request of a financial institution . . . to guarantee the timely payment of principal of, and interest on, troubled assets in amounts not to exceed 100 percent of such payments." Under that arrangement, Treasury does agree to pay the financial institution seeking the guarantee if the person obligated to pay the principal and interest does not do so. The Citigroup arrangement, however, operates in terms of write-down values, which may depend on other factors besides the timely payment of principal and interest.

"credit risk," "premiums," and "actuarial analysis," all classic insurance concepts.[182]

It is likely that if there were a litigant with standing to challenge Treasury's interpretation that Treasury would rely on "Chevron deference" but the eventual outcome of such litigation is not clear.[183]

The second question is whether Section 102 authorizes a program limited to "assets held by systemically significant financial institutions that face a high risk of losing market confidence due to a large portfolio of distressed or illiquid assets" and not "made widely available."[184] Here again, the statute grants considerable discretion to Treasury. Thus, although an initial reading of the statute suggests that Congress sought a broad-based program to complement direct bank stabilization efforts,[185] the broad language of Section 102(a)(2) authorizes the Secretary to "develop guarantees of troubled assets and the associated premiums for such guarantees." That language is sufficiently broad to allow design of a program like the AGP, however far it may have been from Congress' original intention.

The third question is whether Treasury has complied with the terms of Section 102 governing the implementation of guarantee programs. Here the answers are less clear, in two important respects:

- Treasury has not "publish[ed] the methodology for setting the premium for a class of troubled assets together with an explanation of the appropriateness of the class of assets for participation in the program established under [Section 102]," despite the requirement of Section 102(c)(2) that it do so.[186] Treasury has explained in discussions with Panel staff that publication of the methodology has been delayed until the full pool of assets subject to the guarantee has been assembled and will be forthcoming when assembly of the pool is complete.[187]
- Section 102(d)(2) requires that "any balance" in the Troubled Assets Insurance Financing Fund "shall be invested by the Secretary in United States Treasury securities, *or kept in cash on hand or on deposit*, as necessary" (emphasis added). The language, coupled with the traditional understanding of premiums as cash payments, would seem to bar Treasury from taking premiums in

[182] In addition, the fund to be created to hold premiums under section 102 is called the "Troubled Assets Insurance Financing Fund," and Sections 116(e)(2) (termination of reporting obligations of GAO) and 121(h)(2) (termination of authority of Special Inspector General for the Troubled Asset Relief Program) speak of "insurance contracts issued under Section 102." Finally, although the titles of statutes generally have a low impact on statutory meaning, Section 102 is entitled "Insurance of Troubled Assets." There is no legislative history suggesting that Congress intended to distinguish between "guaranteeing" and "insuring" troubled assets.

[183] Under the doctrine of *Chevron U.S.A., Inc.* v. *Natural Resources Defense Council, Inc.*, 467 U.S. 837 (1984), a court defers to an agency's interpretation of an ambiguous statute so long as the interpretation is "based on a permissible construction of the statute." *Id.* at 843.

[184] Treasury AGP Report, *supra* note 31. In exercising the authorities granted under EESA, the Secretary is required to "ensur[e] that all financial institutions are eligible to participate in the program, without discrimination based on size, geography, form of organization, or the size, type and number of assets eligible for purchases under [EESA]." EESA § 103(5).

[185] Section 102(c)(2) speaks of the Secretary developing guarantees and premiums "according to the credit risk associated with the particular troubled asset that is being guaranteed."

[186] EESA § 102(c)(2).

[187] For a discussion of pool finalization, see *supra* Section C(1)(a)(iii). This raises the question as to how the premium for covering assets could be set almost a year ago, before the assets to be covered were known. There is, however, a mechanism for revising premiums upwards. Citigroup Master Agreement, *supra* note 35.

the form of preferred stock and warrants. The reason is to assure that the premiums supporting the actuarial risk of liability do not lose value. Preferred stock and warrants do not have the same constant value.

Treasury reads the statute differently. It believes that Section 102 does not limit the form premiums can take; rather it requires only that *cash balances* in the Fund, for example those derived from preferred stock dividends, must be invested in the specified form. It has also explained that if sufficient cash is not on hand to pay claims under the AGP, it will "borrow from the Bureau of the Public Debt through the financing account to pay the claims. This borrowing will be repaid when cash is received from the preferred stock [received as a premium for the guarantee]."

Whichever reading is correct, receipt of premiums in the form of preferred stock and warrants, without a public statement of the methodology used to set premiums, makes it impossible for the public to determine the sufficiency of what has been received to back Treasury's obligation or the potential cost of that obligation. Treasury can ease the uncertainty raised by its interpretation of the operating rules of Section 102 if it publishes its actuarial methodology, carefully protects the value of the assets received as premiums, administers those assets independently of similar assets received in exchange for direct TARP assistance, and, above all, presents the AGP with transparency and clarity in the future.

b. FDIC's Authority To Participate in the AGP

When asked to identify its legal authority for participating in the AGP, the FDIC pointed to Section 13(c)(4)(G) of the Federal Deposit Insurance Act, which gives the FDIC authority to provide assistance "following the determination of systemic risk by the Secretary of the Treasury (in consultation with the President), with the recommendation of the Board of Directors of the FDIC and the Federal Reserve Board of Governors." [188] The FDIC noted, however, that the Secretary made this determination in order to provide the additional assistance to Citigroup, but did not make the determination for Bank of America.[189] While the Panel recognizes that no definitive AGP agreement was ever reached between Bank of America and the three agencies, the lack of the systemic risk determination for Bank of America raises critical questions about the AGP. First, since the statutory provision calls for this determination, the lack of that determination seems to imply that the FDIC had no authority to enter into the Bank of America deal. Second, in various conversations with Panel staff, Treasury has indicated that it called for Bank of America to pay a termination fee for exit from the AGP because, while there was no contract, Bank of America did incur a benefit and the three agencies represented that they were ready and willing to guarantee and share losses that Bank of America might have incurred commencing on the date the AGP was announced. Being ready and willing to backstop any losses, however, implies that all three agencies participating had the legal authority to participate in the AGP from the date of announcement.

[188] FDIC conversations with Panel staff (Oct. 26, 2009).
[189] FDIC conversations with Panel staff (Oct. 26, 2009).

c. Why was additional assistance necessary?

It is not possible to know what would have happened without additional assistance, and it may be some time before the full story is known, if ever. Certainly, the U.S. governmental agencies believed at the time that such assistance was essential, and there is data and anecdotal evidence to support that view. As discussed above, on November 23, 2008, Treasury, the Federal Reserve, and the FDIC responded to Citigroup's request for assistance by providing Citigroup with an additional package of guarantees, capital, and liquidity access.[190] The additional assistance to Citigroup was considered and ultimately approved by the supervisors primarily because of the systemic risk concerns it posed due to its size and significant international presence. Citigroup was an even larger market player than Bank of America.[191] Believing that additional assistance was necessary, Citigroup engaged in discussions with federal regulators during the weekend of November 21–23, and discussed possible options.[192] In addition, Citigroup faced widening credit default swap (CDS) spreads and losses due to write-downs on leveraged finance investments and securities, particularly those in the automobile, commercial real estate, and residential real estate sectors.[193] For example, in October 2008, credit rating agencies considered placing Citigroup and many other TARP-recipient financial institutions on watch for potential credit downgrades. During a period of much fluctuation, Citigroup's stock price fell below $4 per share on November 21, 2008 from a high of over $14 per share just three weeks earlier on November 3, 2008. This constituted a loss of more than two-thirds of Citigroup's market capitalization during those three weeks. Citigroup ultimately incurred a loss of $8.29 billion for the fourth quarter of 2008. Both regulatory and internal Citigroup projections at this time "showed that the firm would likely be unable to pay obligations and meet expected deposit outflows the following week without substantial government intervention that resulted in positive market perception."[194]

For its part, Bank of America incurred its first quarterly loss in more than seventeen years in the fourth quarter of 2008. Bank of

[190] Treasury Citigroup Press Release, supra note 45; Board of Governors of the Federal Reserve, *Report Pursuant to Section 129 of the Emergency Economic Stabilization Act of 2008: Authorization to Provide Residual Financing to Citigroup, Inc. For a Designated Asset Pool* (online at www.federalreserve.gov/monetarypolicy/files/129citigroup.pdf) (hereinafter "Section 129 Report") (accessed Nov. 2, 2009) (noting that the package of additional assistance to Citigroup "will augment the capital of Citigroup; protect the company from further declines in the value of a substantial pool of primary mortgage-related assets; and better enable the company, its subsidiary depository institutions and the financial system to weather the current difficulties, and provide credit and other financial services needed by consumers, small businesses, and others."); Treasury conversations with Panel staff (Oct. 19, 2009).

[191] Treasury conversations with Panel staff (Oct. 19, 2009).

[192] Citigroup conversations with Panel staff (Oct. 26, 2009). It is interesting to note that in discussions with Panel staff, Citigroup personnel, perhaps naturally, emphasized external elements such as market perception and share price, while government officials focused on whether Citigroup could open its doors the following Monday.

[193] Treasury conversations with Panel staff (Oct. 19, 2009); Federal Deposit Insurance Corporation, *Responses to Panel Questions About the AGP* (Oct. 30, 2009) (in its responses, the FDIC noted that "[o]n Friday, November 21, 2008, market acceptance of the firm's liabilities diminished, as the company's stock plunged to a 16-year low, credit default swap spreads widened by 75 basis points to 512.5 basis points, multiple counterparties advised that they would require greater collateralization on any transactions with the firm, and the UK FSA imposed a $6.4 billion cash lockup requirement to protect the interests of the UK broker dealer . . .").

[194] Federal Deposit Insurance Corporation, *Responses to Panel Questions About the AGP* (Oct. 30, 2009); Treasury conversations with Panel staff (Oct. 19, 2009).

America's year-end financial data for 2008 illustrates that these losses were largely due to capital markets losses and rising credit costs caused by the global economic downturn and continued uncertainty in the capital markets.[195] Upon the completion of its acquisition of Merrill Lynch in early January 2009, Bank of America became substantially exposed to losses on Merrill's distressed assets, including significant assets belonging to Merrill Lynch International.[196] The integration of Merrill Lynch's portfolio—a large and complex broker-dealer portfolio—into Bank of America's substantial commercial lending portfolio presented a major challenge.[197] Following the completion of Bank of America's acquisition of Merrill Lynch, and upon the request of Mr. Lewis,[198] Treasury, the Federal Reserve, and the FDIC provided Bank of America with $20 billion of additional assistance under TIP and asset guarantees related to $118 billion of distressed or illiquid assets.[199]

Treasury, the Federal Reserve, and the FDIC stated that this additional assistance to both institutions was necessary not only to keep these institutions afloat, but also "to strengthen the financial system and protect U.S. taxpayers and the U.S. economy."[200] The banking industry suffered one of the worst earnings quarters in recent history during the fourth quarter of 2008, and economic deterioration persisted into 2009. Noting that at the end of 2008 no one knew what might happen to the economy next, Treasury stated that a driving force behind the decisions was a fear that either institution's failure would cause the same deep, systemic damage as Lehman Brothers' collapse.[201]

Treasury, the Federal Reserve, and the FDIC ultimately decided to use this program for only two institutions. One possible explanation for why the government did not extend asset guarantees to additional institutions may be that the mere existence of the AGP (and its implementation in a test case) calmed the market sufficiently. Several of the factors that supported the provision of additional assistance to Citigroup and Bank of America, however, likely also applied to other financial institutions, including the others that received the initial CPP assistance, especially given the dete-

[195] *See* Bank of America, *Bank of America Earns $4 Billion in 2008,* (Jan. 16, 2009) (hereinafter "Bank of America 1Q 2009 Release") (online at http://newsroom.bankofamerica.com/index.php?s=43&item=8316) (reporting Bank of America's year end 2008 results and describing its fourth quarter losses). Key factors that impacted Bank of America's financial results included losses associated with certain securities and legacy trading books; write-downs in commercial mortgage-backed securities and private equity, trading disruptions, and continued economic decline. These conditions caused additional credit deterioration across Bank of America's loan portfolio.

[196] Treasury conversations with Panel staff (Oct. 19, 2009); Bank of America conversations with Panel staff (Oct. 26, 2009). In the conversation between Bank of America and Panel staff, Bank of America personnel concurred that the additional assistance was necessary primarily because of the Merrill Lynch acquisition. In particular, Bank of America personnel noted the size of the Merrill Lynch loss and the speed with which it happened.

[197] Treasury conversations with Panel staff (Oct. 19, 2009).

[198] Emergency Capital Injections, supra note 30, at 23–29.

[199] See Bank of America 1Q 2009 Release, *supra* note 195 (noting that "in view of the continuing severe conditions," the U.S. government "agreed to assist in the Merrill acquisition by making a further investment in Bank of America of $20 billion in preferred stock" under TIP while also providing Bank of America with asset guarantee protection against further losses on a pool of assets "primarily from the former Merrill Lynch portfolio . . .").

[200] Treasury Citigroup Press Release, *supra* note 45; *see also* U.S. Department of the Treasury, *Treasury, Federal Reserve and the FDIC Provide Assistance to Bank of America* (Jan. 16, 2009) (online at www.financialstability.giov/latest/hp1356.html).

[201] Treasury conversations with Panel staff (Oct. 19, 2009). Confidential Treasury documents shared with Panel staff support this rationale.

riorating economic conditions and deteriorating balance sheets that plagued many financial institutions at the close of 2008 and into 2009. It is also possible that the AGP was superfluous in light of other initiatives.

While Treasury indicated that the existing TARP assistance to both institutions did not influence the decisions to provide additional assistance, Treasury stated that the three agencies remained aware of the substantial capital infusions already provided and realized that they were not sufficient to stabilize these institutions.[202] As reflected above, both institutions received additional TARP capital infusions through TIP, and the additional assistance provided under both TIP and AGP was coordinated and announced simultaneously.

d. How and why was an asset guarantee program selected?

The idea for the AGP was apparently based on a guarantee framework developed earlier by the FDIC and Citigroup to support Citigroup's failed bid for Wachovia in late September 2008.[203] During the discussions preceding the announcement of additional assistance, including the AGP, Citigroup suggested that the parties model the guarantee after the Wachovia structure.[204]

In Treasury's view, asset guarantees would "calm market fears about really large losses," thereby encouraging investors to keep funds in Citigroup and Bank of America.[205]

When asked to discuss possible alternatives to asset guarantees and why they were not selected, Treasury indicated that no alternatives were seriously considered.[206] Since Treasury was already providing capital infusions, it believed that guarantees could work in tandem to help restore market confidence and financial stability.[207] In particular, since Treasury had established a precedent for providing guarantee protection through its additional assistance to Citigroup, Treasury felt that it was important to provide Bank of America with similar assistance so that "systemically significant" institutions needing "exceptional assistance" would be given consistent treatment.[208] However, the FDIC indicated that the agencies considered providing liquidity support to Citigroup through expanded access to the CPFF, the Primary Dealer Credit Facility (PDCF), and the Term Securities Lending Facility (TSLF), but concluded that that type of short-term liquidity support would not have been an effective solution.[209]

Economic and practical considerations largely drove the interagency coordination on the creation and structure of the asset guarantees. Section 102 of EESA seems to intend for the cost of a guarantee program to be borne by TARP, rather than the Federal

[202] Treasury conversations with Panel staff (Oct. 19, 2009).
[203] Citigroup conversations with Panel staff (Oct. 26, 2009).
[204] *Id.*
[205] Treasury conversations with Panel staff (Oct. 19, 2009); Government Accountability Office, *Troubled Asset Relief Program: One Year Later, Actions Are Needed to Address Remaining Transparency and Accountability Challenges,* at 77 (Nov. 2, 2009) (online at www.gao.gov/new.items/d1016.pdf).
[206] Treasury conversations with Panel staff (Oct. 19, 2009).
[207] *Id.*
[208] *Id.*
[209] FDIC written responses to Panel questions (Oct. 30, 2009).

Reserve or the FDIC, perhaps signaling that no tripartite structure was envisioned.[210] Nonetheless, the TARP purchasing authority is reduced dollar-for-dollar by the amount guaranteed, meaning that insuring an asset under Section 102 of EESA has almost an equivalent impact on TARP purchasing authority as purchasing the same asset.[211] Treasury needed the joint participation of the Federal Reserve and the FDIC to cover the sizeable Citigroup and Bank of America guarantees.[212] While the Federal Reserve would provide financing only after the loss sharing agreements with Treasury and the FDIC were exhausted, it is the only agency that could provide a non-recourse loan of large notional value, if necessary, because of its emergency lending authority under Section 13(3) of the Federal Reserve Act. Treasury also indicated that the expertise and experience of the other agencies helped in coordinating, structuring, and implementing the AGP.[213]

EESA statutory considerations largely drove the cost allocation for the asset guarantees among the three agencies—Treasury and the FDIC each received preferred stock and warrants—along with each agency's individual determinations about their loss positions.[214] Potential loss estimates for the asset pools determined the deductibles for Citigroup and Bank of America.[215] Jointly Treasury and the FDIC made the decisions regarding the loss positions and the split of any loss share.[216] The Section 13(3) legal authority supporting the Federal Reserve's participation in the AGP only provides it with emergency lending authority. Since the Federal Reserve lends solely against collateral that meets particular quality criteria (and applies haircuts where necessary), the financing it would provide is collateralized by the assets in the designated pools.[217]

e. How Were Assets Selected with Respect to Citigroup and Bank of America?

Under the AGP, insured assets are "selected by Treasury and its agents in consultation with the financial institution receiving the guarantee." [218] Pursuant to EESA's statutory mandate, the assets

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[210] *See* EESA § 102 (requiring the Secretary of the Treasury to "establish a program to guarantee troubled assets originated or issued prior to March 14, 2008, including mortgage-backed securities," if he establishes the Troubled Asset Relief Program under Section 101, and referring only to the Treasury Secretary throughout the section text).

[211] *See* Treasury AGP Report, *supra* note 31 (noting that Treasury "generally achieves a greater impact per TARP dollar absorbed by taking an early loss position over a narrow interval of losses rather than a late loss position over a larger range of losses").

[212] Treasury conversations with Panel staff (Oct. 21, 2009).

[213] Treasury conversations with Panel staff (Oct. 21, 2009).

[214] Treasury conversations with Panel staff (Oct. 19, 2009).

[215] Treasury conversations with Panel staff (Oct. 19, 2009).

[216] Treasury conversations with Panel staff (Oct. 19, 2009).

[217] The history and role of Treasury, the Federal Reserve, and the FDIC in the provision of additional assistance to Citigroup is the subject of some press accounts suggesting some amount of interagency tension in the decision to extend support. *See, e.g.*, Edmund L. Andrews & Louise Story, *Regulators Press for Change at Two Troubled Big Banks,* New York Times (June 5, 2009) (online at www.nytimes.com/2009/06/06/business/economy/06bank.html) (stating that the FDIC "reluctantly went along" in the decision to provide Citigroup with a package of TARP funds and guarantees). Contradicting these reports, the government agencies assert that the approach was well-coordinated and conversations with Citigroup and Bank of America suggests that the agencies presented a united front.

[218] Treasury AGP Report, *supra* note 31.

selected must be "troubled assets originated or issued prior to March 14, 2008, including mortgage-backed securities."[219]

Initially, Citigroup identified a pool of assets for which it sought coverage under the asset guarantee, selecting what it viewed as some of the riskiest classes of assets on its balance sheet and providing an asset class by asset class presentation.[220] The initial amount of the pool Citigroup presented—roughly $307 billion—was in the same range as the Wachovia guarantee model.[221] The Federal Reserve conducted some initial diligence work on the pool presented, with the understanding that the amount would change after the pool was subject to more thorough diligence.[222] Treasury ultimately narrowed this pool to $306 billion due to certain filters, such as EESA statutory requirements, including the provision that assets needed to be "originated or issued prior to March 14, 2008,"[223] as well as the exclusion of some foreign assets deemed impermissible due to policy considerations. Subsequently, the asset pool amount was lowered to $301 billion due to accounting changes, corrections, and voluntary exclusions.[224]

As discussed above, while the Citigroup Master Agreement does not identify the value or composition of the guaranteed asset pool, it sets forth the criteria for covered assets, as well as a post-signing process for negotiating and finalizing those matters.[225]

As assets are sold, losses are taken against the portfolio and the size of the asset pool diminishes.[226] Citigroup and Treasury have both detailed substantial monitoring and auditing on the asset pool.[227]

Like Citigroup, Bank of America also identified and set forth the pool of assets that it sought the government to cover under the asset guarantee, selecting what it viewed as the riskiest assets on its balance sheet and providing an asset class by asset class presentation.[228] The Federal Reserve also conducted some initial diligence work on the pool presented, with the understanding that the amount would ultimately change after the pool was subject to more thorough diligence.[229] At the time of termination of the term sheet, the value of the pool was established at $83 billion for purposes of calculation of the termination fee.[230]

f. Analysis of the Terms of the Guarantees

As discussed above, the asset guarantees negotiated pursuant to the AGP share several key features. The federal government was largely consistent in negotiating asset guarantee agreements with Citigroup and Bank of America.

Broader comparisons are tricky. In particular, it is difficult to say whether the terms of these asset guarantees resemble "typical" or

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219 EESA § 102(a)(1).

220 Treasury conversations with Panel staff (Oct. 19, 2009); Citigroup conversations with Panel staff (Oct. 26, 2009).

221 Citigroup conversations with Panel staff (Oct. 26, 2009).

222 Treasury conversations with Panel staff (Oct. 21, 2009).

223 EESA § 102(a)(1).

224 Treasury conversations with Panel staff (Oct. 19, 2009).

225 For further discussion on how assets were selected, see Section C, *infra*.

226 Citigroup conversations with Panel staff (Oct. 26, 2009).

227 *Id.*

228 Treasury conversations with Panel staff (Oct. 19, 2009).

229 Treasury conversations with Panel staff (Oct. 21, 2009).

230 Treasury conversations with Panel staff (Oct. 22, 2009).

"standard" commercial terms; the agreements are sui generis. Generally speaking, however, there is nothing unusual about the terms negotiated by the federal government.[231] Moreover, to the extent that useful comparisons are possible, the terms of these guarantees seem relatively typical.[232] For instance, the durations of the guarantees (five years for non-residential assets and ten years for residential assets) mirror the FDIC's standard loss-sharing protocol.[233] In addition, the interest rate that will apply should Citigroup draw funds from the Federal Reserve's loan facility in order to cover residual losses on the guaranteed pool—that is, a floating rate of OIS plus 300 basis points—is standard and within commercial limits. The asymmetric nature of some key terms in the Master Agreement also works in the government's favor while disadvantaging Citigroup in some ways. While losses are calculated with respect to each security, as discussed above,[234] gains and recoveries are credited across the board, meaning that any gain on any asset will offset any losses on the pool. Since the quarterly calculation of net covered losses under the guarantee includes all gains and recoveries, this diminishes the likelihood that the government agencies will have to pay out on the guarantee (and thereby protects the taxpayers).[235]

While there have been reports of banks marking down assets aggressively and then benefitting from an uptick in value, certain clawback provisions in the Master Agreement ensure that the U.S. government will likely be able to benefit from any recoveries or gains in the asset pool. If the deductible is met, Citigroup would be permitted to collect on the insurance while continuing to carry the assets on its books. However, if the assets later stabilize and improve and Citigroup incurs quarterly recoveries or gains (that exceed its quarterly losses), it is required, pursuant to the Master Agreement, to reimburse the U.S. government for its outstanding advances in a specified manner.[236] Such contractual provisions

[231] The Citigroup guarantee arrangement does include an unusual provision limiting Citigroup's ability to issue dividends. *See* Citigroup Master Agreement, *supra* note 35, at 30. Bank of America's provisional guarantee arrangement contemplated a similar limitation.

[232] As a point of comparison, the Panel notes that the United Kingdom is likely to require the Royal Bank of Scotland Group PLC (RBS) to increase its deductible under the U.K. government's asset protection plan. This would increase RBS' deductible to λ60 billion ($99 billion) from 42 billion in initial losses that the bank originally agreed to incur last February. *See* Sara Schaefer Munoz, *RBS Likely to Pay Higher Insurance Fee*, Wall Street Journal (Nov. 2, 2009) (online at online.wsj.com/article/SB125692835737019207.html?mod=rss_Europe_Markets_News). This decision highlights how the European Union is "cracking down on RBS as a condition for the billions in taxpayer aid it has received since the start of the financial crisis." *Id*. While it is unlikely that the assets could be compared, the comparison provides an idea of the appropriateness of the price paid by Citigroup for the guarantee.

[233] U.S. Department of the Treasury, *Citigroup Asset Guarantee Agreement, Summary of Terms*, at 1 (Nov. 23, 2008) (online at www.treas.gov/press/releases/reports/cititermsheet_112308.pdf); Treasury conversations with Panel staff (Oct. 21, 2009). In conversations with Panel staff, Treasury indicated that since the federal government had never created a guarantee program like this before, the agencies determined that it was important to use a pre-existing framework and not resort to another framework on an ad hoc basis.

[234] *See* Section C(1)(a), *infra*.

[235] Treasury winds up paying less by reason of the netting process that only goes one way. To illustrate this accounting method, the Panel provides the following example. Asset A in Pool X has a quarterly loss of $25,000, and Asset B in Pool Y has a quarterly loss of $50,000. A different asset, Asset C, in Pool Z, has a quarterly gain of $100,000. Since the quarterly gain for Asset C exceeds the quarterly losses in Assets A and B, that gain will net out the losses on Assets A and B, even though they are not in the same asset class. However, even if Asset C only had a quarterly gain of $50,000, the losses in Assets A and B would not offset that gain since losses are not treated across the board.

[236] Citigroup Master Agreement, *supra* note 35, at 23–25.

allow the U.S. government (and the taxpayers) the opportunity to benefit from any upside in value within the guaranteed asset pool.

The terms of the Citigroup asset guarantee also address certain corporate governance issues including executive compensation, asset management, and personnel.[237] Recent press reports indicate that Bank of America, as part of its package of additional assistance, is operating under a slightly different memorandum of understanding (MOU) that requires it to change its board of directors and address certain risk and liquidity management issues.[238] The Panel has made numerous requests to Treasury and the Federal Reserve for this MOU and similar documents. To date the Panel has not received this or any other related documents.

g. Termination of the Bank of America Asset Guarantee

As discussed above, Bank of America notified Treasury, the Federal Reserve, and the FDIC on May 6, 2009 that it intended to terminate its asset guarantee because executives "believed that the cost of the guarantees outweighed the potential benefits." [239] The federal government and Bank of America held extensive discussions in the period between January 15 and May 6 regarding the identity of the assets to be covered.[240] In the end, Bank of America was not satisfied with the federal government's negotiating position.[241] Treasury acknowledges that Bank of America's position in May, after the completion of the stress tests, as discussed below, was different than it had been in January when the asset guarantee was announced.[242] For one, the $20 billion TIP investment substantially helped Bank of America's capital ratios.[243] In addition, Mr. Lewis and other Bank of America senior executives concluded that future losses would not exceed the initial $10 billion that the bank would need to cover pursuant to the AGP negotiated term sheet.[244] Upon the termination of the asset guarantee term sheet on September 21, 2009, Mr. Lewis stated, "[w]e are a stronger company than we were even a few months ago, and while we continue to face challenges from rising credit costs, we believe we have all the pieces in place to emerge from this current economic crisis as one of the leading financial services firms in the world." [245]

Between May 6, 2009 and September 21, 2009, Treasury, the Federal Reserve, and the FDIC reviewed the likely effects of Bank of America's withdrawal from the AGP and then negotiated an appropriate fee or rebate for Bank of America's withdrawal.[246] As noted above, Bank of America initially took the view that since no

[237] For further discussion of the particular aspects of corporate governance addressed in the Citigroup Master Agreement, see Section C, *infra*.

[238] *See, e.g.*, Dan Fitzpatrick, *U.S. Regulators to BofA: Obey or Else*, Wall Street Journal (July 16, 2009) (online at online.wsj.com/article/SB124771415436449393.html).

[239] Treasury conversations with Panel staff (Sept. 23, 2009); Emergency Capital Injections, *supra* note 30, at 29.

[240] Treasury conversations with Panel staff (Oct. 19, 2009).

[241] *Id.*

[242] *Id.*

[243] *Id.*

[244] Emergency Capital Injections, *supra* note 30, at 23–29.

[245] Bank of America, *Bank of America Terminates Asset Guarantee Term Sheet* (Sept. 21, 2009) (online at newsroom.bankofamerica.com/index.php?s=43&item=8536).

[246] Treasury conversations with Panel staff (Sept. 23, 2009).

contract was executed, no fee was owed.[247] The government agencies disagreed, on the basis that the government had stood ready to make good on the guarantee even though the guarantee had not been formally executed, and that Bank of America clearly benefitted from the market's perception that the government had agreed to guarantee Bank of America's assets. This approach resulted in a $425 million termination fee. While some critics have argued that the government should have demanded more,[248] it appears that Treasury, the Federal Reserve, and the FDIC negotiated robustly and achieved a commercially reasonable result.

The fees for the guarantee were calculated at the outset of the program, when both parties felt the guarantee was needed, and on the basis of the assets the parties thought would be in the pool.[249] Those fees were set out in the term sheet dated January 15, 2009.[250] The termination fee was calculated using the fees in the term sheet as a starting point, and then adjusted for the length of time the guarantee was perceived to be in effect. Bank of America had obligated itself to pay for the guarantee, pursuant to the rates set out in the term sheet.

While it is impossible to determine whether Treasury, the Federal Reserve, and the FDIC needed to "save" Bank of America, the Panel notes that one of the primary reasons given by both sides for not needing the guarantee is the market-calming effect of the stress tests. The fact that the agencies were ready to backstop Bank of America's losses, if necessary, also had a calming effect on the financial markets, and likely aided its ability to raise capital and terminate the guarantee in the ensuing months.

2. TGPMMF

a. Legal Authority for the TGPMMF

It is not immediately apparent that the Gold Reserve Act of 1934 authorizes Treasury's decision to fund the TGPMMF with the $50 billion assets held in the ESF. The Act currently provides that, "[c]onsistent with the obligations of the Government in the International Monetary Fund on orderly exchange arrangements and a stable system of exchange rates, the Secretary or an agency designated by the Secretary, with the approval of the President, may

[247] Treasury conversations with Panel staff (Oct. 19, 2009).

[248] *See* James Kwak, *Bank of America $4 Billion, Taxpayers $425 Million*, Baselinescenario.com (Sept. 23, 2009) (online at baselinescenario.com/2009/09/23/bank-of-america-4–billion-taxpayers-425-million/); James Kwak, *More on Bank of America*, Baselinescenario.com (Sept. 28, 2009) (online at baselinescenario.com/2009/09/28/more-on-bank-of-america/) (questioning the U.S. government's decision to pro-rate the $4 billion in preferred stock by the effective term of the guarantee—4 months—and arguing that Bank of America was "buying insurance against the bad state of the world" and should not be able to get its money back "[w]hen the good state occurs."). Such arguments, however, do not reflect the terms of the term sheet. The term sheet contemplated that there would be a rebate if the guarantee were terminated. This was a policy decision made by the U.S. government and Bank of America. In addition, the fees for the guarantee were calculated at the outset of the program, when both parties felt asset guarantees were needed, and on the basis of the assets those parties thought would be in the pool. Treasury's negotiating stance was that when the additional assistance was announced, Bank of America had obligated itself to pay for the guarantee at the rates set out in the term sheet. The U.S. government concluded, however, that the construction of Bank of America's fee should be based on the fees in the term sheet, adjusted for the shortened time period between announcement and termination and some adjustments in the size of the asset pool.

[249] Treasury conversations with Panel staff (Sept. 23, 2009); Treasury conversations with Panel staff (Oct. 22, 2009).

[250] Bank of America Provisional Term Sheet, *supra* note 75.

deal in gold, foreign exchange, and other instruments of credit and securities the Secretary considers necessary."[251] The statute and its legislative history both suggest that Congress intended principally for Treasury to use the ESF "to provide short-term credit to foreign countries to counter exchange market instability."[252] Treasury has traditionally used the ESF to support the dollar in international exchange markets and to extend credit and loans to foreign sovereigns and central banks;[253] the use of the ESF to enact an insurance program to ensure macroeconomic stability amidst a domestic financial crisis marks a significant departure from prior practice. The TGPMMF seems to represent Treasury's first use of the ESF involving domestic counterparties and the first to establish an insurance mechanism.

Treasury has justified its use of the ESF for the TGPMMF as follows:

> The IMF obligations referenced in this provision link orderly exchange arrangements to the stability and health of the global financial and economic system. Because the extreme demand for redemptions facing money market funds at the time the [TGPMMF] was initiated had magnified liquidity strains in global funding markets and greatly exacerbated global financial instability, the [TGPMMF] was expected to counter such instability and help restore financial equilibrium. This objective was consistent with the terms of the statute.[254]

While one could argue that the distress in the MMF market had—and the prospect of a prolonged run on the markets would have had—serious consequences for international financial stability,[255] Treasury's position raises the prospect of using the ESF for other domestic activities that can be plausibly linked to ensuring international financial stability.

Treasury's use of the ESF for the TGPMMF led Congress to include in EESA requirements that Treasury replenish any funds paid out of the ESF under the TGPMMF and a prohibition against

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[251] 31 U.S.C. 5302(b).

[252] S. Rep. No. 1295, 94th Cong., 2d Sess. 17 (1976), reprinted in 1976 U.S.C.C.A.N. 5950, 5966; *see also Id.* ("[U]se of the ESF [is] authorized only for purposes consistent with United States obligations in the IMF regarding orderly exchange arrangements and a stable system of exchange rates."); 31 U.S.C. 5302(b) (conditioning in 1976 loan or credit to a foreign government or entity for more than six months only upon written statement of President to Congress of "unique or emergency circumstances.").

[253] *See* U.S. Department of the Treasury, *Exchange Stabilization Fund History* (accessed Nov. 3, 2009) (online at www.treas.gov/offices/international-affairs/esf/history) (periodizing over 100 uses of the ESF from 1936 to 2002; explaining that from 1961 to 1971, the ESF was used to incentivize foreign banks not to make demands on the U.S. gold stock; explaining further that from 1972 to 2002, the ESF was primarily used to acquire foreign currency reserves and extend lines of credit to foreign nations, and, more recently, to provide loans to the United Kingdom, Brazil, Argentina, Nigeria, and Romania).

[254] Treasury information provided in response to Panel written questions (Oct. 29, 2009). Although Treasury informed Panel staff that Treasury's Office of General Counsel had prepared a more formal legal analysis of its authority under the Act, Treasury has not shared this analysis with the Panel despite our requests. Treasury also contended that "the guarantee structure of the Program was consistent with the requirement in § 31 U.S.C. 5302(b) that use of the ESF involved a deal[ing] in an 'instrument of credit'." *Id.*

[255] *See, e.g.*, BIS, U.S. Dollar Money Market Funds and Non-U.S. Banks, *supra* note 95 at 79 (explaining that "[g]lobal interbank and foreign exchange markets felt the strain" of run on MMFs after the collapse of Lehman).

Treasury from using the ESF to guarantee money market funds in the future.[256]

b. Impact of the TGPMMF

Treasury created the TGPMMF at the height of the crisis last fall, and, at the time, stated that "[m]aintaining confidence in the money market fund industry [was] critical to protecting the integrity and stability of the global financial system."[257] The program was designed to enhance market confidence, alleviate investors' concerns that money market funds would drop below a $1.00 NAV, and ease strains on financing that threatened capital markets and financial institutions.[258] The TGPMMF has succeeded under these stated objectives, as measured by the absence of any additional MMFs breaking the buck, the declining commercial paper yield spreads, and stability in the commercial paper market.[259] In conjunction with the Federal Reserve's programs, CFPP and AMLF, which both saw heavy use during the TGPMMF's first months, the TGPMMF has helped stabilize the MMF and commercial paper markets.[260]

After the Reserve Primary Fund broke the buck and before the TGPMMF's institution, investors fled from prime funds and also from MMFs in general. The day the program was announced, the flight from prime funds arrested and, over the course of the program, reversed.[261] Yields in the commercial paper market also reflect the TGPMMF's impact.[262] Perhaps equally important, since the expiration of the guarantee program, strong investment in MMFs has occurred. While total assets in MMFs have declined slightly from $3.482 trillion to $3.372 trillion since September 18, 2009, and have declined more significantly from the January 2009

[256] EESA § 131(a)–(b). Treasury's use of the ESF to purchase $3.6 billion of USGF's assets raises related legal questions. While Treasury has explained that "unique and extraordinary circumstances" justified the purchase, See Treasury Reserve Fund Release, *supra* note 118, its connection with the statutory purposes of the ESF is more attenuated than the use of ESF to fund the TGPMMF. A disorderly liquidation of USGF in November 2008 was likely not large enough to have the same sort of direct impact on global exchange rates as the potential collapse of the entire MMF market in September 2008. While it is possible that the orderly liquidation of USGF had a stabilizing effect on exchange rates and global financial health, it is not clear why a similar result could not have been achieved by allowing USGF to file a claim under the TGPMMF.

[257] U.S. Department of the Treasury, *Treasury Announces Guaranty Program for Money Market Funds* (Sept. 19, 2008) (online at www.treas.gov/press/releases/hp1147.htm).

[258] *Id.*

[259] *See* Section E, *infra*.

[260] *See* Board of Governors of the Federal Reserve System, *Federal Reserve Statistical Release H.4.1: Factors Affecting Reserve Balances of Depository Institutions* (online at www.federalreserve.gov/releases/h41/) (accessed Oct. 29, 2009) (showing peak CPFF participation of $351 on January 21, 2009 declining to $39.4 billion on October 21, 2009 and peak AMLF lending at $152 billion on October 1, 2008 declining to $0 on October 21, 2009).

[261] *See* Figure 12, *infra*; ICI Money Market Working Group Report, *supra* note at 98 ("The U.S. Government's programs were highly successful in shoring up confidence in the money market and money market funds. Immediately following the difficulties of Primary Fund, assets in institutional share classes of prime money market funds dropped sharply as institutional investors, Seeking the safest, most liquid investments, moved into institutional share classes of Treasury and government-only money market funds . . . and bank deposits. Within a few days of the announcements on September 19 of the Treasury Guarantee Program and the Federal Reserve's AMLF program, however, outflows from institutional share classes of prime money market funds slowed dramatically. Indeed, by mid-October, the assets of prime money market funds began to grow and continued to do so into 2009, indicating a return of confidence by institutional investors in these funds. During this same time period, assets of Treasury and government-only money market funds also continued to grow, although at a much reduced pace.").

[262] *See* Figure 14, *infra* (showing a narrowing of spreads between overnight commercial paper and 3-month Treasury bills in the months following the implementation of the TGP).

market peak of $3.920 trillion,[263] market observers attribute this gradual decline to the relative attractiveness of other higher risk investments, not to fears regarding MMF market stability.[264]

One result at least partially attributable to the TGPMMF was the Congressional decision in October 2008 to increase deposit insurance from $100,000 to $250,000. Banks complained that the guarantee program tilted the balance unfairly to MMFs in their competition with FDIC-insured depository institutions for funds and used this argument effectively as leverage to have deposit insurance increased.[265]

TGPMMF made no outlays, but that does not mean that the program eliminated all pressure on funds' NAVs. Even after the guarantee, funds provided "parental support" to preserve their NAV, although the rate of this support decreased as liquidity improved. No fund chose to rely on the TGPMMF in part because the consequences of a triggering event and payment from the fund were so draconian—liquidation, and the reputational hit that liquidation would involve.[266]

Draconian consequences tend to temper the moral hazard resulting from government guarantees of private obligations.[267] The Obama Administration has called for and the SEC has moved to further mitigate the moral hazard in the MMF industry through regulatory reform.[268] The first approach to reform is to minimize the risk by mandating disclosure and setting further limits on the liquidity, maturities, and composition in assets in MMF portfolios.[269] The premise behind this approach is that more tightly regulated MMFs will not include illiquid and/or high risk assets. This approach may be insufficient to address the contagion dy-

[263] Investment Company Institute, *Money Market Fund Assets October 22, 2009* (Oct. 22, 2009) (online at www.ici.org/research/stats/mmf/mm_10_22_09); Investment Company Institute, *Weekly Total Net Assets (TNA) and Number of Money Market Mutual Funds* (online at www.ici.org/pdf/mm_data_2009.pdf) (accessed Nov. 4, 2009); *see also* Figure 13, *infra*.

[264] *See*, *e.g.*, David Serchuk, *Another Run on Money Market Funds?*, Forbes.com (Sept. 24, 2009) (online at www.forbes.com/2009/09/24/money-market-lehman-intelligent-investing-break-buck.html) (quoting Jeff Rubin, head of research at Birinyi Associates, as attributing move from MMFs since January 2009 peak to the search for higher yields).

[265] Letter from Edward L. Yingling, President, American Bankers Association, to Henry M. Paulson, Jr., Secretary of the Treasury and Ben S. Bernanke, Chairman of the Federal Reserve System (Sept. 19, 2008) (hereinafter "ABA Letter to Paulson and Bernanke") (illustrating the comparative advantage the TGP granted MMFs in their competition for investors' funds with FDIC-insured banks, which he contended face higher costs to fund deposit insurance and a greater regulatory burden than MMFs) (online at www.aba.com/aba/documents/press/LetterGuarantyProgramMoneyMarketFunds091908.pdf); *see* James B. Stewart, *The $4 Trillion Rescue You Should Be Grateful For*, SmartMoney.com (Sept. 15, 2009) (online at www.smartmoney.com/investing/stocks/the-4-trillion-rescue-you-should-be-grateful-for/) (reporting that guarantee set off "howls of protest from the banking industry" that led the FDIC to raise the insurance limit to $250,000).

[266] *See* BIS, U.S. Dollar Money Market Funds and Non-U.S. Banks, *supra* note 95, at 68, 71 (reporting that while around 145 funds provided support in the thirty years up to July 2007, one third of the top 100 U.S. MMFs received support since that time); *Id.* at 71 (showing largest money market funds seeking support both before and after program was in place); U.S. Securities and Exchange Commission, *No-Action Letters for Money Market Funds* (online at www.sec.gov/divisions/investment/im-noaction.shtml#money) (accessed Nov. 2, 2009).

[267] Moral hazard is discussed in more detail in Section E(2), *supra*.

[268] *See* U.S. Department of the Treasury, *Financial Regulatory Reform: A New Foundation*, at 38–39 (online at www.financialstability.gov/docs/regs/FinalReport_web.pdf) (accessed Nov. 2, 2009) (instructing SEC to promulgate rules "to reduce the credit and liquidity risk profile of individual MMFs and to make the MMF industry as a whole less susceptible to runs."); SEC Proposed Money Market Fund Reform Rule, *supra* note 124.

[269] This approach was advocated by the Investment Company Institute, the industry trade group, and largely reflected in the SEC's proposed amendments to Rule 2a–7. *See* SEC Proposed Money Market Fund Reform Rule, *supra* note 124; ICI Money Market Working Group Report, *supra* note 98 (recommending new disclosure requirements, shorter maturities, and new liquidity standards).

namic of runs on MMFs, and it raises the possibility of excess reliance on the credit rating agencies. The second approach is to create a private or public insurance mechanism that would internalize the cost of a potential bailout to market participants.[270] Institution of a public insurance mechanism would go some way into regulating MMFs like banks, with the acknowledgement that some MMFs will adopt strategies that will fail, but that the industry will pay for any bailout and that contagion will be limited by the existence of an explicit guarantee. This approach would have its own problems in that the traditional boundaries between banking and securities regulators would be tested. Some commentators have taken this insight a step further and counseled the abandonment of expectation of a $1.00 NAV either for a portion or the entirety of the market.[271] The SEC is in the process of finalizing its rule, and the President's Working Group on Financial Markets has delayed the issuance of its report on MMF regulatory reform in order to assimilate the public comments on the proposed rule.[272]

Finally, on October 10, 2008, the SEC ruled that funds could temporarily (until January 12, 2009) value their portfolio securities by reference to their amortized cost value rather than their market quotations as part of MMFs' daily shadow pricing to determine NAV.[273] The SEC's action was intended to correct for what MMFs contended were depressed market-based values of commercial paper that would not accurately reflect asset values at maturity because they were attributable more to market disruption and illiquidity than to fundamental components of asset valuation like credit risk.[274] Although the Panel has not been able to test this proposition, according to market participants, the SEC's measure was successful in relieving pressure on MMFs facing pressure on their NAVs due to temporarily illiquid commercial paper markets.[275]

c. USGF Purchase

As previously noted, Treasury support of the Reserve Fund's USGF appears to constitute an activity outside of the parameters of the TGPMMF.[276] Treasury's actions in this regard raise additional important questions, including the legal authority for Treasury's use of the ESF for such purpose. The letter agreement be-

[270] *See*, *e.g.*, Bullard, Federally-Insured Money Market Funds, *supra* note 95 (proposing the creation of permanent, full federal insurance for MMFs and similarly regulated "narrow banks" both regulated by the FDIC).

[271] *See* Letter from Jeffery N. Gordon, Alfred W. Bressler Professor of Law, Columbia University School of Law, to Elizabeth M. Murphy, Secretary of the U.S. Securities and Exchange Commission (Sept. 9, 2008) (commenting on SEC Proposed Money Market Fund Reform Rule and stating "Institutional MMFs should give up the promise of a fixed NAV.").

[272] *See* Mary L. Schapiro, Chairman, U.S. Securities and Exchange Commission, *Speech at SEC Open Meeting* (June 24, 2009) (online at www.sec.gov/news/speech/2009/spch062409mls.htm).

[273] Unlike other mutual funds, which can use an amortized cost value to calculate their daily NAV, MMFs have typically been required to rely on market quotations for their daily shadow price valuations of portfolio securities. *See* Investment Company Institute, *SEC No-Action Letter* (Oct. 10, 2008) (online at www.sec.gov/divisions/investment/noaction/2008/ici101008.htm) (hereinafter, "SEC No-Action Letter to ICI"). The SEC restricted the application of amortized cost valuation to First Tier Securities of MMFs with 60-day or less maturities that the fund reasonably expected to hold to maturity. *Id.*

[274] *See* SEC No-Action Letter to ICI, *supra* note 273; ICI Money Market Working Group Report, *supra* note 98, at 99–100.

[275] ICI Money Market Working Group Report, *supra* note 98, at 100.

[276] *See* Treasury Reserve Fund Release, *supra* note 118 (describing the asset purchase as a "separate agreement").

tween Treasury and the Reserve Fund was entered into on November 19, 2008, which was more than one month after EESA prohibited the Secretary of the Treasury from using the ESF for "any future guaranty programs."[277] Given Congress's pronouncement only a month previously in enacting EESA that it would not allow Treasury to use ESF in the future to fund an MMF guarantee program, Treasury's decision to go forward with another novel use of ESF to stabilize the MMF market—albeit through an asset purchase and not through the use of a guarantee—raises significant questions.[278]

The second issue is a question of policy. Why did Treasury determine it was more beneficial to purchase the USGF's assets, rather than trigger the TGPMMF?[279] Treasury's choice to provide support to the USGF in this case raises the question whether Treasury believed that the bolstering of market confidence that occurred upon TGPMMF implementation might be vitiated if the program actually had to pay a claim.

3. FDIC Guarantee Program

a. The Rationale for Creating Guarantees

On October 14, 2008, the same day that Treasury announced the CPP and the Federal Reserve announced additional details of its Commercial Paper Funding Facility, the FDIC announced the creation of the TLGP. The TLGP is part of a coordinated effort by Treasury, the Federal Reserve, and the FDIC to address substantial disruptions in credit markets and the resultant inability of many institutions to obtain funding and make loans. The FDIC has cited the disruptions in the credit markets, especially inter-bank credit markets, as well as concerns that bank account holders "might withdraw their uninsured balances from depository institutions" (the loss of which might have "impaired the funding structures of the institutions that relied on them") as primary rationales for the creation of the TLGP.[280] The FDIC worked closely with

[277] *See* EESA § 131.

[278] *See* Report *infra*, section 2(a) (discussing authority for the TGPMMF under 31 U.S.C. § 5302(b)). Treasury disagrees with this analysis and states that the USGF asset purchase was authorized under the TGPMMF. In Treasury's view, a September 29, 2009 Presidential approval of the TGPMMF did not limit the mechanism of meeting TGPMMF's "principal" objective—making shareholders whole—to a guarantee claim and thus provides sufficient authority within its broad contours for Treasury to make shareholders whole by entering a contingent asset purchase agreement (separate from the Guarantee Agreement) with a liquidating participating MMF. On September 29, 2009, the President issued a memorandum to the Secretary of the Treasury approving "the use of funds from the Exchange Stabilization Fund as a guaranty facility for certain money market mutual funds, consistent with your recommendation to me and the terms and conditions set out in your memorandum to me dated September 26, 2008." *See* Administration of George W. Bush, *Memorandum on Use of the Exchange Stabilization Fund To Support the Money Market Mutual Fund Guaranty Facility,* at 1279 (Sept. 29, 2008) (online at http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=2008_presidential_documents&docid=pd06oc08_txt_15.pdf). Treasury has provided the Panel a brief oral summary of the September 26, 2008 memorandum from the Secretary of the Treasury to the President, but has not provided the memorandum to the Panel.

[279] Treasury's press release further indicates that were the SEC to have allowed other funds to suspend redemptions, Treasury may have pursued a similar course. *See* Treasury Reserve Fund Release, *supra* note 118 (stating "no other funds participating in Treasury's temporary guarantee program received a similar order from the SEC. Because of this, Treasury does not foresee a need to take similar actions with regard to any other funds participating in Treasury's temporary guarantee program.").

[280] FDIC written responses to Panel questions (Oct. 30, 2009).

Treasury and the Federal Reserve in formulating this multi-pronged governmental intervention.[281]

While the TARP-funded CPP capital infusions would help bolster banks' balance sheets, the agencies concluded that the provision of guarantees through the TLGP would help foster liquidity in the nation's banking system.[282] By guaranteeing debt, the FDIC acted to provide investors "with the comfort necessary to invest in longer-term obligations of financial institutions."[283] With respect to eligibility, the FDIC concluded that making the program as widely inclusive as possible would help ensure that credit—particularly inter-bank lending—would start to flow again.[284] The FDIC decided to allow banks, thrifts, and holding companies to participate given their substantial role in the credit markets and inter-bank lending. FDIC Chairman Sheila Bair encouraged eligible institutions of all sizes to participate in the TLGP, hoping that the program "will once again spur credit to flow, which is essential for banks to return to normal lending activity."[285]

While these developments were influential, the FDIC tailored its programs to problems in the U.S. markets.[286] The actions of foreign governments, including members of the G–20, also substantially influenced the creation of the TLGP. In the absence of similar action by the U.S. government, foreign banks could have gained a competitive advantage. Prior to the FDIC's announcement, various European countries announced plans to provide additional deposit insurance or to guarantee various debt obligations of financial institutions, including Austria, Belgium, France, Germany, Ireland, Italy, Portugal, Spain, the Netherlands, and the United Kingdom. As FDIC Chairman Bair noted in announcing the TLGP, "[o]ur efforts also parallel those by European and Asian nations. Their guarantees for bank debt and increases in deposit insurance would put U.S. banks on an uneven playing field unless we acted as we are today."[287]

The FDIC introduced the DGP to restart senior debt issuances by banks. Only $661 million in debt was issued in September 2008, a 94 percent decrease from September 2007. The program succeeded in jumpstarting debt issuances, with $106 billion in guaranteed debt issued before the end of 2008.[288] There was no non-guaranteed senior unsecured debt issued by DGP eligible entities between October 14 and December 31, 2008.

[281] FDIC conversations with Panel staff (Oct. 22, 2009).

[282] *Id.*

[283] Federal Deposit Insurance Corporation, *Chairman's Statement on the Temporary Liquidity Guarantee Program* (Oct. 23, 2008) (online at www.fdic.gov/regulations/resources/TLGP/chairman_statement.html).

[284] *Id.*

[285] TLGP Interim Rule, *supra* note 167.

[286] FDIC written responses to Panel questions (Oct. 30, 2009).

[287] Federal Deposit Insurance Corporation, *Statement by Federal Deposit Insurance Corporation Chairman Sheila Bair, U.S. Treasury, Federal Reserve, FDIC Joint Press Conference* (Oct. 14, 2008) (online at www.fdic.gov/news/news/press/2008/pr08100a.html) (hereinafter "Bair Statement").

[288] *See* Last Call for TLGP Debt, *supra* note 158.

b. Analysis of the Terms of the Guarantees

The FDIC released the TLGP master agreement for the DGP on November 24, 2008.[289] The terms contained in the master agreement generally seem to be normal commercial terms. To some degree, however, any discussion about "normal" commercial terms in this context is complicated and challenging because the creation of this program involved the invocation of the "systemic risk exception," which can be applied only in very explicit and unusual circumstances.[290] In other words, the government provided normal financing at normal prices during abnormal times.

There are, however, several provisions worth noting. For example, unlike Treasury, which obtained special supervisory powers from Citigroup with respect to the ring-fenced assets and management and imposed other restrictions on the institution,[291] the FDIC does not seem to have obtained such consideration from the institutions participating in the TLGP. While such additional leverage might not have been practical or feasible given the size of the TLGP and the number of participating institutions, it is at least worth noting.

Additionally, the FDIC also indicated that it based its fee structure on practical considerations.[292] While the FDIC found the idea of risk-based pricing (i.e., calculating fees by reference to the risk or the size of the institution, which would have been normal commercial practice)[293] appealing and considered it in the process, the combination of the short amount of time available and the fact that non-insured depository institutions were eligible to participate in the TLGP made such risk-based pricing impractical, according to the FDIC.[294]

c. FDIC Decision to End the DGP and the Rationale Behind It

Initially, the DGP allowed participating institutions to issue FDIC-guaranteed senior unsecured debt until June 30, 2009. The FDIC Board subsequently issued a final rule that extended the period during which participating institutions could issue FDIC-guaranteed debt until October 31, 2009, with the stated purpose of reducing "market disruption at the conclusion of the DGP and [facilitating] the orderly phase-out of the program."[295]

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[289] Federal Deposit Insurance Corporation, *Master Agreement, Federal Deposit Insurance Corporation Temporary Liquidity Guarantee Program—Debt Guarantee Program* (online at www.fdic.gov/regulations/resources/TLGP/master.pdf) (accessed Nov. 2, 2009) (hereinafter "TLGP Master Agreement").

[290] *See* Federal Deposit Insurance Act of 1950, Pub. L. No. 81–797, § 13(c)(4)(G). The systemic risk determination authorized the FDIC to take actions to avoid or mitigate serious adverse effects on economic conditions or financial stability, and in response to this determination, the FDIC established the TLGP. The FDIC adopted the TLGP in October 2008 following a determination of systemic risk by the Secretary of the Treasury (after consultation with the President) that was supported by recommendations from the FDIC and the Federal Reserve.

[291] For further discussion on the structure of the Citigroup guarantee, *see* Section C, *infra*.

[292] FDIC conversations with Panel staff (Oct. 22, 2009).

[293] For example, the FDIC uses risk-based premiums for its Deposit Insurance Fund and Congress, in providing the Treasury Secretary with the authority to create an asset guarantee program in § 102 of EESA, also provided him with the authority to base premiums on the credit risk pertaining to the asset(s) being guaranteed.

[294] FDIC conversations with Panel staff (Oct. 26, 2009).

[295] Federal Deposit Insurance Corporation, *Notice of Proposed Rulemaking, Expiration of the Issuance Period for the Debt Guarantee Program; Establishment of Emergency Guarantee Facility* (Sept. 9, 2009) (hereinafter "FDIC DGP Rule Notice") (online at www.fdic.gov/news/board/NoticeSept9no6.pdf) The FDIC chose October because it believed that the markets "were recov-

In early September 2009, the FDIC issued a notice of proposed rulemaking that presented two options for ending the program.[296] While acknowledging that the DGP could terminate in light of improved market conditions, the FDIC indicated that it might be "prudent" to create an emergency guarantee facility to serve as a safeguard in limited circumstances.[297] Under the first alternative, the DGP would terminate as provided in the existing regulation. Under the second alternative, the DGP would terminate as provided in the existing regulation, but the FDIC would create a limited six-month emergency guarantee facility[298] to be used by insured depository institutions and other DGP participants to guarantee senior unsecured debt.[299] Institutions seeking to participate in the emergency guarantee facility would need to "demonstrate an inability to issue non-guaranteed debt to replace maturing senior unsecured debt as a result of market disruptions or other circumstances beyond the entity's control."[300] According to the FDIC, a limited six-month extension (with a definite end date of April 30, 2010) would "serve as a mechanism to phase-out the DGP," not to promote "indefinite participation."[301] The FDIC would also assess an annualized participation fee of at least 300 basis points (or three percent of the amount of debt issued) on any FDIC-guaranteed debt that institutions issued under the emergency guarantee.[302] The FDIC intends this provision to deter applications based on "other, less severe circumstances or concerns."[303]

After receiving only four comments on the proposed rule, all of which generally supported the second alternative, the FDIC Board voted for the second alternative on October 20, 2009, offering a limited six-month emergency extension through April 30, 2010.[304] In doing so, the FDIC selected the approach that it believed to be the "most appropriate phase-out of the DGP,"[305] and signaled that the DGP adds value as an additional support mechanism even if it is not heavily utilized.

The FDIC's decision-making has been largely driven by recent market data suggesting that the TLGP and other federal efforts

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ering in the spring of 2009, and that they were likely to return to a reasonable level of stability by then—just over one year from the start of the crisis." FDIC written responses to Panel questions (Oct. 30, 2009).

[296] FDIC DGP Rule Notice, *supra* note 295.

[297] FDIC DGP Rule Notice, *supra* note 295.

[298] In the FDIC's view, creating an emergency guarantee facility would be in accord with both the rationale for developing the TLGP and the October 14, 2008 systemic risk determination pursuant to Federal Deposit Insurance Act of 1950, Pub. L. No. 81–797, § 13(c)(4)(G), and the authority to act was granted to the FDIC Board by § 9(a)(Tenth) to issue "such rules and regulations as it may deem necessary to carry out the provisions of the FDI Act." Pub. L. No. 81–797 § 9(a)(Tenth); *see also* FDIC DGP Rule Notice, *supra* note 295.

[299] FDIC DGP Rule Notice, *supra* note 295.

[300] FDIC DGP Rule Notice, *supra* note 295.

[301] Federal Deposit Insurance Corporation, *Final Rule: Amendment of the Debt Guarantee Program to Provide for the Establishment of a Limited Six-Month Emergency Guarantee Facility* (Oct. 20, 2009) (hereinafter "DGP Final Rule") (online at www.fdic.gov/news/board/Oct098.pdf); FDIC conversations with Panel staff, Oct. 22, 2009.

[302] FDIC DGP Rule Notice, *supra* note 295.

[303] FDIC DGP Rule Notice, *supra* note 295. As the discussion in Section C, *infra*, indicates, this fee is significantly higher than the fee initially charged.

[304] *See* Federal Deposit Insurance Corporation, *Memorandum Re: Final Rule Allowing the Basic Debt Guarantee Component of the Temporary Liquidity Guarantee Program (TLGP) to Expire on October 31, 2009 and Establishing a Six-Month Emergency Guarantee Facility* (Oct. 20, 2009) (online at www.fdic.gov/news/board/Oct097.pdf) (providing FDIC staff recommendation that the Board allow the DGP to expire on October 31, 2009 and to establish a six-month emergency guarantee facility); DGP Final Rule, *supra* note 301.

[305] DGP Final Rule, *supra* note 301.

have helped to restore liquidity and confidence in the banking and financial services industries.[306] Furthermore, the FDIC noted that only a limited number of participating institutions have issued FDIC-guaranteed debt under the extended DGP, and that a number of banks have issued debt successfully and rather inexpensively without government backing.[307] FDIC-backed deals, which reached 60 in number during the first quarter of 2009, dropped to eight in the third quarter.[308] Such events are in large part a reflection of the TLGP's design and structure. The FDIC intended for the TLGP debt guarantee program to become uneconomic once the market improved. While fees to issue debt under the TLGP ranged from 50 to 100 basis points at the program's commencement, the FDIC increased these fees by 25 to 50 basis points on April 1, 2009.[309] As the market has stabilized and economic conditions have shifted, borrowing costs in the private markets have lessened, making the TLGP debt guarantee program fees less appealing to issuers from an economic standpoint.[310] As of October 22, 2009, there has been one failure of an institution, an affiliate of which had issued guaranteed debt.[311] The FDIC anticipates up to a $2 million loss on that issuance. No losses, however, have been paid out yet with respect to the DGP and the FDIC expects "very few losses on the remaining outstanding debt through the end of the program in 2012."[312] This decision parallels Treasury's decision to terminate its TGPMMF as of September 18, 2009.[313]

E. Cost/Benefit to Taxpayers of the Guarantee Programs

By guaranteeing or backstopping the assets of troubled financial institutions, the federal government was taking sizeable risks. It is important to consider the relationship between measures of the benefit provided—the risk absorbed by the taxpayer—and the fees and other compensation the government received for taking such extraordinary risks.

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[306] FDIC DGP Rule Notice, *supra* note 295.

[307] FDIC DGP Rule Notice, *supra* note 295. According to FDIC Chairman Sheila C. Bair, "[t]he TLGP has been very effective at helping financial institutions bridge the uncertainty and dysfunction that plagued our credit markets last fall. As domestic credit and liquidity markets appear to be normalizing and the number of entities utilizing the Debt Guarantee Program (DGP) has decreased, now is an important time to make clear our intent to end the program. It is also important to note that FDIC has collected over $9 billion in fees associated with this program. FDIC will be using some of this money to offset resolution costs associated with bank failures." Federal Deposit Insurance Corporation, *FDIC Board Approves Phase Out of Temporary Liquidity Guarantee Program Debt Guarantee Program to End October 31st* (Sept. 9, 2009) (hereinafter "TLGP Phase Out Notice") (online at www.fdic.gov/news/news/press/2009/pr09166.html). Furthermore, data provider Dealogic highlighted that the DGP's largest users had issued over $81.3 billion in medium-term debt outside of the program by early September.

[308] FDIC DGP Rule Notice, *supra* note 295.

[309] Federal Deposit Insurance Corporation, *FDIC Extends the Debt Guarantee Component of Its Temporary Liquidity Guarantee Program* (Mar. 17, 2009) (online at www.fdic.gov/news/news/press/2009/pr09041.html).

[310] At this point, it remains unclear whether these changed circumstances have arisen because creditors view the banks as strong and not needing guarantees or because creditors view the banks as receiving other implicit guarantees for which the banks are not paying.

[311] FDIC written responses to Panel questions (Oct. 30, 2009); *see also* discussion in Section E, infra.

[312] FDIC written responses to Panel questions (Oct. 30, 2009); *see also* discussion in Section E, infra.

[313] *See* U.S. Department of the Treasury, *Treasury Announces Expiration of Guarantee Program for Money Market Funds* (Sept. 18, 2009) (hereinafter "Money Market Expiration Release") (online at www.treasury.gov/press/releases/tg293.htm).

1. Direct Cost/Benefit from the Programs

To date, the federal government has made one small payout on a financial stability guarantee program: a $2 million DGP claim associated with a failed bank.[314] Fee income has been significant: a total of $17.4 billion across the three major programs. A simple summation of claim payments relative to fees received does not capture the long-term costs and benefits of these programs. A better analytical approach would be to calculate the discounted present value of the projected cash flows of the guarantee program. This is the approach CBO and OMB use to estimate the credit reform subsidy when calculating the federal budget, as described in Section B. On this basis, for example, the Asset Guarantee Program was estimated in May by OMB to produce a "negative subsidy," or net benefit, of 0.18 percent, meaning that, from the federal government's perspective, the program's fees and revenues will exceed its projected losses by roughly $752 million.[315]

Receipts may not accurately measure the benefits conveyed under a federal guarantee, even when discounted at a rate that attempts to capture market risk, which is the calculation made by CBO and OMB under EESA. One obvious alternative is to look at market prices to gauge the value of the financial guarantee. This can be approached in two ways: (1) determining what a private sector entity would charge for guaranteeing debt issuances on the exact terms as those guaranteed under the TLGP and TGPMMF; or (2) measuring the spread between the interest rate at which banks or money market funds have in fact been able to issue debt under these programs and the rate they would have been charged without the guarantee. Not surprising, there are virtually no private sector institutions capable of insuring the risks of the magnitude discussed in this report. Hence, only the second analytical approach was pursued here.

a. Asset Guarantee Program

The Panel reviewed an analysis performed for Treasury by the FRBNY of the asset guarantees for Citigroup. No such analysis was performed for the Bank of America guarantees because supporting details—such as the composition of the ring-fenced asset pool and projected losses on that pool—were not available.

In order to calculate the fees that should be charged for the Citigroup AGP, the FRBNY conducted an actuarial analysis of the performance and estimated future losses of the ring-fenced assets included in the Citigroup AGP.[316] This involved using a statistical model that incorporates probabilities of expected losses based on a stress test, and a discount rate that includes a market risk component.

The stress test undertaken by the FRBNY provided an estimate of losses on the ring-fenced assets in the AGP under two scenarios: (1) a moderately adverse asset performance, and (2) a severely ad-

[314] FDIC written responses to Panel questions (Oct. 30, 2009).

[315] Office of Management and Budget, *FY 2010 Budget: Department of the Treasury* at 983 (online at www.whitehouse.gov/omb/budget/fy2010/assets/tre.pdf) (hereinafter "Treasury 2010 Budget").

[316] This analysis was performed in late November 2008 for the Citigroup ring-fenced assets as of November 21, 2008.

verse asset performance. Given the fact that the asset composition of the guaranteed pool was not finalized at the time the stress test was conducted as part of the actuarial analysis, the FRBNY based the performance on assets similar to those likely to be in the portfolio. Two key economic indicators that were factored into the stress tests were: the projected unemployment rates for 2009 and 2010, and housing prices, utilizing the Case-Shiller 20-city housing price index for 2009 and 2010 (see table below for details). It should be noted that, as illustrated in Figure 4, the projected unemployment rate for the severely adverse scenario is lower than the actual unemployment rate as of October 2009 (9.8 percent).

FIGURE 4: ECONOMIC INDICATORS INCLUDED IN STRESS TEST MODELS

Moderately Adverse Scenario		
Projected unemployment rate		
4th Quarter 2009	**8.2%**	
4th Quarter 2010	**8.3%**	
Case-Shiller 20-city housing price index estimated decline from peak to trough		**45%**

Severely Adverse Scenario		
Projected unemployment rate		
4th Quarter 2009	**9.5%**	
4th Quarter 2010	**9.6%**	
Case-Shiller 20-city housing price index estimated decline from peak to trough		**50%**

The result of the FRBNY's actuarial analysis (conducted November 21, 2008) on the expected future losses on the ring-fenced assets was $26.5 billion in losses above $8.1 billion in loan loss reserves (total $34.6 billion) under the moderately adverse scenario and $35.8 billion in losses above $8.1 billion in loan loss reserves (total $43.9 billion) under the severely adverse scenario. As such, the base scenario conducted during November 2008 projected losses below the $39.5 billion AGP loss threshold or deductible that must be reached before any losses are absorbed by the federal government. On the other hand, the severely adverse scenario analyzed by the FRBNY projected $4.4 billion in losses above the $39.5 billion AGP loss threshold or deductible that must be reached before any losses are absorbed by the federal government. This implies that Treasury will have to pay out $3.96 billion under its share of the Citigroup AGP agreement. The Panel believes this a more likely scenario than the moderately adverse case because: (1) the unemployment assumptions used in both scenarios have in fact already been exceeded, and (2) the FRBNY analysis was based upon the Citigroup asset pool prior to Citigroup's exercise of its ability to substitute more troubled assets.

Finally, based on a probability model for its two stress test scenarios, the FRBNY then formulated a loss distribution analysis to predict the estimated expected costs to the guarantor (Treasury, the Federal Reserve, and the FDIC). The result was that the FRBNY actuarial analysis of the Citigroup AGP projected that premiums would exceed expected losses to be absorbed by Treasury and other government guarantors by $700 million.[317]

[317] The FRBNY estimated the expected cost to TARP was $2.07 billion. The estimated benefit to TARP, based on the expected cashflows of the fees received by TARP (estimating the current value of the preferred shares and warrants using information on the current market value of similar Citigroup preferred shares and expected returns to Treasury and the FDIC from holding the preferred shares and warrants) was $2.73 billion (calculated using a simple average of cashflows under the 2–10 year preferred shares prepayment).

Similarly, the two federal budget agencies OMB and CBO are required under EESA to estimate the costs of the AGP (and other TARP initiatives) under modified "credit reform" budget accounting rules (see Section B above). As noted above, the most recent OMB analysis for the combined Citigroup and Bank of America guarantees produces a "negative subsidy" of 0.18 percent, meaning the guarantees produce a $752 million receipt to the federal government. CBO calculates a large positive subsidy amount for the Citigroup (64 percent) and presumably would have shown a similar estimate for Bank of America had it been executed. For the Citigroup guarantee alone, the latest CBO analysis shows a cost to the federal government of $3 billion out of the $5 billion maximum exposure. This calculation is based upon their analysis of the Citigroup ring-fenced portfolio and disclosed charge-off rates of comparable assets. However, the CBO subsidy estimate excludes offsetting fees, which are recorded elsewhere in the budget.

The Panel was not able to complete its own analysis of expected losses on the Citigroup guaranteed portfolio. On the benefit or receipt side of the ledger, however, the Panel estimated the current market value (as of November 4, 2009) of the preferred shares issued to the federal government for the Citigroup AGP (subsequently converted to trust preferred shares). This analysis is based on using existing Citigroup trust preferred shares trading in the market with a similar dividend yield and maturity to model a "synthetic Citi AGP trust preferred security" to estimate the market price of the non-trading Citi AGP trust preferred shares. According to the Citigroup AGP Master Agreement, Treasury and the FDIC received Citigroup non-voting preferred shares with a combined face value of $7.059 billion ($4.034 billion to Treasury and $3.025 billion to the FDIC). Figure 5 below highlights the estimate. Based on the analysis, the Panel's staff estimates that the market value of Citigroup AGP trust preferred shares at $5.76 billion as of November 4, 2009, of which Treasury holds $3.29 billion and the FDIC holds $2.47 billion. By comparison, the Panel's staff estimates the market value of the Citigroup preferred shares on November 21, 2008 were $2.14 billion.

FIGURE 5: ESTIMATE OF THE MARKET VALUE OF PREFERRED SHARES ISSUED UNDER THE CITIGROUP AGP

Citigroup 7.625% Trust Preferred Share (Existing Trading Security)	
Maturity date	12/1/2036
Outstanding shares	200,000
Issue price	$100
Market price (11/04/2009)	$82.00
Dividend	7.625%
Market price/issue price	82.0%
Synthetic Citigroup AGP 8% Trust Preferred Share (Model)	
Maturity date	7/30/2039
Outstanding shares	7,059,000
Issue price	$1,000
Market price (11/04/2009)	$816.14
Dividend	8.000%

FIGURE 5: ESTIMATE OF THE MARKET VALUE OF PREFERRED SHARES ISSUED UNDER THE CITIGROUP AGP—Continued

Market price/issue price	81.6%	
Market price/issue price		81.61%
Face value of Citigroup AGP Trust preferred shares		$7.06 billion
Estimated market value of Citigroup AGP Trust pref shares		$5.76 billion

The Panel also estimates the value of the warrants received by Treasury for the Citigroup AGP at $61.2 million as of October 20, 2009 using an estimated implied volatility of 58.7 percent. The Citigroup AGP actuarial analysis conducted by the FRBNY estimated that the value of the warrants on November 21, 2008 was $30 million using an estimated volatility of 40 percent.

Finally, the Panel also reviewed Citigroup's own internal monthly summary analysis of the performance of the ring-fenced assets.[318] Citigroup conducted its own stress test of the ring-fenced assets with similar inputs to FRBNY's actuarial analysis. Citigroup's stress test of the ring-fenced assets is periodically adjusted to reflect changing economic and asset assumptions. Given the Panel's review of the FRBNY's analysis as discussed above, the Panel intends to monitor closely trends in the performance of the ring-fenced assets.

b. TGPMMF

MMFs do not issue marketable securities but instead purchase securities issued by others, and there is a unified market for and hence no difference in the interest rates of similar securities held by MMFs versus those held outside such funds. Furthermore, there is no private sector firm that provides protection for investors' holdings in MMFs by guaranteeing the MMFs' NAVs.

The government incurred no costs from claims made under the TGPMMF. It should be noted, however, that the government was exposed to significant potential costs from claims while the program was in effect. The Administration's 2010 Budget, for example, projected losses of $2.5 billion in 2009 for the TGPMMF, well in excess of the $1.2 billion in fees collected. There is evidence that yields of commercial paper were substantially affected largely by the financing available in the healthy and stable MMF market buttressed by the TGPMMF and related Federal Reserve initiatives. Commercial paper yields, as measured by spreads over Treasury securities, quickly declined after the program was instituted and stayed at low levels for the duration of the program.[319] This is an understandable result of the program (which, at the onset guaranteed 93 percent of the MMFs outstanding value), the fact that a substantial amount of commercial paper was held in MMFs, and the liquidity and purchase of commercial paper by the Federal Reserve's AMLF and CPFF. The MMF guarantees allowed issuers of commercial paper to pay lower interest rates.[320] As with the TLGP analysis discussed below, the difference between what the interest rates were after the MMF guarantees and what the rates would

[318] These documents were provided to the Panel on a confidential basis by Treasury.
[319] *See* Annex, Figure 14; ICI Money Market Working Group Report, *supra* note at 98.
[320] *Id.*

have been without guarantees is a measure of the government subsidy to the issuers of commercial paper, typically large businesses.

c. Temporary Liquidity Guarantee Program DGP

In order to measure the value of the government assistance to the banking industry provided by the DGP, the Panel measured the spread between the interest rate at which banks issued debt under TLGP and compared that rate to non-TLGP debt they issued in the same period. This analysis was conducted using two alternative methodologies. The first method, highlighted in Figure 6 below, is based upon interest rate spreads calculated by SNL. This analysis calculates how much the TLGP participating firms saved in borrowing costs by comparing the interest rates on the $304 billion in senior debt issued under TLGP to interest rates on $7.1 billion of non-TLGP senior debt with similar maturities issued by some of the same firms. The difference represents the interest rate savings and provides an estimate of the TLGP subsidy. (The analysis compared debt that had a fixed coupon rate and did not include debt issued with a floating rate.)[321]

For the period of November 21, 2008 through November 4, 2009, TLGP-participating banks have issued senior debt on a guaranteed basis at a weighted average coupon rate of 2.374 percent, compared to a 3.9 percent coupon rate for the small amount of comparable debt issued on a non-guaranteed basis (see table below). This savings of 1.53 percentage points would translate into an annual subsidy of almost $4.73 billion, or a subsidy of $13.4 billion over the weighted average term of the TLGP loans.

A second method for calculating the implicit subsidy provided by the TLGP is to compare the interest rates on each slice of the $276 billion in senior debt issued under TLGP program by the top ten issuers to non-TLGP floating senior debt with similar maturities issued by these same firms and trading in the secondary market on the date of issuance of TLGP debt. This allows for computation of an implicit savings for those banks that did not actually issue any non-TLGP debt during this period. The result as computed by the Panel shows a subsidy of $28.9 billion (see Figure 7 below).

It should be noted that compared to the two subsidy estimates described above ranging from $13.4 to 28.9 billion—FDIC's TLGP collected fees of $9.64 billion during the same period (see table).

[321] When comparing TLGP debt and debt issued outside of FDIC's TLGP, SNL Financial used all senior debt that had been issued between 11/21/2008 and 11/04/2009. For TLGP debt, SNL Financial used all senior debt that had been issued under the TLGP, excluding issuances with maturities of less than one year (e.g., commercial paper), for a total of $303.78 billion. For the offerings issued in foreign currencies, SNL Financial converted those offerings to USD by using the appropriate exchange rate as of the offering completion date. In addition, SNL excluded equity linked notes such as ELKS or Internotes and offerings with maturities of less than one year.

FIGURE 6: TLGP DEBT COMPARED TO NON-TLGP SENIOR DEBT ISSUANCE (METHOD 1)

[Dollars in millions]

	Amount offered		Weighted average coupon (%)		Weighted average maturity (years)		Borrowing cost savings [322]
	Non-TLGP	TLGP	Non-TLGP	TLGP	Non-TLGP	TLGP	
Citigroup Inc.	$1,453	$64,600	0.00	1.91	3.02	2.55	
General Electric Co.	1,500	54,846	3.50	2.26	3.01	2.96	$1,941.6
Bank of America Corp.	15	44,000	0.00	2.48	1.01	2.76	
JPMorgan Chase & Co.	2	40,435	0.00	2.61	1.04	2.80	
Morgan Stanley	....	23,769	0.00	2.50	0.00	2.81	
Goldman Sachs Group Inc.	1,000	21,614	3.63	2.61	3.05	2.50	606.9
Wells Fargo & Co.	....	9,500	0.00	2.68	0.00	3.12	
GMAC Inc.	....	7,400	0.00	2.20	0.00	3.55	
American Express Co.	....	5,900	0.00	3.15	0.00	2.67	
State Street Corp.	....	3,950	0.00	2.03	0.00	2.55	
All other participants	3,177	27,767	4.33	2.44	2.75	2.91	
Total	$7,147	$303,781	3.90	2.35	2.90	2.78	$13,445.2

[322] The method 1 cost savings analysis was conducted using a company-specific comparison made between non-TLGP senior unsecured offerings made between 11/21/08 and 10/19/09 and TLGP issued debt issued during the same period. There were only three instances of a participant with both a non-TLGP offering with a set coupon rate and a TLGP offering. Thus, the analysis represents an extrapolation from these three eligible offerings.

FIGURE 7: TLGP DEBT COMPARED TO NON-TLGP SENIOR DEBT ISSUANCE (METHOD 2)

[Dollars in millions]

	Amount offered	Weighted average maturity (years)	Weighted average coupon (%)	Weighted average of existing non-TLGP floating debt (%)	Borrowing cost savings
Citigroup Inc.	$64,600	2.7	1.9	5.6	$6,780
General Electric Co.	54,846	2.9	2.3	5.3	4,696
Bank of America Corp.	44,000	2.7	2.4	5.5	3,761
JPMorgan Chase & Co.	40,435	3.1	2.7	4.5	2,156
Morgan Stanley	23,769	2.8	2.4	7.7	3,748
Goldman Sachs Group Inc.	21,614	2.8	2.6	6.7	2,379
Wells Fargo & Co.	9,500	3.1	2.7	5.7	903
GMAC Inc.	7,400	3.4	2.0	17.1	3,813
American Express Co.	5,900	2.9	3.1	4.8	327
State Street Corp.	3,950	3.1	2.0	4.8	362
Total for Top 10 Issuances	$276,014	2.8	2.3	5.9	$28,924

FIGURE 8: TLGP FEES COLLECTED [323]

[Dollars in millions]

Period	Fees
Fourth Quarter 2008	$3,437
January 2009	1,024
February 2009	1,087
March 2009	1,323
April 2009	712
May 2009	488
June 2009	597
July 2009	387
August 2009	296
September 2009	288
Total	$9,639

[323] Federal Deposit Insurance Corporation, *Monthly Reports on Debt Issuance Under the Temporary Liquidity Guarantee Program* (Oct. 21, 2009) (www.fdic.gov/regulations/resources/TLGP/fees.html).

2. Moral Hazard Considerations

In addition to direct monetary costs, the guarantee programs discussed in this report have broader costs resulting from the moral hazard that arises when the government agrees to guarantee the assets and obligations of private parties. Generally, the question of moral hazard arises when a party is protected, or expects to be protected, from loss. The insured party might take greater risk than it would otherwise, and market discipline is undermined.[324]

The problem is more pronounced when the protected party is not required to purchase the protection. For example, investors and issuers of commercial paper paid nothing directly for Treasury's guarantee of MMFs,[325] and yet received its protection or benefits. The TGPMMF served to backstop not only the funds themselves, but also the commercial paper market to which the funds are so crucial. It should also be noted that the fees the government charged the financial institutions for the guarantees in all of the programs were lower than fees commercial entities would have charged for the same protection.

Some commentators have expressed the view that market participants believe that should money market funds again threaten to break the buck or threaten contagion, the federal government will again step in to guarantee the money market funds and the solvency of system.[326] (On the other hand, not everyone believes

[324] Without protections, Citigroup would have more of an incentive to not properly manage the protected assets under the AGP. Treasury has provided certain safeguards against this risk. First, the AGP carries a very high deductible for Citigroup—it is liable for the first $39.5 billion of losses in the pool, and 10 percent of losses thereafter. Second, Citigroup must abide by strict asset management guidelines as set forth in the agreement. And third, if the pool loses more than $27 billion, the government may demand a change in the management of the pool.

[325] The funds themselves paid fees, however, which were passed on to investors. *See, e.g.,* BlackRock Liquidity Funds, Certified Shareholder Report (Form N–CSRS), at 60, 102 (Apr. 30, 2009) (online at www.sec.gov/Archives/edgar/data/97098/000119312509141660/dncsrs.htm) (accounting for TGP fees as "federal insurance" on statement of operations and explaining that fees "are not ordinary expenses and are not covered by the contractual agreement to reduce fees and reimburse expenses").

[326] American Enterprise Institute for Public Policy Research, *Do Money Market Funds Have a Future in the New Financial System* (May 5, 2009) (online at www.aei.org/EMStaticPage/100048?page=Summary) (quoting Marcel Bullard: "We have permanent implied money market insurance. It's with us now and it's likely to be with us forever . . ."); ABA Letter to Paulson & Bernanke, *supra* note 265; (citing the "perception by the market that money market mutual funds now have a permanent implicit government guaranty—much like Fannie Mae and Freddie Mac did"); Robert L Hetzel, *Should Increased Regulation of Bank Risk-Taking Come from Regu-*

that the government's temporary guarantee of money market funds created an implicit and permanent guarantee.)[327]

A larger issue arises when one considers the implicit guarantees, those that are paid for by neither party, but whose cost is borne by the taxpayer. The DGP and TGPMMF both carry fees paid for by the financial institutions. But their existence, and the existence of the other elements of the bailout of the financial system, could imply that there is a permanent, and "free," insurance provided by the government, especially for those institutions deemed "too big to fail," or "too connected to fail." There is an implication that, in the case of another major economic collapse, the government will again step in to prop up the financial system, especially the "too big to fail" institutions. This moral hazard creates a real risk to the system.

This "free" insurance causes a number of distortions in the marketplace. On the financial institution side, it might promote risky behavior. On the investor and shareholder side, it will provide less incentive to hold management to a high standard with regard to risk-taking. By creating a class of "too big to fail" institutions, it has provided these institutions with an advantage with respect to the pricing of credit:

> Creditors who believe that an institution will be regarded by the government as too big to fail may not price into their extensions of credit the full risk assumed by the institution. That, of course, is the very definition of moral hazard. Thus the institution has funds available to it at a price that does not fully internalize the social costs associated with its operations. The consequences are a diminution of market discipline, inefficient allocation of capital, the socialization of losses from supposedly market-based activities, and a competitive advantage for the large institution compared to smaller banks.[328]

The implied guarantee of "too big to fail" institutions might also result in a concentration of risk in this group, resulting in greater danger to the taxpayer if and when the government must step in again.

Treasury and the other government entities involved in the financial system bailout are aware of the problem of moral hazard, and have taken a number of steps to combat it.[329] It will be dif-

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lators or from the Market?, Economic Quarterly, Vol. 95, No. 2, at 161 (Spring 2009) ("[R]egulators had drawn the financial-safety-net line to exclude money market mutual funds, these funds would have been subject to the market discipline of possible failure. They would then have had to make one of two hard choices to become run-proof. Prime money funds could have chosen some combination of high capital and extremely safe, but low-yielding, commercial paper and government debt. Alternatively, they could have accepted variable NAV as the price of holding risky assets. Either way, the money market mutual fund industry would have had to shrink. At present, the incentive exists for money funds to take advantage of the government safety net by increasing the riskiness of their asset portfolios.").

[327] Peter Wallison, *Panel Discussion: Do Money Market Funds Have a Future in the New Financial System,* American Enterprise Institute for Public Policy Research, at 1:05 (May 5, 2009) (online at www.aei.org/video/101087) ("I disagree completely with [the] view that money funds are now guaranteed or insured in some way because the government stepped in this case.").

[328] Speech of Federal Reserve Board Governor Daniel K. Tarullo, *Confronting Too Big to Fail* (Oct. 21, 2009) (online at www.federalreserve.gov/newsevents/speech/tarullo20091021a.htm).

[329] *See, e.g.* Senate Committee on Banking, Housing, and Urban Affairs, Statement of Sheila C. Bair, Chairman, Federal Deposit Insurance Corporation, *Modernizing Bank Supervision And Regulation* (Mar. 19, 2009). Likewise, federal regulators have proposed and undertaken several

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ficult, however, if not impossible, to erase all effects of the moral hazards created by these government guarantees, whether expressed or implied.

F. Market Impact

Measuring the value of the federal financial guarantee programs means looking beyond the costs and benefits of assisting individual financial institutions or individual sectors of the financial market. These guarantee initiatives were part of the larger effort to restore financial stability and to renew access to credit. Improved credit conditions and restoration of markets for commercial paper and other short-term debt suggest that guarantee programs have helped achieve their objectives and can now be withdrawn.

Treasury interest rates dropped sharply during this period as investors engaged in a "flight to quality." [330] Rates have subsequently rebounded as the markets have stablized and as guarantee programs have provided nervous investors with assurance that other debt instruments are as safe as Treasuries.[331] Guarantees are now being phased out in an orderly manner without a renewed flight to Treasuries or a spike in interest rates.

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initiatives designed to lessen the moral hazards caused by the existence of financial entities that are perceived as "too big" or "too important" to fail, such as:

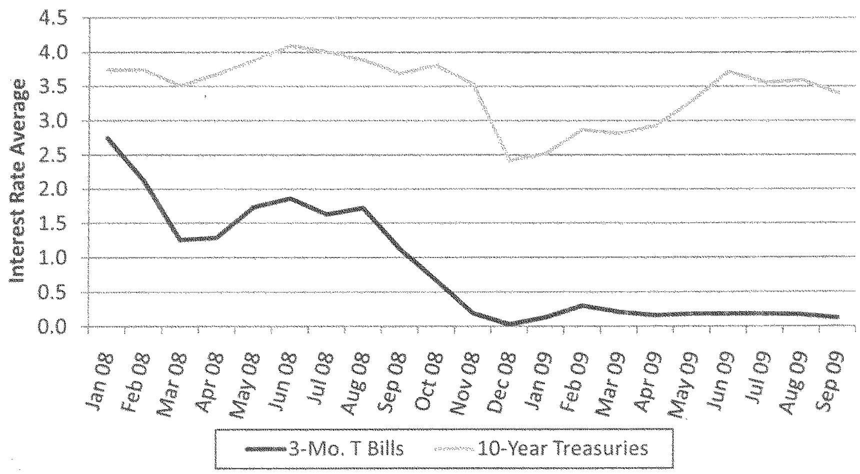
- Partnering with other central bankers, the Fed developed heightened international standards for bank capital and liquidity under the Basel II framework.
- The Fed, FDIC, Office of the Comptroller of the Currency, and Office of Thrift Supervision proposed a rule requiring banks to factor their unconsolidated subsidiaries into risk-based capital adequacy calculations.
- The White House and House Committee on Financial Services drafted legislation centralizing oversight for systemically important financial firms and requiring them to pay into a "Resolution Fund" for future financial system backstops.

See Board of Governors of the Federal Reserve System, Speech given by Chairman Ben S. Bernanke at the Federal Reserve Bank of Boston 54th Economic Conference, *Financial Regulation and Supervision after the Crisis: The Role of the Federal Reserve* (Oct. 23, 2009); Federal Deposit Insurance Corporation, *Notice of Proposed Rulemaking with Request for Public Comment: Risk-Based Capital Guidelines; Capital Adequacy Guidelines; Capital Maintenance: Regulatory Capital; Impact of Modifications to Generally Accepted Accounting Principles; Consolidation of Asset-Backed Commercial Paper Programs; and Other Related Issues* (Aug. 26, 2009); House Committee on Financial Services, *Financial Services Committee and Treasury Department Release Draft Legislation to Address Systemic Risk, "Too Big to Fail" Institutions* (Oct. 27, 2009).

[330] Securities Industry and Financial Markets Association, *SIFMA Research and Statistics: US Key Stats* (Instrument: "Other and IR", 3 Month T Bills and 10 Year Treasuries) (online at www.sifma.org/uploadedFiles/Research/Statistics/SIFMA_USKeyStats.xls). *See* Figure 9 below.

[331] *Id.*

FIGURE 9: TREASURY BILL AVERAGE YIELDS SINCE JANUARY 2008 [332]



Introduction of the money market guarantee reversed investor flight from prime funds; recent outflows may reflect both a continuing low interest rate environment and renewed relative attractiveness of higher yielding alternative investments. Moreover, there is evidence that yields of commercial paper were substantially affected by the financing available in the healthy and stable MMF market buttressed by TGPMMF and related Federal Reserve initiatives. Commercial paper yields, as measured by spreads over Treasury securities, quickly declined after the program was instituted and remained at low levels for the duration of the program.[333]

G. The Guarantee Programs as Part of the Broader Stabilization Effort

1. The TARP and the Guarantee Programs

The TARP, the TLGP, and the Federal Reserve Board's programs are, and have been presented as, parts of a single, coordinated program to stabilize the nation's financial institutions.[334] The first two, and several of the Reserve Board's programs, were organized immediately after enactment of EESA.[335] A joint statement by Sec-

[332] Securities Industry and Financial Markets Association, *SIFMA Research and Statistics: US Key Stats* (Instrument: "Other and IR", 3 Month T Bills and 10 Year Treasuries) (online at www.sifma.org/uploadedFiles/Research/Statistics/SIFMA_USKeyStats.xls).

[333] *See* Figure 14; ICI Money Market Working Group Report, *supra* note at 98.

[334] Neither TARP nor the TLGP can operate without the authority of the Secretary of the Treasury. The TARP is implemented by Treasury; the TLGP is an FDIC program, but its creation required a finding by the Secretary (in consultation with the President), upon the recommendation of both the FDIC and the Board, that the program was necessary to avoid "serious adverse effects on economic conditions or financial stability" that would be avoided or mitigated by that program. *See* 12 U.S.C. 1823(c)(4)(G)(i). Whether this clause in fact authorizes creation of a general program, rather than an exception to the "least cost resolution standard" directed at a single failing institution, is an issue on which the Panel takes no view.

[335] The use of such arrangements during the crisis predates EESA. For example, the FRBNY provided $29 billion to finance the acquisition of Bear Stearns by JPMorgan Chase in March 2008 under an arrangement providing that Morgan would bear only the first $1 billion in losses; the rest is to be borne by the FRBNY. And FDIC concluded a loss-sharing agreement as part of the transfer in the same month of the single-family residential portfolio of the failed IndyMac

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retary Paulson, FDIC Chairman Bair, and Chairman Bernanke made 11 days after EESA became law described TARP's Capital Purchase Program (CPP), the TLGP, and the Federal Reserve's new Commercial Paper Funding Facility [336] as

> actions to protect the U.S. economy, to strengthen public confidence in our financial institutions, and to foster the robust functioning of our credit markets [, as well as] to restore and stabilize liquidity necessary to support economic growth.[337]

The CPP and DGP are structurally connected. The debt guaranteed by FDIC—and hence FDIC's potential liability as guarantor—had, and has, a claim that is senior to the claims of the CPP preferred stock on the assets of the guaranteed institution. The TLGP initially ran through June 30, 2012, the year before the rate of interest on the CPP preferred stock increases from five to nine percent.

Perhaps more important, the DGP guarantee allowed participating institutions to raise funds through obligations that were backed by the full faith and credit of the United States, when those banks otherwise might not have been able to do so at acceptable interest rates, or perhaps at all. Addition of the amounts generated through the issuance of guaranteed debt likely took pressure off the balance sheets of participating institutions at the same time that Treasury used the CPP to stabilize those balance sheets as an alternative to purchasing troubled assets directly.[338] The FDIC announced the end of the DGP (other than for emergency situations) at the same time as the nation's largest banks were starting to repay their CPP assistance; the DGP termination means that banks that end their participation in the CPP cannot continue to receive a related form of assistance from the FDIC, or to use the continued availability of the guarantee program to obtain assistance while avoiding the limitations imposed by the executive compensation and corporate governance provisions of EESA.

The support the two programs gave affected banks is indicated by the numbers. Citigroup, for example, has received $45 billion in TARP assistance, as well as the $301 billion asset guarantee, and it has issued $64.6 billion of debt under the DGP. Bank of America has received $45 billion of TARP assistance, benefitted from a never-consummated asset guarantee, and has issued $44 billion of debt under the DGP. The 19 stress tested banks received a total

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to OneWest Bank as part of an agreement by the latter to continue FDIC's loan modification program. (The single-family portfolio made up $12.8 billion of the total $20.7 billion in assets transferred to OneWest; the transfer of the $20.7 billion at an overall $4.7 billion discount has the economic effect of a second guarantee).

[336] That facility, which began operation on October 27, was created to finance the purchase of highly-rated unsecured and asset-backed commercial paper from eligible issuers via eligible primary dealers.

[337] Board of Governors of the Federal Reserve System, *Joint Statement by Treasury, Federal Reserve and FDIC* (Oct. 14, 2008) (online at www.federalreserve.gov/newsevents/press/monetary/20081014a.htm). At the news conference that accompanied release of the statement, Chairman Bair stated that "the bulk of the U.S. banking industry is healthy and remains well-capitalized. What we do have, however, is a liquidity problem . . . In addition to the actions just announced by Secretary Paulson and Chairman Bernanke, the FDIC Board yesterday approved a new Temporary Liquidity Guarantee Program to unlock inter-bank credit markets and restore rationality to credit spread. This will free up funding for banks to make loans to creditworthy businesses and consumers." Bair Statement, *supra* note 287.

[338] *See* COP August Oversight Report, *supra* note 45.

of $163.5 billion under the CPP (GMAC received $12.5 billion under the AIFP and Bank of America and Citigroup got $20 billion each under TIP, which are not included in this total) and issued $238 billion of debt under the DGP.[339] The nation's other banks received $41 billion in CPP assistance and issued $65.6 billion of debt under the DGP.[340]

FIGURE 10: 19 STRESS TESTED BANKS, CPP ASSISTANCE AND DGP ISSUANCE (AS OF OCTOBER 23, 2009) [341]

Institution	TARP assistance amount	TARP investments repaid	TARP investments outstanding	Debt guaranteed under the TLGP	Asset guarantee program (AGP)
JPMorgan Chase ..	$25,000,000,000	$25,000,000,000	–	$40,435,009,000	
Citigroup	50,000,000,000	–	$50,000,000,000	64,600,000,000	$266,400,000,000
Bank of America	45,000,000,000	–	45,000,000,000	44,000,000,000	
Wells Fargo	25,000,000,000	–	25,000,000,000	9,500,000,000	
Goldman Sachs ...	10,000,000,000	10,000,000,000	–	21,614,310,000	
Morgan Stanley ...	10,000,000,000	10,000,000,000	–	23,768,503,000	
MetLife	–	–	–	397,436,000	
PNC	7,579,200,000	–	7,579,200,000	3,900,000,000	
U.S. Bancorp	6,599,000,000	6,599,000,000	–	2,679,873,000	
Bank of New York Mellon	3,000,000,000	3,000,000,000	–	603,448,000	
GMAC	12,500,000,000	–	12,500,000,000	7,400,000,000	
Sun Trust	4,850,000,000	–	4,850,000,000	3,000,000,000	
State Street	2,000,000,000	2,000,000,000	–	1,500,000,000	
Capital One	3,555,199,000	3,555,199,000	–	–	
BB&T	3,133,640,000	3,133,640,000	–	–	
Regions	3,500,000,000	–	3,500,000,000	3,750,000,000	
American Express	3,388,890,000	3,388,890,000	–	5,900,000,000	
Fifth Third Bancorp	3,408,000,000	–	3,408,000,000	–	
KeyCorp	2,500,000,000	–	2,500,000,000	1,937,500,000	
Total Stress Test Banks	221,013,929,000	66,676,729,000	154,337,200,000	234,986,079,000	266,400,000,000
Total All Other Participants	245,964,872,956	6,199,452,870	239,765,420,086	68,624,448,000	
Total	$466,978,801,956	$72,876,181,870	$394,102,620,086	$303,610,527,000	$266,400,000,000

[341] October 30 TARP Transactions Report, *supra* note 27, SNL Financial, *TLGP Debt Issued* (online at www1.snl.com/interactivex/TDGPParticipants.aspx) (accessed Nov. 5, 2009).

As under the CPP, there was no requirement to track the use of funds obtained through the DGP without the cooperation of the banks involved.[342] The FDIC does not require financial institutions to use capital raised through the issuance of guaranteed debt for lending or to free up funds for lending. Although the FDIC cautioned that the short-term nature of these guaranteed funds meant that downstreaming them to augment the capital of a subsidiary bank "should be carefully considered," it allowed such a use. More-

[339] October 30 TARP Transactions Report, *supra* note 27; SNL Financial, *TLGP Debt Issued* (online at www1.snl.com/interactivex/TDGPParticipants.aspx) (accessed Nov. 5, 2009).

[340] October 30 TARP Transactions Report, *supra* note 27.

[342] Federal Deposit Insurance Corporation, Temporary Liquidity Guarantee Program Frequently Asked Questions (online at www.fdic.gov/regulations/resources/TLGP/faq.html) (accessed Nov. 5, 2009). In July, SIGTARP released an audit on the topic. The first paragraph of the audit states: "Although most banks reported that they did not segregate or track TARP fund usage on a dollar-for-dollar basis, most banks were able to provide insights into their actual or planned use of TARP funds. Over 98% of survey recipients reported their actual uses of TARP funds." SIGTARP Bank Audit, *supra* note 42, at 1.

over, the extent to which a bank holding company can use guaranteed funds in its securities trading activities is unclear. The FDIC will not guarantee debt issued directly by a broker dealer holding company subsidiary, and many market instruments are altogether excluded from the definition of DGP guarantee-eligible senior debt. But the FDIC has also explicitly stated that firms may use capital raised by selling guaranteed instruments in market-making activities.

Thus, the relationship between the DGP and the FDIC's general resolution authority is unclear.[343] The FDIC protects guaranteed amounts if a holding company becomes insolvent according to the terms of the guarantees.[344] But the resolution authority only extends to depository institutions, and the use of funds raised with guaranteed debt is not restricted to shoring up depository institutions. The FDIC's intention to maintain an emergency guarantee facility once the DGP is terminated would not seem to alter this situation.

Finally, the terms of the DGP permit its use for other non-insured financial institutions. The FDIC has repeatedly used this capability. Approximately $248.2 billion of debt has been issued by non-insured affiliated bank and thrift holding companies.[345] The policy implications of the use of the FDIC guarantee in this situation is beyond the scope of this report. While the public could have reasonably expected that the FDIC would provide support for insured depository institutions, they may well not have anticipated that the FDIC would come to the aid of non-insured financial institutions.

2. Interaction with Stress Tests

In early 2009, Treasury and the Federal Reserve announced that the 19 BHCs, including Bank of America and Citigroup, would undergo a supervisory action to test the BHCs' current economic health and their projected health if the economic crisis continued.[346] Specifically, the tests considered whether these BHCs had the necessary capital buffers to withstand losses while continuing lending even in a worsening economy. These tests, called the Supervisory Capital Assessment Program or colloquially the "stress tests," assessed the BHCs' capital under two potential scenarios: one in which the crisis continued along the trajectory most economists were projecting at that time, and another more adverse scenario in which the crisis worsened beyond current projections.

On May 7, 2009, the Federal Reserve announced the results of the stress tests under the more adverse scenario.[347] The tests found that Bank of America would require $33.9 billion in addi-

[343] The Panel has not studied, and expresses no view, on the general relationship between the TLGP and the capital position of FDIC.

[344] TLGP Final Rule, *supra* note 146.

[345] Federal Deposit Insurance Corporation, *Monthly Reports on Debt Issuance Under the Temporary Liquidity Guarantee Program* (Oct. 21, 2009) www.fdic.gov/regulations/resources/TLGP/total_issuance9_09.html

[346] For a detailed description and analysis of the tests, *see* Congressional Oversight Panel, *June Oversight Report: Stress Testing and Shoring up Bank Capital*, at 13 (June 9, 2009) (online at cop.senate.gov/documents/cop–060909–report.pdf) (hereinafter "COP June Oversight Report").

[347] Board of Governors of the Federal Reserve System, *The Supervisory Capital Assessment Program: Overview of Results* (May 7, 2009) (online at www.federalreserve.gov/newsevents/press/bcreg/bcreg20090507a1.pdf).

tional tier 1 capital in the more adverse scenario and Citigroup would require $5.5 billion.[348]

The AGP guarantees had a very limited effect on the stress tests. They did not affect the calculation of potential losses at all, however, they did impact the calculation of assets available to absorb losses. In conducting the test on Citigroup, this effect was taken into account in reaching the final determination that Citigroup required an additional $5.5 billion in tier 1 capital. In the case of Bank of America, however, Bank of America indicated it wished to terminate the guarantee while the stress test was ongoing. For this reason, the Federal Reserve calculated two possible results for Bank of America, which would be required to raise $33.9 billion in tier 1 capital in the event the guarantee was in place and $35.7 billion if the guarantee were terminated, which was eventually the case.[349] One consideration that would have reduced the impact of the guarantees on the stress tests overall is the fact that the guarantees were not likely to have become relevant until after the period covered by the stress tests because the banks were unlikely to exceed their "deductibles" under the AGP by then. As of June 30, 2009, Bank of America reported that it had increased its tier 1 capital by $39.7 billion, which renders the distinction between $33.9 billion and $35.7 billion moot.[350]

3. The Guarantees and Exit from TARP

None of the financial stabilization programs were intended to be permanent. Under EESA, Treasury's authority to guarantee and make and fund commitments to purchase assets with TARP funding will terminate on December 31, 2009. (The Secretary of the Treasury may extend that authority to October 3, 2010 by submitting written certification to Congress.)[351] For various reasons, however, while some of the guarantees discussed in this report have already terminated, others extend beyond 2010.

For example, while Treasury created the AGP pursuant to its TARP authority, Treasury is contractually obligated to continue guaranteeing Citigroup assets until 2013 (for non-residential assets in the guaranteed pool) or 2018 (for residential assets in the guaranteed pool).[352] For Bank of America, Treasury's guarantee obligations ended when the parties agreed to terminate Bank of America's guarantee.

The TGPMMF and the TLGP are not TARP programs. As discussed above, Treasury terminated the TGPMMF on September 18, 2009, claiming that it had accomplished its goal of adding stability

[348] *Id.* at 20, 24.

[349] *See* Board of Governors of the Federal Reserve System, *Overview of Results*, at 9 (May 7, 2009) (online at www.federalreserve.gov/newsevents/press/bcreg/20090507a.htm) (stating "[f]or BofA, includes capital benefit from risk-weighted asset impact of eligible asset guarantee" but does not mention Citigroup's asset guarantee).

[350] U.S. Securities and Exchange Commission, *Quarterly Report for Bank of America Corporation (for the quarter ended June 30, 2009) (Form 10–Q)* (Aug. 7, 2009) (online at sec.gov/Archives/edgar/data/70858/000119312509168935/d10q.htm).

[351] EESA § 120. The Secretary has not, as of this writing, announced whether he intends to extend TARP.

[352] Next Phase Report, *supra* note 49, at 44. According to Treasury, these guarantee obligations may also be terminated "upon mutual agreement by Citigroup, Treasury, Federal Reserve, and FDIC." *Id.*

to the money market mutual fund industry.[353] The DGP component of the FDIC's TLGP ended on October 31, 2009. Banks were permitted to issue new FDIC-insured debt only until October 31, 2009, with the guarantee for such debt terminating by December 31, 2012.[354] However, the FDIC created a limited guarantee facility for insuring debt in emergency situations beyond October 31, 2009. This facility will be available only for banks that are unable to issue debt without the guarantee, and will carry significantly higher fees.

Finally, it is worth noting that the DGP plays a role in determining which financial institutions may repay the capital infusions they received under the CPP and TIP.[355] Specifically, the federal government has announced that if any of the 19 TARP recipient, stress-tested BHCs wish to repay those funds,[356] they must first "demonstrate [their] financial strength by issuing senior unsecured debt for terms greater than five years, not backed by FDIC guarantees, in amounts sufficient to demonstrate a capacity to meet funding needs independently."[357]

H. Transparency Issues

Treasury, the Federal Reserve, and the FDIC have taken different approaches with respect to disclosing information regarding the implementation, administration, and status of their respective guarantee programs.

1. Asset Guarantee Program

On January 16, 2009, after Treasury and Citigroup had finalized the terms of their guarantee agreement, Treasury disclosed these terms by posting the Citigroup Master Agreement on its Web site.[358] The Master Agreement sets forth much if not all of the process with respect to asset valuation, the criteria for selecting covered assets, as well as the criteria for asset selection.[359] Also, at the time of each announcement, Treasury publicly disclosed the term sheets for the transactions with each institution. The Federal Reserve, pursuant to Section 129(b) of EESA, released a report discussing its authorization to provide residual financing to Citigroup

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[353] *See* Money Market Expiration Release, *supra* note 313.

[354] FDIC DGP Rule Notice, *supra* note 295.

[355] *See* Congressional Oversight Panel, *July Oversight Report: TARP Repayments, Including the Repurchase of Stock Warrants*, at 8 (July 10, 2009) (online at cop.senate.gov/documents/cop–071009-report.pdf) (hereinafter "COP July Oversight Report").

[356] *See id.* at 40.

[357] U.S. Department of the Treasury, *Capital Purchase Program, FAQs on Capital Purchase Program Repayment*, at 1 (May 2009) (online at www.financialstability.gov/docs/CPP/FAQ_CPP_guidance.pdf) (emphasis added); *see also* Board of Governors of the Federal Reserve System, *Federal Reserve Outlines Criteria It Will Use to Evaluate Applications to Redeem U.S. Treasury Capital from Participants in Supervisory Capital Assessment Program* (June 1, 2009) (online at www.federalreserve.gov/newsevents/press/bcreg/20090601b.htm) ("Any BHC seeking to redeem U.S. Treasury capital must demonstrate an ability to access the long-term debt markets without reliance on the [TLGP], and must successfully demonstrate access to public equity markets."). To be clear, however, a financial institution is not excluded from participating in the TLGP simply because it has repaid TARP funds. See COP July Oversight Report *supra* note 355, at 18, *supra* note 355 (observing that institutions who have repaid TARP funds "remain eligible to use FDIC's Temporary Liquidity Guarantee Program, as well as other indirect support through the Federal Reserve's various liquidity Programs").

[358] Treasury AGP Terms Release, *supra* note 31. In a September 2009 briefing with Treasury, the Panel learned the absence of a master agreement contract with Bank of America on Treasury's website was because no formal asset guarantee agreement had been signed.

[359] *See* Citigroup Master Agreement, supra note 35, at §§ 1, 5.

for its asset pool.[360] Treasury provides a summary of the program on its website.[361] Furthermore, in its quarterly SEC filings, Citigroup has disclosed the current value of the assets, with any declines due to receipt of principal repayment charge-offs, and asset sales.

While Treasury, the Federal Reserve, and the FDIC provided extensive details of the mechanics with respect to additional assistance to Citigroup and Bank of America, the rationale underlying the guarantees remains somewhat unclear. To date the three agencies have not disclosed why these programs were selected; why Citigroup and Bank of America were the only institutions selected for asset guarantee protection; what alternatives were available; and why those alternatives were not chosen. Nor has Treasury provided a detailed legal analysis explaining how the AGP is consistent with section 102 of EESA. While Treasury, the Federal Reserve, the Federal Reserve Bank of New York, and the FDIC discussed some of these issues with Panel staff during recent briefings, the Panel believes that the assumptions and rationale underlying policy decisions should be made public to ensure program transparency, and as they are necessary in order to provide meaningful program evaluation and oversight. More transparency also assists the efficiency and stability of the financial markets.

The Panel has identified several instances where Treasury's disclosures have been insufficient. First, since the Master Agreement was executed in January, Treasury has not provided sufficient information concerning the estimated potential losses on Citigroup's asset pool. While Citigroup's second quarter 10-Q recorded approximately $5.3 billion of charge-offs on the asset pool for the period between November 21, 2008 and June 30, 2009,[362] Treasury has not disclosed information concerning cumulative asset pool losses or the projected losses of the pool and how they have been calculated. While as yet the losses remain less than the deductible needed to trigger Treasury and FDIC pay-outs, these metrics are critical to any assessment of the program.[363]

Additionally, given the deteriorating economic conditions at the time when Citigroup and Bank of America received guarantee protection, and that the banking industry as a whole suffered substantial losses during this period, it would be useful to have better details and analysis on why these financial institutions were selected for the AGP and not others. It would also be useful to understand why these institutions received asset guarantees instead of the approach used with AIG, the giant failing financial institution. AIG received cash and its shareholders were wiped out.

2. TGPMMF

Several transparency-related concerns arise with respect to the TGPMMF. First, Treasury has not disclosed why it decided to use a guarantee program to stabilize the money market funds, nor

[360] Section 129 Report, *supra* note 190.
[361] AGP Overview, *supra* note 34.
[362] Citigroup Second Quarter 2009 Report, *supra* note 48.
[363] It must also be noted that a complete list of Citigroup covered assets has not yet been published. Treasury has informed the Panel that such a list is pending finalization of the asset pool. At the time the final list is published, Treasury will also be able to publish the methodology by which it calculated the premium for coverage.

whether it considered alternative methods for achieving that policy goal. Understanding the analysis that informed these decisions would permit the Panel, and taxpayers, better to evaluate Treasury's performance.

Second, as discussed above, Treasury has never fully explained the legal basis for structuring the program as it did. In particular, Treasury has never explained how its initial reliance on up to $50 billion in funding from the ESF comports with the language and intent of the Gold Reserve Act of 1934. Treasury has failed to disclose publicly any internal analysis of its legal authority to expose the ESF to liability in the way discussed above.[364]

Finally, Treasury did not take steps to address uncertainty among market participants regarding the true extent of Treasury's obligation to honor the guarantees under the program in the hypothetical context of widespread claims beyond the $50 billion ESF.

Treasury's disclosures were geared primarily to explaining program requirements to potential market participants, and these appeared to be responsive to participants' needs. After announcing the program, Treasury created a Web page that detailed the eligibility conditions and application processes for would-be-participant money market funds.[365] The website also included samples of guarantee agreements, a comprehensive list of frequently asked questions, and a term sheet for the guarantee program.

Treasury never disclosed a list of participating MMFs for the initial program period or for the two subsequent extensions of the program. In addition, Treasury, unlike the FDIC in its disclosures under TLGP, did not provide monthly reports of the total number of MMFs participating in the program or the total dollar value of funds guaranteed, and provided only aggregate data participation levels and premiums collected on its program website in September 2009, days before the program was set to expire.[366] Treasury explained that it relied on the funds themselves to decide whether to disclose their participation in the program to their potential investors.[367]

Before Treasury's limited September 2009 disclosures, the only additional publicly available information on many key aspects of the TGPMMF's operation resulted from the Panel's publication of the results of an information request that it had submitted to Treasury. Chair Elizabeth Warren, on behalf of the Panel, sent a

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[364] Section 131 of EESA requires Treasury to reimburse ESF for any depletion of the fund attributable to the TGPMMF and prohibits Treasury "from using the [ESF] for the establishment of any future guaranty programs for the United States money market mutual fund industry." EESA § 131(b). One could interpret the latter provision as an expression of Congressional disapproval of Treasury's use of the ESF in this case. While Congressional disapproval does not necessarily signal illegality, it does further support the notion that Treasury was obligated to explain and justify its actions.

[365] U.S. Department of the Treasury, *Treasury's Temporary Guarantee Program for Money Market Funds* (online at www.treas.gov/offices/domestic-finance/key-initiatives/money-market-fund.shtml) (accessed Nov. 2, 2009).

[366] *See* Next Phase Report, *supra* note 49, at 2, 10, 46 (reporting aggregate fees collected to date at $1.2 billion, number of funds participating at 1,486, and gross assets of and percentage of total MMFs participating the program in its initial and two extension periods). Treasury did provide monthly and fiscal year to date program insurance premium fees in its monthly reports on the ESF, *see, e.g.*, U.S. Department of the Treasury, *Exchange Stabilization Fund Statement of Financial Position as of July 31, 2009* (July 31, 2009) (online at www.treas.gov/offices/international-affairs/esf/esf-monthly-statement.pdf), but this information was sequestered in a difficult to locate and to interpret financial statement on the website of a different Treasury office and only minimally added to the TGPMMF's transparency.

[367] Treasury conversations with Panel staff (Oct. 20, 2009).

letter to U.S Treasury Secretary Geithner on May 26, 2009 concerning, among other issues, the extent of Treasury's obligation under EESA to reimburse the ESF for any funds used for the TGPMMF.[368] In his July 21, 2009 response, Secretary Geithner stated that money market funds that applied for participation in the money market guarantee "represented over $3.2 trillion of money market assets as of September 19, 2008," and that those funds continuing to participate through the program's extension period had an "aggregate designated asset base of nearly $2.5 trillion calculated as of September 19, 2008." [369]

Also of concern is Treasury's transparency regarding two important aspects of the operation of the TGPMMF. First, it appears that Treasury never conducted an estimate of losses under the program. While the Office of Management and Budget's fiscal year 2010 budget request for Treasury estimates a $2.5 billion pay-out under the TGPMMF for fiscal year 2009, [370] Treasury did not assist in calculating this estimate.[371] In addition, despite the presence of a yearly audit of ESF that implies that Treasury undertook some form of an analysis of the likelihood and magnitude of claims under the program,[372] and a statutory requirement for Treasury to provide Congress with a monthly estimate of ESF liabilities,[373] Treasury has informed the Panel that it did not conduct any extensive analysis regarding the risk of losses to the TGPMMF because of the "exigent circumstances" of the program's establishment." [374] Although the TGPMMF was undoubtedly created in an atmosphere of dire necessity, the program was in place for a full calendar year with taxpayers subject to large exposures, and it is troubling that Treasury did not conduct (or could not produce to the Panel) any substantial analysis of program risks.

The second issue concerns Treasury's purchase of $3.6 billion of GSE securities from the USGF to provide support to the fund and to prevent a TGPMMF claim. Although it appears that Treasury will not incur any losses from the purchase, Treasury's disclosures about the purchase have been less than complete. While Treasury announced the asset purchase agreement shortly after the time of its execution and posted the letter agreement on its website, it has not adequately publicly explained its connection with the TGPMMF or disclosed how much of a subsidy it represented to the USGF and its investors.

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[368] *See* COP June Oversight Report, *supra* note 346 (reprinting "Letter from Chair Elizabeth Warren to Secretary Timothy Geithner").

[369] *See* Geithner Letter to Warren, *supra* note 133, at 126–129.

[370] *See* Treasury 2010 Budget, *supra* note 315, at 975; see also Section E, *infra*.

[371] Treasury responses to Panel questions (Nov. 2, 2009).

[372] *See* U.S. Department of the Treasury, *Department of the Treasury Exchange Stabilization Fund: Financial Report Fiscal Year 2008*, at 26 (online at www.treas.gov/offices/international-affairs/esf/congress_reports/final_22509wdc_combined_esf_auditreports.pdf) (accessed Nov. 4, 2009) ("ESF management has assessed the likelihood of claims related to this contingency as well as any potential resultant losses. This included gathering analytical data about the Money Market fund industry and specifically the history of funds from which NAV has dropped below the aforementioned thresholds. Based on this assessment, management has determined that while any loss on claims could be significant, currently such amount is not quantifiable and the likelihood of claims under the Treasury Guarantee Program is deemed to be remote.").

[373] *See* 31 U.S.C. § 5302(c)(1) (requiring that Treasury provide the Senate Banking and House Financial Services Committees a monthly "detailed financial statement on the stabilization fund showing all agreements made or renewed, all transactions occurring during the month, and all projected liabilities").

[374] Treasury responses to Panel questions (Nov. 2, 2009).

3. Temporary Liquidity Guarantee Program

Nine days after the FDIC announced the TLGP, it issued an interim rule to implement the TLGP and defined in detail the program's framework and operating mechanics.[375] A legal analysis supporting the FDIC's authority to create the program also accompanied this release. The FDIC provided a 15–day comment period for institutions to suggest changes to the interim rule, offer feedback, and consider their interest in program participation. In response to more than 700 comments, the FDIC made significant alterations to the interim rule, including changing the debt guarantee trigger to payment default rather than bankruptcy or receivership, and determining that short-term debt issued for one month or less would not be included in the TLGP.[376] The FDIC Board of Directors approved the TLGP final rule on November 21, 2008.[377]

In general, the FDIC has disclosed extensive information related to the TLGP throughout the life of the program. For example, the FDIC's website includes a separate webpage devoted to the TLGP that contains various postings such as financial institution letters, reports, and data. It has also included all TLGP amendments and modifications since the program's commencement.[378] The FDIC has published regular reports of debt issuance under the TLGP, including the amount outstanding and type and term of FDIC-guaranteed debt instruments at issuance, as well as TLGP opt-out lists.[379] The FDIC has also provided extensive information concerning its subsequent decision to extend the debt guarantee portion of the TLGP from June 30 through October 31, 2009, and impose a surcharge on debt issued with a maturity of one year in order to phase-out the program.[380] In particular, the FDIC concluded that an extension of the program would "provide an orderly transition period for participating entities returning to non-FDIC-guaranteed funding, and reduce the potential for market disruption when the DGP ends."[381] Additionally, on September 9, 2009, the FDIC issued a detailed notice of proposed rulemaking seeking comment on its proposed alternatives for terminating the DGP and describing its rationale for setting forth both alternatives.[382] The FDIC noted that it would be "prudent" to allow the DGP to expire as of October 31, 2009, while also creating a limited six-month emergency facility to be accessed on a "limited, case-by-case basis."[383] By voting to establish a limited extension on October 20, 2009, the FDIC intends to provide protection to DGP participants unable to issue non-gov-

[375] FDIC DGP Rule Notice, *supra* note 295; TLGP Interim Rule, *supra* note 167.

[376] *See* TLGP Final Rule, *supra* note 146.

[377] Federal Deposit Insurance Corporation, *FDIC Board of Directors Approves TLGP Final Rule* (Nov. 21, 2008) (online at www.fdic.gov/news/news/press/2008/pr08122.html) (accessed Nov. 5, 2009).

[378] Federal Deposit Insurance Corporation, *Temporary Liquidity Guarantee Program* (online at www.fdic.gov/regulations/resources/TLGP/index.html) (accessed Nov. 2, 2009).

[379] *Id. See* Section C, *infra*, for a detailed explanation of the opt-out concept.

[380] TLGP Extension Notice, *supra* note 162; Federal Deposit Insurance Corporation, *Amendment of the Temporary Liquidity Guarantee Program to Extend the Debt Guarantee Program and to Impose Surcharges on Assessments for Certain Debt Issued on or after April 1, 2009*, 12 C.F.R. § 370 (hereinafter "TLGP March 2009 Rule") (online at www.fdic.gov/news/board/Mar1709rule.pdf) (accessed Nov. 2, 2009).

[381] TLGP March 2009 Rule, *supra* note 380.

[382] FDIC DGP Rule Notice, *supra* note 295.

[383] FDIC DGP Rule Notice, *supra* note 295.

ernment-guaranteed debt due to "market disruptions or other circumstances beyond their control." [384]

The FDIC's disclosures to date help policymakers and the public evaluate the TLGP's impact on the availability of credit and its effectiveness in achieving its objective: "helping financial institutions bridge the uncertainty and dysfunction that plagued our credit markets last fall." [385]

I. Conclusions and Recommendations

With so many stabilization initiatives in use at any time, it is impossible to attribute specific results to a particular initiative. The guarantees provided by Treasury, the Federal Reserve, and the FDIC helped restore confidence in financial institutions, and did so without significant expenditure, initially at least, of taxpayer money. Moreover, as the market stabilizes and the scope of the programs decreases, the likelihood that any such expenditure will be necessary diminishes. Additionally, the U.S. government—and thus the taxpayers—benefit financially from the fees charged for guarantees. At the time of this report, the programs under discussion have generated fees of $17.4 billion, and only up to $2 million is expected to be paid out to cover a default under the DGP.

This apparently positive outcome, however, was achieved at the price of a significant amount of risk. A significant element of moral hazard has been injected into the financial system and a very large amount of money remains at risk. At its high point, the federal government was guaranteeing or insuring $4.3 trillion in face value of financial assets under the three guarantee programs discussed in this report. Taxpayers' funds remain at risk as follows:

- The TGPMMF has ended with no loss, but $3.6 billion was used from the ESF to purchase assets from the USGF outside of the TGPMMF.
- The DGP currently guarantees a principal amount of $307 billion (plus interest), which will diminish as June 2012 approaches, with $2 million in expected losses to date.
- The AGP guarantee for Citigroup is still in place, and initial actuarial estimates point towards a possible $34.6 billion loss under the moderate stress test scenario and $43.9 billion loss under the severe stress test scenario, which, after the 39.5 billion "deductible," would result in no loss for the government entities under the moderate scenario and a loss of $3.96 billion to Treasury under the severe scenario. The AGP guarantee for Bank of America ended with no loss.

The Panel has not identified significant flaws in Treasury's implementation of the programs. To the contrary, the Panel has noted a trend towards a more aggressive and commercial stance on the part of Treasury staff in safeguarding the taxpayers' money, evidenced, for example, in the apparently robust negotiation of the Bank of America termination fee. The Panel recommends that this

[384] FDIC DGP Rule Notice, *supra* note 295.

[385] TLGP Phase Out Notice, *supra* note 307. Although the FDIC has achieved a high level of transparency with regard to this program overall, the importance of transparency with regard to the TAG portion of the program must be emphasized. Given the widespread impact of this portion of the program, and its potential impact on the vulnerabilities of weaker small banks, it is particularly important that the FDIC be transparent and vocal about its decisions regarding the duration of the TAG.

trend continue. It should be noted, however, that this newly aggressive stance has a disproportionate effect on banks that remain governed by TARP, meaning that financial institutions that have already exited TARP have been treated more leniently.

The analysis in this report raises some issues, however, particularly with respect to the question of transparency and clarity of purpose, a theme of several previous reports. While it may be understandable that much of the government's reaction to the financial crisis was based on expediency rather than clear and transparent principles, the result is that government intervention has caused confusion and muddled expectations. Extraordinary transparency is necessary in order to determine the rationale behind the guarantee programs, and whether they have achieved their objectives.

- First, the Panel recommends that Treasury disclose the rationale behind the creation of guarantee programs, including a discussion of any alternatives, why those were not selected, a cost-benefit analysis of all options, and why Citigroup and Bank of America were the only institutions selected for asset guarantee protection.
- Second, the Panel recommends that Treasury fully and publicly disclose its legal justification for creating the TGPMMF through the use of the Exchange Stabilization Fund. Treasury should also provide reports of the total number of money market funds participating in the program, or the total dollar value guaranteed, for each month that the program was in existence.
- The Panel also recommends that the MOUs with Citigroup and Bank of America, and the MOU with any other institution relevant to this report on the AGP and other TARP-related guarantees, be provided to the Panel to inform its oversight functions, to be used subject to applicable legal protections.
- Finally, the Panel recommends that Treasury provide regular disclosures relating to the guarantee of Citigroup assets under the AGP, including the final composition of the asset pool (as reflected on Schedule A to the Master Agreement) and total asset pool losses to date, as well as projected losses of the pool, and how these estimates have been calculated.

ANNEX TO SECTION ONE:

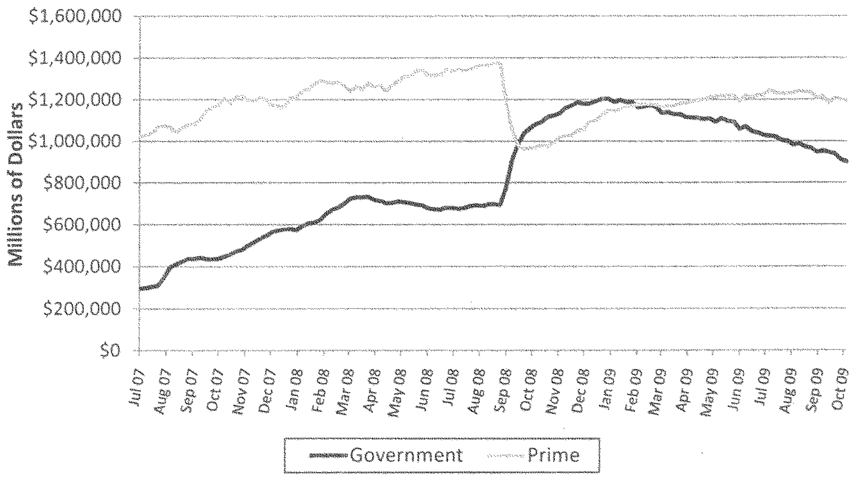
FIGURE 11: TLGP DEBT BY CONSOLIDATED ISSUER [386]

[Dollars in millions]

	TLGP issuance		
	Total amount offered	Weighted average coupon	Weighted average maturity
Access National Corp.	$30,000.0	2.7	3.0
American Express Co.	5,900,000.0	3.2	2.7
Banco Bilbao Vizcaya Argentaria SA	470,000.0	2.2	2.7
Bank of America Corp.	44,000,000.0	2.5	2.8
Bank of New York Mellon Corp.	603,448.0	FLOAT	3.3
Cascade Bancorp	41,000.0	2.7	3.0
BNP Paribas Group	1,000,000.0	2.2	3.0
Banner Corp.	50,000.0	2.6	3.0
Citigroup Inc.	64,600,000.0	1.9	2.5
First Merchants Corp.	52,882.0	2.6	3.0
General Electric Co.	54,846,345.0	2.3	3.0
GMAC Inc.	7,400,000.0	2.2	3.5
Goldman Sachs Group Inc.	21,614,310.0	2.6	2.5
HSBC Holdings plc	2,675,000.0	3.1	3.0
Huntington Bancshares Inc.	600,000.0	FLOAT	3.3
Integra Bank Corp.	50,000.0	2.6	3.0
Deere & Co.	2,000,000.0	2.9	3.5
JPMorgan Chase & Co.	40,435,009.0	2.6	2.8
KeyCorp	1,937,500.0	3.2	2.9
LaPorte Savings Bank MHC	5,000.0	2.7	3.0
MetLife Inc.	397,436.0	FLOAT	3.3
Morgan Stanley	23,768,503.0	2.5	2.8
National Consumer Cooperative Bank	75,000.0	2.3	3.0
New York Community Bancorp Inc.	602,000.0	2.9	3.3
Oriental Financial Group Inc.	105,000.0	2.8	3.0
PAB Bankshares Inc.	20,000.0	2.7	3.8
PNC Financial Services Group Inc.	3,900,000.0	2.2	2.9
Preferred Bank	26,000.0	2.7	3.9
Provident New York Bancorp	51,493.0	2.7	3.0
Regions Financial Corp.	3,750,000.0	3.1	2.3
Renasant Corp.	50,000.0	2.6	3.0
Banco Santander SA	1,600,000.0	2.7	3.3
State Bancorp Inc.	29,000.0	2.6	3.0
State Street Corp.	3,950,000.0	2.0	2.6
SunTrust Banks Inc.	3,576,000.0	3.0	2.7
Superior Bancorp	40,000.0	2.6	3.0
U.S. Bancorp	2,679,873.0	2.0	3.0
Mitsubishi UFJ Financial Group Inc.	1,000,000.0	FLOAT	2.5
United Services Automobile Association	95,000.0	2.2	3.0
Wells Fargo & Co.	9,500,000.0	2.7	3.1
Zions Bancorp.	254,895.0	FLOAT	3.4
Total (For All Issuances)	$303,780,694.0	2.4	2.8

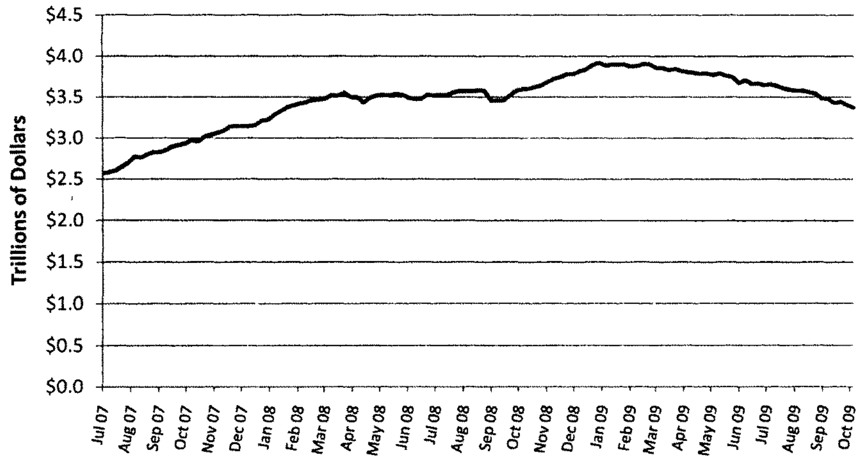
[386] SNL Financial, *TLGP Debt Issued* (online at WWW1snl.com/interactivex/TDGPParticipants.aspx) (accessed Nov. 5, 2009). This data includes only senior debt issued under the TLGP as of September 29, 2009 and excludes short-term offerings and commercial paper.

Figure 12: Total Net Assets of Government and Prime Institutional MMFs[387]



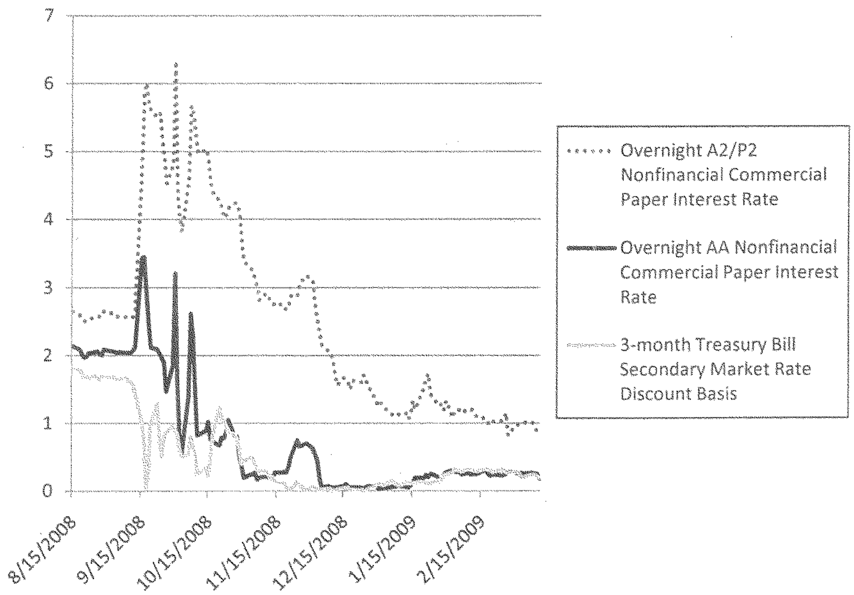
[387] Data provided to Panel by Investment Company Institute.

Figure 13: Total Net Assets of MMFs[388]



[388] Data provided to Panel by Investment Company Institute.

Figure 14: Overnight Commercial Paper Annual Yields (in percentage points)[389]



[389] Board of Governors of the Federal Reserve System, *Federal Reserve Statistical Release* (online at www.federalreserve.gov/releases/h41/) (accessed Oct. 26, 2009).

SECTION TWO: ADDITIONAL VIEWS

A. Damon Silvers

While I support this report, there is an important limitation to its analysis that was not present in prior reports of this panel addressing valuation issues associated with TARP.

Past reports of our Panel have valued securities such as CPP preferred stock and warrants by reference to public market prices for related securities. This report contains similar efforts to value guarantees for bank public debt and the preferred stock and warrants received as compensation for the Citigroup guarantee. I view this type of analysis as a critical component of our Panel's mission.

However, the Panel staff's efforts to analyze the asset guarantees provided to Citigroup have been hampered by the staff not having access to a comprehensive, itemized list of the assets that have been guaranteed by Treasury or information as to the detailed characteristics of those assets. In addition, there remains uncertainty as to which assets will ultimately be guaranteed by Treasury because a final agreement has not been entered into between Treasury and Citigroup that fixes which assets are subject to the guarantee.

As a result the Panel has had to rely upon the analysis of the tentative portfolio of assets subject to the guarantees performed by the Congressional Budget Office and the Office of Management and Budget. In the case of OMB their analysis was in turn reliant upon the analyses of the parties to the transaction—Citigroup, Treasury, and the Federal Reserve. CBO's analysis was based not on looking at the assets themselves but on making estimates based on assumptions that categories of assets in the guarantee pool would perform similarly to their asset class as a whole. In each case, our staff, CBO and OMB lacked the data needed to do more.

The consequence is that there has been no independent, asset-specific valuation of the Citigroup guarantee either as of the time the guarantee was made or as of a more recent date. Thus the detailed statements made in this report about potential losses on Citigroup assets covered under the Citigroup guarantee must be understood to be based on Federal Reserve Bank of New York analyses and not on an informed, independent valuation of the risk Treasury has assumed as a result of the guarantee of these specific assets.

B. Paul S. Atkins

With the publication of a report on federal government guarantee programs to the financial system, the Panel has produced a detailed perspective on an area that has received little public attention. I support the issuance of the report and appreciate the very hard work during the past month that the Panel staff has poured into this subject to produce this historical analysis.

With Congressman Hensarling, I believe that a few points should be noted with respect to this report:

First, American taxpayers have borne and continue to bear significant costs from the huge risk incurred in extending the guarantees, the direct administrative costs of the guarantee programs, and the expense of overseeing the programs. Even though many today seem to think mistakenly that the federal budget is limitless, there are also indirect costs to the taxpayer of issuing guarantees in the hundreds of billions of dollars, including market distortions, potential higher borrowing costs, opportunity costs of these off-balance sheet contingencies, and hard-to-quantify implications of moral hazard that arise when the government issues guarantees to private parties who have been unsuccessful in the marketplace, for whatever reason.

Second, the report's very matter-of-fact treatment of the guarantee programs should not be taken as a sign that all of the Panel members necessarily approve of the use of U.S. Government authority and resources in this way. These guarantees were issued in unusual circumstances, and as the facts come to light over time and ARE scrutinized as the crisis recedes, the wisdom and outworkings of the various decisions will be debated and judged. I also agree with Congressman Hensarling that this report should not be interpreted as advocating any particular legislative or regulatory response.

Finally, it is important that the Panel focus on ways in which TARP might be transformed over the coming months, particularly if the Treasury Secretary extends it pursuant to Section 120(b) of Emergency Economic Stabilization Act (EESA). Programs that demand especial scrutiny by the Panel are those that have the greatest enduring financial exposure and public policy implications for the taxpayer: AIG, Chrysler, GM, GMAC, Citigroup, the Capital Purchase Program, and imprudent efforts regarding mortgage foreclosures. If TARP is extended, perhaps the greatest danger is that other initiatives may be undertaken that depart from the intent of the Congress that approved EESA in 2008. The taxpayers depend on this Panel's vigilance in that respect.

C. Representative Jeb Hensarling

I concur with the issuance of the November report subject to my observations included in prior reports as well as those noted below.[390] I thank the Panel for incorporating several of the suggestions I offered during the drafting process.

- The TARP funded and other guarantee programs analyzed in the November report carry significant costs to the taxpayers attributable to the moral hazard that arises when the government agrees to guarantee the assets and obligations of private parties.
- Simply because the guarantee programs do not require an immediate outlay of taxpayer sourced funds, they are by no means free from risk. Such programs in fact burden the taxpayers with hundreds of billions of dollars of contingent obligations that must be funded in accordance with the terms of each governmental undertaking.
- The guarantee programs analyzed in the report should not serve as a template for future bailouts and the report should not

[390] The Panel's reports may be found at cop.senate.gov/reports/. My separate views are included in each report. For example, my dissenting views from the September report on the bailout of Chrysler, GM and GMAC may be found at cop.senate.gov/documents/cop-090909-report-additionalviews.pdf, and my dissenting views from the October report on foreclosure mitigation may be found at cop.senate.gov/documents/cop-100909-report-hensarling.pdf.

be interpreted as advocating any particular legislative or regulatory response.

- As Treasury unwinds several TARP programs where the taxpayers have recouped their investments with interest, the Panel should focus its attention on the new and existing programs that are likely more enduring and costly to the taxpayers. The opportunity cost of not providing rigorous oversight in these areas is high. These programs include taxpayer funds directed to AIG, Chrysler, GM, GMAC, foreclosure mitigation, preferred share purchases in Citigroup, Bank of America and hundreds of additional large and small financial institutions and other initiatives.
- TARP was promoted as a way to provide "financial stability," and the American Reinvestment and Recovery Act (ARRA) was promoted as a way to provide "economic stimulus." Regrettably, TARP has evolved from a program aimed at financial stability during a time of economic crisis to one that increasingly resembles another attempt by the Administration to promote its economic, political and social agenda through fiscal stimulus.
- In order to end the abuses of EESA as evidenced by the Chrysler and GM bankruptcies, misguided foreclosure mitigation programs and the "re-animation" of reckless behavior, the TARP program must end. To accomplish this goal, I introduced legislation—H.R. 2745—to end the TARP program on December 31, 2009.
- As discussed in detail in the October report, I encourage the Panel to adopt and make publicly available an oversight plan and a budget.
- I again note my disappointment that the Panel has not held a hearing with AIG, Citigroup, Bank of America (other than with respect to foreclosure mitigation) and many other significant recipients of TARP funds.

1. TARP's Guarantee Programs

Although I do not object to the subject matter addressed in the November report, I suggest that other topics would have been more relevant and timely regarding the Panel's discharge of its oversight responsibility. For example, the Panel has yet to produce a report on AIG or Treasury's exit strategy with respect to its TARP funded investments. I also question the overall timeliness of the topic. With the exception of Citigroup, most guarantee programs associated with financial stability through TARP, the FDIC and the Federal Reserve are winding down in the immediate term. Treasury's Temporary Guarantee Program for Money Market Funds (TGPMMF) ended in September and the FDIC's Temporary Liquidity Guarantee Program (TLGP) expired for new contracts at the end of October. Bank of America terminated its term sheet for the Asset Guarantee Program (AGP) at the end of September and the actual risk-sharing program was never launched.

In voting to approve the report, it is with the caveat that I do not endorse further extensions of TARP, either through asset or debt guarantees or other means. I also submit that it is too early to properly determine if the guarantee programs analyzed in the report achieved their intended purposes or whether the fees charged by Treasury were properly structured or adequate in amount relative to the contingent liabilities undertaken by the taxpayers. I am also by no means convinced that Treasury had the authority under EESA to implement the guarantee programs as structured.

I appreciate there may be upfront advantages of contingent credit support—which is not triggered unless certain adverse events occur—over direct taxpayer outlays. But the long term moral hazard effects on entrepreneurial activity and the capital costs of unfurling the government safety net widely will surely dwarf even CBO's $3 billion [391] in estimated subsidies. By its very nature, ringfencing allows firms to keep poorly-performing assets on their balance sheets until recovery when a backstop is no longer needed. This type of credit support cannot become a permanent part of an overall expectation that the taxpayers will again respond and assume risky bets should they sour. In other words, the guarantee programs analyzed in the report should not serve as a template for future bailouts and the report should not be interpreted as advocating any particular legislative or regulatory response.

2. Moral Hazard

I am pleased the Panel gave some consideration to the issue of moral hazard. Indeed, one of the most regrettable legacies of TARP is that the all-but-explicit government guarantee of financial institutions (and non-financial institutions such as Chrysler and GM) [392] has severed the link between risk and responsibility, resulting in greater threats to economic stability and growth.

Given the length of the report, I think it is important to highlight the Panel's analysis of the moral hazard issue presented by the guarantee programs in particular and the broader TARP program in general.

> In addition to direct monetary costs, the guarantee programs discussed in this report have broader costs resulting from the moral hazard that arises when the government agrees to guarantee the assets and obligations of private parties. Generally, the question of moral hazard arises when a party is protected, or expects to be protected, from loss. The insured party might take greater risk than it would otherwise, and market discipline is undermined.[393]
>
> A larger issue arises when one considers the implicit guarantees, those that are paid for by neither party, but whose cost is borne by the taxpayer. The DGP and TGPMMF both carry fees paid for by the financial institutions. But their existence, and the existence of the other elements of the bailout of the financial system, could imply that there is a permanent, and "free," insurance provided by the government, especially for those institutions

[391] Congressional Budget Office, *The Troubled Asset Relief Program: Report on Transactions Through June 17, 2009* (June 2009) (online at www.cbo.gov/ftpdocs/100xx/doc10056/06-29-TARP.pdf).

[392] The Administration "invested" TARP funds in Chrysler and GM even though neither company is a "financial institution" as required by EESA.

[393] Without protections, Citigroup would have more of an incentive to not properly manage the protected assets under the AGP. Treasury has provided certain safeguards against this risk. First, the AGP carries a very high deductible for Citigroup—it is liable for the first $39.5 billion of losses in the pool, and 10 percent of losses thereafter. Second, Citigroup must abide by strict asset management guidelines as set forth in the agreement. And third, if the pool loses more than $27 billion, the government may demand a change in the management of the pool.

> deemed "too big to fail," or "too connected to fail." There is an implication that, in the case of another major economic collapse, the government will again step in to prop up the financial system, especially the "too big to fail" institutions. This moral hazard creates a real risk to the system.
>
> This "free" insurance causes a number of distortions in the marketplace. On the financial institution side, it might promote risky behavior. On the investor and shareholder side, it will provide less incentive to hold management to a high standard with regard to risk-taking. By creating a class of "too big to fail" institutions, it has provided these institutions with an advantage with respect to the pricing of credit.
>
> Creditors who believe that an institution will be regarded by the government as too big to fail may not price into their extensions of credit the full risk assumed by the institution. That, of course, is the very definition of moral hazard. Thus the institution has funds available to it at a price that does not fully internalize the social costs associated with its operations. The consequences are a diminution of market discipline, inefficient allocation of capital, the socialization of losses from supposedly market-based activities, and a competitive advantage for the large institution compared to smaller banks.[394]
>
> The implied guarantee of "too big to fail" institutions might also result in a concentration of risk in this group, resulting in greater danger to the taxpayer if and when the government must step in again.

The Panel also concludes:

> This apparently positive outcome, however, was achieved at the price of a significant amount of risk. A significant element of moral hazard has been injected into the financial system and a very large amount of money remains at risk. At its high point, the federal government was guaranteeing or insuring $4.3 trillion in face value of financial assets under the three guarantee programs discussed in this report. Taxpayers' funds remain at risk as follows:
>
> • The TGPMMF has ended with no loss, but $3.6 billion was used from the ESF to purchase assets from the USGF outside of the TGPMMF.
>
> • The DGP currently guarantees a principal amount of $307 billion (plus interest) which will diminish as June 2012 approaches, with $2 million in expected losses to date.
>
> • The AGP guarantee for Citigroup is still in place, and initial actuarial estimates point towards a possible $34.6 billion loss under the moderate stress test scenario and $43.9 billion loss under the severe stress test scenario, which, after the $39.5 billion "deductible," would result in no loss for the government entities under the moderate

[394] Speech of Federal Reserve Board Governor Daniel K. Tarullo, *Confronting Too Big to Fail* (Oct. 21, 2009) (online at www.federalreserve.gov/newsevents/speech/tarullo20091021a.htm).

scenario and a loss of $3.96 billion to Treasury under the severe scenario. The AGP guarantee for Bank of America ended with no loss.

I wish to emphasize that the apparently "favorable" outcome for some of the guarantee programs analyzed in the report should not obscure the overwhelming burden that could have fallen to the taxpayers if the government had been called upon to honor its guarantee obligations. The take away point is not to view government sponsored guarantee programs as cost-effective bailout tools. Instead, these programs are fraught with uncertainty and peril for the taxpayers and create significant moral hazard risks.

3. Taxpayer Protection

As Treasury unwinds several TARP programs where the taxpayers have recouped their investments with interest, the Panel should focus its attention on the new or existing programs that are likely more enduring and costly to the taxpayers. The opportunity cost of not providing rigorous oversight in these areas is high. These programs include taxpayer funds directed to AIG, Chrysler, GM, GMAC, foreclosure mitigation, preferred share purchases in Citigroup, Bank of America and hundreds of additional large and small financial institutions and other initiatives. Despite a weakened appetite from the private sector and recovery in asset values, Treasury has recently used $16 billion of authority for a public-private investment vehicle to purchase troubled assets.[395] Although the Capital Purchase Program (CPP) has yielded around a 17 percent annualized rate of return (mainly through the repayment of institutions like Goldman Sachs and JP Morgan Chase),[396] Treasury is set to chart a new course by providing lower-interest financing for community banks that extend credit to small businesses.[397] The Panel should undertake to analyze these programs to determine if the investment of taxpayer funds is appropriate, authorized under EESA and adequately protected.

4. Financial Stability v. Economic Stimulus

TARP was promoted as a way to provide "financial stability," and the American Reinvestment and Recovery Act was promoted as a way to provide "economic stimulus." Regrettably, TARP has evolved from a program aimed at financial stability during a time of crisis to one that increasingly resembles another attempt by the Administration to promote its economic, political and social agenda through fiscal stimulus.

If TARP is not being used for "economic stimulus," then how else is it possible to explain the $81 billion "investment" in Chrysler and GM, neither of which is a "financial institution" as required

[395] U.S. Department of the Treasury, *Transactions Report* (Nov. 3, 2009) (online at www.financialstability.gov/docs/transaction-reports/10-30-09%20Transactions%20Report%20as%20of%2010-28-09.pdf).

[396] U.S. Department of the Treasury, *Secretary of the Treasury Timothy F. Geithner Written Testimony before the Congressional Oversight Panel* (Sept. 10, 2009) (online at www.ustreas.gov/press/releases/tg283.htm). *See also*, Dealbook, Some Profits from TARP, but Are They Enough, New York Times, (Aug. 31, 2009) (online at dealbook.blogs.nytimes.com/2009/08/31/are-profits-on-tarp-funds-enough-feel-free-to-change/) (illustrating the repayment returns).

[397] White House, *Treasury Announces New Efforts to Improve Credit for Small Businesses,* (Oct. 21, 2009) (online at www.whitehouse.gov/assets/documents/small_business_final.pdf).

under EESA?[398] In addition, the United States government has agreed to transfer to Fiat part of the equity it received in Chrysler if Fiat assists Chrysler in building a car that produces 40 miles per gallon. What does this transfer of United States government owned Chrysler stock to Fiat have to do with "financial stability"? As if this was not enough, the *Wall Street Journal* recently reported that Treasury is considering the investment of up to an *additional* $5.6 billion in GMAC.[399] No transparent end-game is in sight for TARP's $81 billion plus commitment to support Chrysler, GM and GMAC.

If, in effect, the Administration now equates TARP funds with Stimulus funds, the Administration should direct the resources in the most efficient, equitable and transparent manner by granting tax and regulatory relief to small businesses—the economic engine that creates approximately three out of every four jobs—and other American taxpayers.

In a recent report, SIGTARP addressed the problem of moral hazard, stating that "TARP runs the risk of merely re-animating markets that had collapsed under the weight of reckless behavior."[400] I am concerned that TARP is again inflating the problem of moral hazard by providing government capital to institutions that contributed to the crisis, modifications to homeowners who may have taken on too much risk, and lower-cost loans to spur the purchase of what may be volatile, high-priced asset backed securities.

The SIGTARP report also discussed the cost of TARP to the government's credibility. It claims, "[u]nfortunately, several decisions by Treasury—including Treasury's refusal to require TARP recipients to report on their use of TARP funds, its less-than accurate statements concerning TARP's first investments in nine large financial institutions, and its initial defense of those inaccurate statements—have served only to damage the Government's credibility and thus the long-term effectiveness of TARP."[401] I do not see how Treasury will be able to regain the public's trust so long as it continues to employ taxpayer sourced funds to make investments based upon the Administration's economic, political and social agenda where there is little promise that such funds will be recouped.[402]

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[398] Although not directly related, an analysis recently released by Edmunds.com indicates that the so-called "cash-for-clunkers" program cost the American taxpayers approximately $24,000 per car purchased ($3 billion program divided by 125,000 incremental sales attributable to the program).

"Edmunds.com has determined that Cash for Clunkers cost taxpayers $24,000 per vehicle sold.

Nearly 690,000 vehicles were sold during the Cash for Clunkers program, officially known as CARS, but Edmunds.com analysts calculated that only 125,000 of the sales were incremental. The rest of the sales would have happened anyway, regardless of the existence of the program," *See* Edmunds.com at www.edmunds.com/help/about/press/159446/article.html.

[399] "The U.S. government is likely to inject $2.8 billion to $5.6 billion of capital into the Detroit company, on top of the $12.5 billion that GMAC has received since December 2008, these people said. The latest infusion would come in the form of preferred stock. The government's 35.4% stake in the company could increase if existing shares eventually are converted into common equity." *GMAC Asks for Fresh Life*, the Wall Street Journal, (October 29, 2009) (online at http://online.wsj.com/article/SB125668489932511683.html?mod=djemalertNEWS).

[400] *See* SIGTARP, *Quarterly Report to Congress*, at 4 (October 21, 2009), (online at) http://sigtarp.gov/reports/congress/2009/October2009_Quarterly_Report_to_ Congress.pdf.

[401] *See id*.

[402] Three recent examples of the problems that may arise with respect to government financed investments in the private sector include:

(i) GAO recently issued a report on the Chrysler and GM bailout. The GAO report states:

In order to end the abuses of EESA as evidenced by the Chrysler and GM bankruptcies, misguided foreclosure mitigation programs and the "re-animation" of reckless behavior, the TARP program must end. These activities clearly show that the program is beyond capable oversight. Further, the TARP program should be terminated due to:

- the desire of the taxpayers for the TARP recipients to repay all TARP related investments sooner rather than later;
- the troublesome corporate governance and regulatory conflict of interest issues raised by Treasury's ownership of equity and debt interests in the TARP recipients;
- the stigma associated with continued participation in the TARP program by the recipients; and
- the demonstrated ability of the Administration to use the program to promote its economic, social and political agenda with respect to, among others, the Chrysler and GM bankruptcies.

Some of the adverse consequences that have arisen for TARP recipients include, without limitation:

- the private sector must now incorporate the concept of "political risk" into its due diligence analysis before engaging in any transaction with the United States government;
- corporate governance and conflict of interest issues; and
- the distinct possibility that TARP recipients—including those who have repaid all Capital Purchase Program advances

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"As long as Treasury maintains ownership interests in Chrysler and GM, it will likely be pressured to influence the companies' business decisions.

"Treasury officials stated that they established such up-front conditions not solely to protect Treasury's financial interests as a creditor and equity owner but also to reflect the Administration's views on responsibly utilizing taxpayer resources for these companies. While Treasury has stated it does not plan to manage its stake in Chrysler or GM to achieve social policy goals, these requirements and covenants to which the companies are subject indicate the challenges Treasury has faced and likely will face in balancing its roles."

GAO, TARP: Continued Stewardship Needed as Treasury Develops Strategies for Monitoring and Divesting Financial Interests in Chrysler and GM, (November 2009), (online at http://www.gao.gov/new.items/d10151.pdf).

(ii) Evidence exists that Treasury arguably "pressured" creditors of Chrysler to support the Chrysler Section 363 bankruptcy sale. I requested Secretary Geithner to investigate the allegation and, to my disappointment, he declined. Specifically, I submitted the following question for the record to the Secretary:

"Will you agree to conduct a prompt and thorough investigation of this matter by contacting Mr. Rattner, Mr. Lauria and representatives of Weinberg Perella and submit your findings to the Panel?"

The Secretary responded:

"SIGTARP will determine the appropriate actions with regard to this issue. But as noted above, I would reiterate that Mr. Rattner categorically denies Mr. Lauria's allegations.

"Again, I ask the Secretary to investigate this matter and report his findings to the Panel."

Congressional Oversight Panel, *Questions for the Record from the Congressional Oversight Panel at the Congressional Oversight Panel Hearing on Sept. 10, 2009, Questions for Timothy Geithner, Secretary of the Treasury, U.S. Department of the Treasury,* at 27 (Sept. 23, 2009).

See my dissent from the September report on the auto bailouts at http://cop.senate.gov/documents/cop-090909-report-additionalviews.pdf, pages 166–168.

(iii) *The Wall Street Journal* recently reported.

"Federal support for companies such as GM, Chrysler Group LLC and Bank of America Corp. has come with baggage: Companies in hock to Washington now have the equivalent of 535 new board members—100 U.S. senators and 435 House members.

"Since the financial crisis broke, Congress has been acting like the board of USA Inc., invoking the infusion of taxpayer money to get banks to modify loans to constituents and to give more help to those in danger of foreclosure. Members have berated CEOs for their business practices and pushed for caps on executive pay. They have also pushed GM and Chrysler to reverse core decisions designed to cut costs, such as closing facilities and shuttering dealerships."

See Politicians Butt in At Bailed-Out GM, The Wall Street Journal, (October 29, 2009), (online at http://online.wsj.com/article/SB125677552001414699.html#mod=todays_us_page_one).

but have warrants outstanding to Treasury—and other private sector entities may be subjected to future adverse rules and regulations.

A recent report issued by SIGTARP provides an insightful analysis of the actual cost of the TARP program.[403]

• Assuming that most financing for TARP comes from short-term Treasury bills, Treasury estimates the interest cost for TARP funds spent to be about $2.3 billion, although SIGTARP says a blended cost would double this amount and an "all-in" estimate would triple or quadruple it.[404]

• Were TARP to reach its $699 billion potential, it would mean a $5,000 expenditure for each taxpayer.[405] TARP represents 5 percent of 2008 GDP.

• Other costs identified by SIGTARP include (1) higher borrowing costs in the future as a result of increased Treasury borrowing levels, (2) a potential "crowding out effect" on prospective private-sector borrowers, potentially driving private-sector borrowers out of the market, (3) moral hazard, or unnecessary risk-taking in the private sector due to the bailout, and (4) costs incurred by the other financial-rescue-related Federal agencies that have not yet been quantified.

I introduced legislation—H.R. 2745—to end the TARP program on December 31, 2009. In addition, the legislation:

- requires Treasury to accept TARP repayment requests from well capitalized banks;
- requires Treasury to divest its warrants in each TARP recipient following the redemption of all outstanding TARP-related preferred shares issued by such recipient and the payment of all accrued dividends on such preferred shares;
- provides incentives for private banks to repurchase their warrant preferred shares from Treasury; and
- reduces spending authority under the TARP program for each dollar repaid.

5. Oversight Plan, Budget, Press Releases and Hearings

As discussed in detail in the October report, I encourage the Panel to adopt and make publicly available an oversight plan and a budget.[406]

Finally, I again note my disappointment that the Panel has not held a hearing with AIG, Citigroup, Bank of America (other than with respect to foreclosure mitigation) and other significant recipients of TARP funds.

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[403] SIGTARP, *Quarterly Report to Congress*, (October 21, 2009), (online at http://sigtarp.gov/reports/congress/2009/October2009_Quarterly_Report_to_Congress.pdf).

[404] A blended cost combines short- and medium-term Treasury securities, while an "all-in" cost balances those with longer-term Treasury securities. If TARP is a medium- to longer-term program, either approach would seem more sensible than Treasury's current short-term interest estimate.

[405] The $5,000 "cost" per taxpayer assumes 138.4 million taxpayers are covering the full $699 billion.

[406] *See* Representative Jeb Hensarling, *An Assessment of Foreclosure Mitigation Efforts After Six Months, Additional View by Representative Jeb Hensarling*, (Oct. 9, 2009) (online at http://cop.senate.gov/documents/cop-100909-report-hensarling.pdf).

SECTION THREE: TARP UPDATES SINCE LAST REPORT

A. TARP Repayment

Since the Panel's prior report, additional banks have repaid their TARP investments under the Capital Purchase Program (CPP). A total of 42 banks have repaid in full their preferred stock TARP investments provided under the CPP to date. Of these banks, 27 have repurchased their warrants as well. Additionally, during the month of September, CPP participating banks paid $138.9 million in dividends and $1.92 million in interest on Treasury investments.

B. CPP Monthly Lending Report

Treasury releases a monthly lending report showing loans outstanding at the top 22 CPP-recipient banks. The most recent report, issued on October 15, 2009, includes data through the end of August 2009 and shows that CPP recipients had $4.21 trillion in loans outstanding as of August 2009. This represents a one percent decline in loans outstanding between the end of July and the end of August.

C. Term Asset-Backed Securities Loan Facility (TALF)

At the October 21, 2009 facility, there were $2.1 billion in loans requested for legacy CMBS, but none for new CMBS. By way of comparison, there were $1.4 billion in loans for legacy CMBS requested at the September facility, and $2.3 billion at the August facility. There has never been a request for TALF loans for new CMBS.

At the November 3, 2009 facility, there were $1.1 billion in loans requested to support the issuance of ABS collateralized by loans in the credit card, equipment, floorplan, small business and student loan sectors.No loans in the auto, premium financing, and servicing advances sectors were requested. By way of comparison, there were $2.47 billion in loans requested at the October 2, 2009 facility to support the issuance of ABS collateralized by loans in the auto, credit card, equipment, floorplan, small business, and student loan sectors.

D. TARP Executive Compensation Determinations

On October 22, 2009, Kenneth R. Feinberg, the Special Master for TARP Executive Compensation, released his determinations on the compensation packages for the top executives at the seven firms that have received exceptional TARP assistance. These seven firms are: AIG, Bank of America, Citigroup, Chrysler Financial, Chrysler Group, General Motors, and GMAC. The executives covered by these determinations include the senior executive officers and the next 20 most highly compensated employees at each of these seven firms.

For each of these firms, the Special Master's determinations set specific standards in compensation for the covered employees. The determinations limit the annual base salaries of these employees to no more than $500,000 unless determined otherwise by the Special Master. In three cases, the Special Master approved annual base salaries of greater than $1 million: the new CEO of AIG and two employees of Chrysler Financial.

The determinations also affect covered employees with respect to cash bonus payments, incentive awards, stock received as salary, personal expense payments and "golden parachutes." Cash bonus payments are prohibited. Incentive awards may only be paid if the employee provides at least three years of service to the firm after an award is made. Additionally, stock received as salary may only be sold in one-third installments not to begin until 2011. Further, personal expense payments made to these employees by each of the firms will be capped at $25,000, unless determined otherwise by the Special Master. Finally, the new rules prohibit any increases in golden parachute payments made in 2009.

E. Metrics

Each month, the Panel's report highlights a number of metrics that the Panel and others, including Treasury, the Government Accountability Office (GAO), Special Inspector General for the Troubled Asset Relief Program (SIGTARP), and the Financial Stability Oversight Board, consider useful in assessing the effectiveness of the Administration's efforts to restore financial stability and accomplish the goals of EESA. This section discusses changes that have occurred in several indicators since the release of the Panel's October report.

- Interest Rate Spreads. Interest rate spreads continue to flatten. Interest rates on overnight commercial paper have returned to near pre-crisis levels. The interest rate spread for AA asset-backed commercial paper, which is considered mid-investment grade, has decreased by 23 percent since the Panel's October report. The TED Spread, which is the difference between three month LIBOR and the three month Treasury Bill rate, increased by 16 percent during the same period. Contrary to the other key metrics presented here, increases in the TED Spread signify a contraction of liquidity in the market. This measure, however, still remains 94 percent below its October 3, 2008 level (see Figure 15 below).

FIGURE 15: INTEREST RATE SPREADS

Indicator	Current spread (as of 10/28/09)	Percent change since last report (10/09/09)
3 month LIBOR-OIS spread [407]	0.11	−12.2
1 month LIBOR-OIS spread [408]	0.09	−5.5
TED spread [409] (in basis points)	23.2	16.1
Conventional mortgage rate spread [410]	1.57	4
Corporate AAA bond spread [411]	1.73	1.17
Corporate BAA bond spread [412]	2.87	1.06
Overnight AA asset-backed commercial paper interest rate spread [413]	0.20	−23.1
Overnight A2/P2 nonfinancial commercial paper interest rate spread [414]	0.13	−7.1

[407] *3 Mo LIBOR-OIS Spread,* Bloomberg (online at www.bloomberg.com/apps/quote?ticker=.LOIS3:IND) (accessed October 28, 2009).

[408] *1 Mo LIBOR-OIS Spread,* Bloomberg (online at www.bloomberg.com/apps/quote?ticker=.LOIS1:IND) (accessed October 28, 2009).

[409] *TED Spread,* SNL Financial.

[410] Board of Governors of the Federal Reserve System, *Federal Reserve Statistical Release H.15: Selected Interest Rates: Historical Data* (Instrument: Conventional Mortgages, Frequency: Weekly) (online at www.federalreserve.gov/releases/h15/data/Weekly_Thursday_/H15_MORTG_NA.txt) (accessed October 28, 2009); Board of Governors of the Federal Reserve System, *Federal Reserve Statistical Release H.15: Selected Interest Rates: Historical Data* (Instrument: U.S. Government Securities/Treasury Constant Maturities/Nominal 10-Year, Frequency: Weekly) (online at www.federalreserve.gov/releases/h15/data/Weekly_Friday_/H15_TCMNOM_Y10.txt) (accessed October 28, 2009) (hereinafter "Fed H.15 10-Year Treasuries").

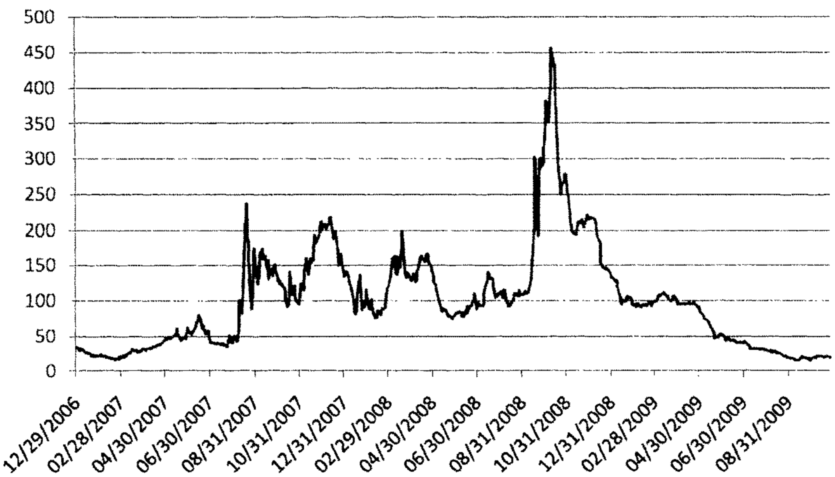
[411] Board of Governors of the Federal Reserve System, *Federal Reserve Statistical Release H.15: Selected Interest Rates: Historical Data* (Instrument: Corporate Bonds/Moody's Seasoned AAA, Frequency: Weekly) (online at www.federalreserve.gov/releases/h15/data/Weekly_Friday_/H15_AAA_NA.txt) (accessed October 28, 2009); Fed H.15 10-Year Treasuries, *supra* note 410.

[412] Board of Governors of the Federal Reserve System, *Federal Reserve Statistical Release H.15: Selected Interest Rates: Historical Data* (Instrument: Corporate Bonds/Moody's Seasoned BAA, Frequency: Weekly) (online at www.federalreserve.gov/releases/h15/data/Weekly_Friday_/H15_BAA_NA.txt) (accessed October 28, 2009); Fed H.15 10-Year Treasuries, *supra* note 410.

[413] Board of Governors of the Federal Reserve System, *Federal Reserve Statistical Release: Commercial Paper Rates and Outstandings: Data Download Program* (Instrument: AA Asset-Backed Discount Rate, Frequency: Daily) (online at www.federalreserve.gov/DataDownload/Choose.aspx?rel=CP) (accessed October 28, 2009); Board of Governors of the Federal Reserve System, *Federal Reserve Statistical Release: Commercial Paper Rates and Outstandings: Data Download Program* (Instrument: AA Nonfinancial Discount Rate, Frequency: Daily) (online at www.federalreserve.gov/DataDownload/Choose.aspx?rel=CP) (accessed October 28, 2009) (hereinafter "Fed CP AA Nonfinancial Rate").

[414] Board of Governors of the Federal Reserve System, *Federal Reserve Statistical Release: Commercial Paper Rates and Outstandings: Data Download Program* (Instrument: A2/P2 Nonfinancial Discount Rate, Frequency: Daily) (online at www.federalreserve.gov/DataDownload/Choose.aspx?rel=CP) (accessed October 28, 2009); Fed CP AA Nonfinancial Rate, *supra* note 413.

Figure 16: TED Spread Since December 29, 2006 (in basis points)[415]



- Commercial Paper Outstanding. Commercial paper outstanding, a rough measure of short-term business debt, is an indicator of the availability of credit for enterprises. While non-financial commercial paper outstanding increased by over 25 percent since the last report, the total outstanding is still 25 percent below its level in January 2007.[416] Financial commercial paper outstanding increased again in October, returning the measure to its January 2007 level.[417]

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[415] *SNL Financial, Historical Dividend Yield Values, 3 Month Libor* (online at www1.snl.com/InteractiveX/history.aspx?RateList=1&Tabular =True&GraphType=2&Frequency =0&TimePeriod 2=11&Begin Date=12%2F29%2F06 &End Date=11%2F4%2F2009&Selected Yield2=YID%3A63&ctl00%24ctl09%24Index Preference=default&Comparison Index2=0&Comparison Yield2=1&Custom Index=0&ComparisonTicker2=&Action=Apply) (accessed Nov. 5, 2009); SNL Financial, *Historical Dividend Yield Values, 3 Month Treasury Bill* (online at www1.snl.com/InteractiveX/history.aspx?Rate List=1 & Tabular=True & Graph Type =2 & Frequency=0 &Time Period2=11 &Begin Date=12%2F29%2F06&EndDate=11%2F4%2F2009&SelectedYield2=YID%3A63&ctl00%24ctl09%24 Index Preference=default & Comparison Index 2=0 & Comparison Yield2=1 & Custom Index = 0& ComparisonTicker2=&Action=Apply) (accessed Nov. 5, 2009).

[416] Board of Governors of the Federal Reserve System, *Federal Reserve Statistical Release: Commercial Paper Rates and Outstandings: Data Download Program* (Instrument: Nonfinancial Commercial Paper Outstanding, Frequency: Weekly) (online at www.federalreserve.gov/DataDownload/Choose.aspx? rel=CP) (accessed Oct. 28, 2009).

[417] Board of Governors of the Federal Reserve System, *Federal Reserve Statistical Release: Commercial Paper Rates and Outstandings: Data Download Program* (Instrument: Financial Commercial Paper Outstanding, Frequency: Weekly) (online at www.federalreserve.gov/DataDownload/Choose.aspx? rel=CP) (accessed Oct. 28, 2009).

FIGURE 17: COMMERCIAL PAPER OUTSTANDING

[Dollars in billions]

Indicator	Current level (as of 10/28/09)	Percent change since last report (10/09/09)
Asset-backed commercial paper outstanding (seasonally adjusted)[418]	$548.6	5.04
Financial commercial paper outstanding (seasonally adjusted)[419]	683.3	13.4
Nonfinancial commercial paper outstanding (seasonally adjusted)[420]	133.2	25.5

[418] Board of Governors of the Federal Reserve System, *Federal Reserve Statistical Release: Commercial Paper Rates and Outstandings: Data Download Program* (Instrument: Asset-Backed Commercial Paper Outstanding, Frequency: Weekly) (online at www.federalreserve.gov/DataDownload/Choose.aspx?rel=CP) (accessed October 28, 2009).

[419] Board of Governors of the Federal Reserve System, *Federal Reserve Statistical Release: Commercial Paper Rates and Outstandings: Data Download Program* (Instrument: Financial Commercial Paper Outstanding, Frequency: Weekly) (online at www.federalreserve.gov/DataDownload/Choose.aspx?rel=CP) (accessed October 28, 2009).

[420] Board of Governors of the Federal Reserve System, *Federal Reserve Statistical Release: Commercial Paper Rates and Outstandings: Data Download Program* (Instrument: Nonfinancial Commercial Paper Outstanding, Frequency: Weekly) (online at www.federalreserve.gov/DataDownload/Choose.aspx?rel=CP) (accessed October 28, 2009).

- Lending by the Largest TARP-recipient Banks. Treasury's Monthly Lending and Intermediation Snapshot tracks loan originations and average loan balances for the 22 largest recipients of CPP funds across a variety of categories, ranging from mortgage loans to commercial real estate to credit card lines. The data below exclude lending by two large CPP-recipient banks, PNC Bank and Wells Fargo, because significant acquisitions by those banks since October 2008 make comparisons difficult. Originations decreased across nearly all categories of bank lending in August when compared to July.[421] Lenders surveyed by Treasury attribute this decrease to bank charge-offs, outstanding debt payments, decreased demand from borrowers, and natural seasonal patterns.[422] Average loan balances decreased by approximately one percent from July to August while total loan originations declined by over 16 percent during that same period.

FIGURE 18: LENDING BY THE LARGEST TARP-RECIPIENT BANKS (WITHOUT PNC AND WELLS FARGO)[423]

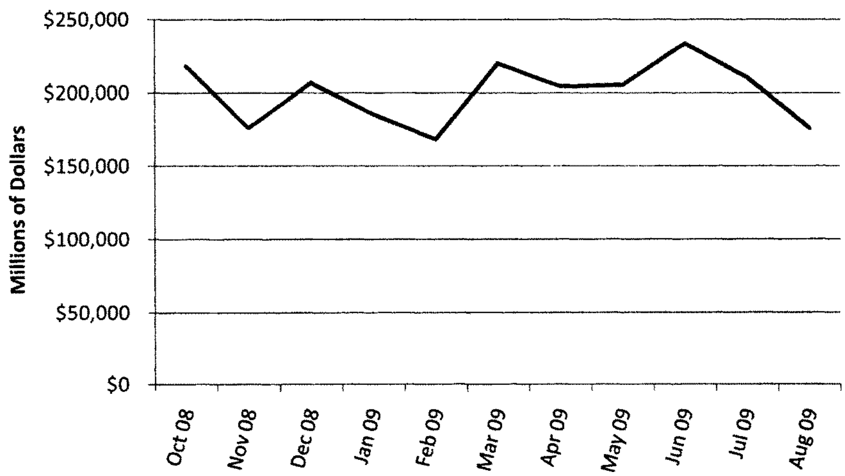
Indicator	Most recent data (August 2009)	Percent change since July 2009	Percent change since October 2008
Total loan originations	$175,850	−16.5	−19.4
Total mortgage originations	61,181	−19	38.1
Mortgage new home purchases	23,614	−8	10.3
Mortgage refinancing	35,201	−25.2	87.6
HELOC originations (new lines & line increases)	2,216	−10.8	−53.4
C&I renewal of existing accounts	44,148	−21.9	−23.1
C&I new commitments	26,431	−17.8	−55.2
Total average loan balances	$3,398,679	−0.89	−0.7

[423] Treasury August Lending Snapshot, *supra* note 422.

[421] U.S. Department of the Treasury, *Treasury Department Monthly Lending and Intermediation Snapshot Data for October 2008—August 2009* (Aug. 31, 2009) (online at www.financialstability.gov/docs/surveys/Snapshot_Data_August_2009.xls) (accessed Nov. 5, 2009).

[422] U.S. Department of the Treasury, *Treasury Department Monthly Lending and Intermediation Snapshot: Summary Analysis for August 2009* (Oct. 28, 2009) (online at www.financialstability.gov/docs/surveys/Snapshot%20Analysis%20August%202009%20Data%2010%2014%2009.pdf).

Figure 19: Top 22 CPP-Recipients, Total Loan Originations (without PNC and Wells Fargo)



• Housing Indicators. Foreclosure filings increased by roughly seven percent from May to June, and are nearly 25 percent above the level of last October. Housing prices, as illustrated by the S&P/Case-Shiller Composite 20 Index, increased slightly in June. The index remains down over 10 percent since October 2008.

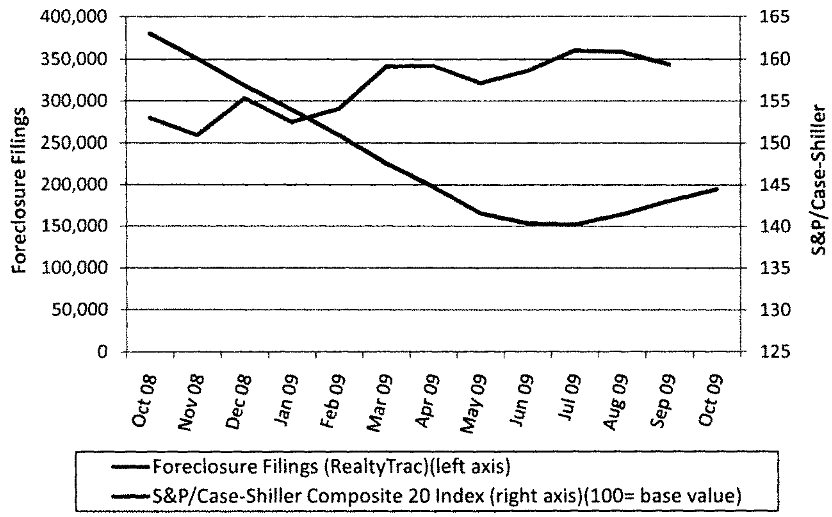
FIGURE 20: HOUSING INDICATORS

Indicator	Most recent monthly data	Percent change from data available at time of last report (8/5/09)	Percent change since October 2008
Monthly foreclosure filings [424]	343,638	−4.1	22.9
Housing prices—S&P/Case-Shiller Composite 20 Index [425]	144.5	.97	−7.9

[424] RealtyTrac, *Foreclosure Activity Press Releases* (online at www.realtytrac.com//ContentManagement/PressRelease.aspx) (accessed Oct. 28, 2009). Most recent data available for September 2009.

[425] Standard & Poor's, *S&P/Case-Shiller Home Price Indices* (Instrument: Seasonally Adjusted Composite 20 Index) (online at www2.standardandpoors.com/spf/pdf/index/SA_CSHomePrice_History_102706.xls) (accessed Oct. 28, 2009). Most recent data available for August 2009.

Figure 21: Foreclosure Filings as Compared to the Case-Shiller 20 City Home Price Index (as of August 2009) (millions of dollars)[426]



• Commercial Real Estate. The commercial real estate market has continued to deteriorate since the Panel's last report. New CRE lending by the top 22 CPP recipients has decreased by over 71 percent since the enactment of EESA. A recent Goldman Sachs report notes that rent growth in this market declined at an annualized rate of 8.7 percent in the second quarter and estimates that there will be a total of $287 billion in aggregated losses.[427] Furthermore, the Federal Reserve's recently released quarterly survey of senior loan officers reported that the net percentage of respondents reporting weaker demand for CRE loans was 63 percent during the third quarter of 2009.[428]

FIGURE 22: COMMERCIAL REAL ESTATE LENDING BY TOP 22 CPP RECIPIENTS (WITHOUT PNC AND WELLS FARGO)[429]

[Dollars in millions]

Indicator	Current level (as of 8/31/09)	Percent change since last report (10/9/09)	Percent change since ESSA signed into law (10/3/08)
CRE New Commitments	$2,982	−13.4	−71.7
CRE Renewal of Existing Accounts	8,246	−20	−8.3
CRE Average Total Loan Balance	377,433	0.43	0.69

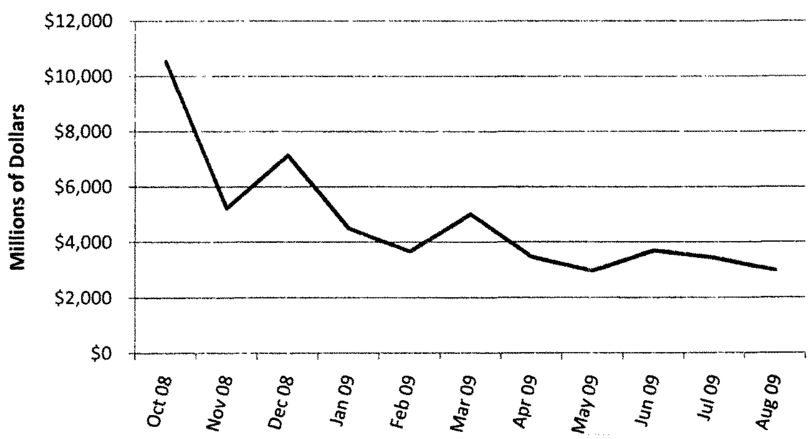
[429] Treasury August Lending Snapshot, *supra* note 422.

[426] RealtyTrac, *Foreclosure Activity Press Releases* (online at www.realtytrac.com//ContentManagement/PressRelease.aspx) (accessed Oct. 28, 2009); Standard & Poor's, *S&P/Case-Shiller Home Price Indices* (Instrument: Seasonally Adjusted Composite 20 Index) (online at www2.standardandpoors.com/spf/pdf/index/SA_CSHomePrice_History_102706.xls) (accessed Oct. 28, 2009).

[427] The Goldman Sachs Group, Inc., *US Commercial Real Estate Take III: Reconstructing Estimates for Losses,* Timing (Sept. 29, 2009).

[428] Board of Governors of the Federal Reserve System, *The July 2009 Senior Loan Officer Opinion Survey on Bank Lending Practices* (online at www.federalreserve.gov/boarddocs/snloansurvey/200908/fullreport.pdf) (accessed Nov. 4, 2009).

Figure 23: Top 22 CPP-Recipients, CRE New Commitments (without PNC and Wells Fargo)[430]



F. Financial Update

Each month since its April oversight report, the Panel has summarized the resources that the federal government has committed to economic stabilization. The following financial update provides: (1) an updated accounting of the TARP, including a tally of dividend income and repayments that the program has received as of September 30, 2009; and (2) an update of the full federal resource commitment as of October 28, 2009.

1. TARP

a. Costs: Expenditures and Commitments [431]

Treasury is currently committed to spend $531.3 billion of TARP funds through an array of programs used to purchase preferred shares in financial institutions, offer loans to small businesses and automotive companies, and leverage Federal Reserve loans for facilities designed to restart secondary securitization markets.[432] Of this total, $391.6 billion is currently outstanding under the $698.7 billion limit for TARP expenditures set by EESA, leaving $307.1 billion available for fulfillment of anticipated funding levels of existing programs and for funding new programs and initiatives. The $391.6 billion includes purchases of preferred and common shares, warrants and/or debt obligations under the CPP, TIP, SSFI Program, and AIFP; a $20 billion loan to TALF LLC, the special purpose vehicle (SPV) used to guarantee Federal Reserve TALF loans; and the $5 billion Citigroup asset guarantee, which was exchanged for a guarantee fee composed of additional preferred shares and

[430] Treasury August Lending Snapshot, *supra* note 422.

[431] Treasury will release its next tranche report when transactions under the TARP reach $500 billion.

[432] EESA, as amended by the Helping Families Save Their Homes Act of 2009, limits Treasury to $698.7 billion in purchasing authority outstanding at any one time as calculated by the sum of the purchases prices of all troubled assets held by Treasury. Pub. L. No. 110–343, § 115(a)–(b); Helping Families Save Their Homes Act of 2009, Pub. L. No. 111–22, § 402(f) (reducing by $1.26 billion the authority for the TARP originally set under EESA at $700 billion).

warrants and has subsequently been exchanged for Trust Preferred shares.[433] Additionally, Treasury has allocated $27.3 billion to the Home Affordable Modification Program, out of a projected total program level of $50 billion.

b. Income: Dividends, Interest Payments, and CPP Repayments

A total of 42 institutions have completely repaid their CPP preferred shares, 27 of which have also repurchased warrants for common shares that Treasury received in conjunction with its preferred stock investments. Treasury received $88.4 million in repayments from three CPP participants during October.[434] There were over $68 billion in repayments made by 12 banks in June the total repayments since then have been approximately $680.8 million. In addition, Treasury is entitled to dividend payments on preferred shares that it has purchased, usually five percent per annum for the first five years and nine percent per annum thereafter.[435] In total, Treasury has received approximately $86 billion in income from repayments, warrant repurchases, dividends, and interest payments deriving from TARP investments[436] and another $1.2 billion in participation fees from its Guarantee Program for Money Market Funds.[437]

d. TARP Accounting

FIGURE 24: TARP ACCOUNTING (AS OF OCTOBER 28, 2009)

[Dollars in billions]

TARP Initiative	Anticipated funding	Purchase price	Repayments	Net current investments	Net available
Total	$531.3	$467	$72.9	$391.6	[438] $307.1
CPP	218	204.7	70.8	133.9	[439] 13.3
TIP	40	40	0	40	0
SSFI program	69.8	69.8	0	69.8	0
AIFP	80	80	2.1	[440] 75.4	[441] 0
AGP	5	5	0	5	0
CAP	TBD	0	N/A	0	N/A
TALF	20	20	0	20	0
PPIP	30	16.7	N/A	16.7	13.3
Supplier support program	[442] 3.5	3.5	0	3.5	0
Unlocking SBA lending	15	0	N/A	0	15
HAMP	50	[443] 27.3	0	27.3	22.7
(Uncommitted)	167.4	N/A	N/A	N/A	[444] 242.6

[438] This figure is the sum of the uncommitted funds remaining under the $698.7 billion cap ($167.4 billion) and the difference between the total anticipated funding and the net current investment ($139.7 billion).
[439] This figure excludes the repayment of $70.7 billion in CPP funds. Secretary Geithner has suggested that funds from CPP repurchases will be treated as uncommitted funds of the TARP upon return to the Treasury.
[440] This number consists of the original assistance amount of $80 billion less de-obligations ($2.4 billion) and repayments ($2.14 billion); $2.4 billion in apportioned funding has been de-obligated by Treasury ($1.91 billion of the available $3.8 billion of DIP financing to Chrysler and a $500 million loan facility dedicated to Chrysler that was unused). October 30 TARP Transactions Report, *supra* note 27.
[441] Treasury has indicated that it will not provide additional assistance to GM and Chrysler through the AIFP. Government Accountability Office, *Auto Industry: Continued Stewardship Needed as Treasury Develops Strategies for Monitoring and Divesting Financial Interests in Chrysler and GM*, at 28 (Nov. 2009) (GAO–10–151) (online at www.gao.gov/new.items/d10151.pdf) (hereinafter "GAO Auto Report"). The Panel therefore considers the repaid and de-obligated AIFP funds to be uncommitted TARP funds.

[433] October 30 TARP Transactions Report, *supra* note 27.
[434] October 30 TARP Transactions Report, *supra* note 27.
[435] *See, e.g.*, U.S. Department of the Treasury, *Securities Purchase Agreement: Standard Terms* (online at www.financialstability.gov/docs/CPP/spa.pdf) (accessed Nov. 4, 2009).
[436] U.S. Department of the Treasury, *Cumulative Dividends Report as of August 31, 2009* (Oct. 1, 2009) (online at www.financialstability.gov/docs/dividends-interest-reports/August2009_DividendsInterestReport.pdf); October 30 TARP Transactions Report, *supra note 27.*
[437] Money Market Expiration Release, *supra* note 313.

[442] On July 8, 2009, Treasury lowered the total commitment amount for the program from $5 billion to $3.5 billion, this reduced GM's portion from $3.5 billion to $2.5 billion and Chrysler's portion from $1.5 billion to $1 billion. October 30 Transactions Report, *supra* note 28.

[443] This figure reflects the total of all the caps set on payments to each mortgage servicer. October 30 Transactions Report, *supra* note 27.

[444] This figure is the sum of the uncommitted funds remaining under the $698.7 billion cap ($167.4 billion), the repayments ($72.8 billion), and the de-obligated portion of the AIFP ($2.4 billion). Treasury provided de-obligation information on August 18, 2009, in response to specific inquiries relating to the Panel's oversight of the AIFP. Specifically, this information denoted allocated funds that had since been de-obligated.

FIGURE 25: TARP REPAYMENTS AND INCOME

[Dollars in billions]

TARP Initiative	Repayments (as of 10/28/09)	Dividends [445] (as of 9/30/09)	Interest [446] (as of 9/30/09)	Warrant repurchases [447] (as of 10/28/09)	Total
Total	$72.9	$9.3	$0.22	$2.9	$85.6
CPP	70.8	6.8	0.01	2.9	80.5
TIP	0	1.9	N/A	0	1.9
AIFP	2.1	0.5	0.2	N/A	2.82
ASSP	N/A	N/A	0.01	N/A	0.01
AGP [448]	0	0.2	N/A	0	0.2
Bank of America Guarantee					.28

[445] U.S. Department of the Treasury, *Cumulative Dividends Report as of September 30, 2009 (Oct. 30, 2009)* (online at www.financialstability.gov/docs/dividends-interest-reports/September%202009_Dividends%20and%20Interest%20Report.pdf).

[446] U.S. Department of the Treasury, *Cumulative Dividends Report as of September 30, 2009 (Oct. 30, 2009)* (online at www.financialstability.gov/docs/dividends-interest-reports/September%202009_Dividends%20and%20Interest%20Report.pdf).

[447] This number includes $1.6 million in proceeds from the repurchase of preferred shares by privately-held financial institutions. For privately-held financial institutions that elect to participate in the CPP, Treasury receives and immediately exercises warrants to purchase additional shares of preferred stock. October 30 Transactions Report, *supra* note 28.

[448] Citigroup is the lone participant in the AGP.

Rate of Return

As of October 30, 2009, the average internal rate of return for all financial institutions that participated in the CPP and fully repaid the U.S. government (including preferred shares, dividends, and warrants) is 17.2 percent. The internal rate of return is the annualized effective compounded return rate that can be earned on invested capital.

2. Other Financial Stability Efforts

Federal Reserve, FDIC, and Other Programs

In addition to the direct expenditures Treasury has undertaken through TARP, the federal government has engaged in a much broader program directed at stabilizing the U.S. financial system. Many of these initiatives explicitly augment funds allocated by Treasury under specific TARP initiatives, such as FDIC and Federal Reserve asset guarantees for Citigroup, or operate in tandem with Treasury programs, such as the interaction between PPIP and TALF. Other programs, like the Federal Reserve's extension of credit through its section 13(3) facilities and SPVs and the FDIC's Temporary Liquidity Guarantee Program, operate independently of TARP. As shown in the following tables, the Federal Reserve and the FDIC have earned approximately $18 billion in fees from programs aimed at stabilizing the economy and expanding the credit markets.

3. Total Financial Stability Resources (as of October 28, 2009)

Beginning in its April report, the Panel broadly classified the resources that the federal government has devoted to stabilizing the economy through a myriad of new programs and initiatives as outlays, loans, or guarantees. Although the Panel calculates the total value of these resources at over $3 trillion, this would translate into the ultimate "cost" of the stabilization effort only if: (1) assets do not appreciate; (2) no dividends are received, no warrants are exercised, and no TARP funds are repaid; (3) all loans default and are written off; and (4) all guarantees are exercised and subsequently written off.

With respect to the FDIC and Federal Reserve programs, the risk of loss varies significantly across the programs considered here, as do the mechanisms providing protection for the taxpayer against such risk. As discussed elsewhere in this report, the FDIC assesses a premium of up to 100 basis points on TLGP debt guarantees. In contrast, the Federal Reserve's liquidity programs are generally available only to borrowers with good credit, and the loans are over-collateralized and with recourse to other assets of the borrower. If the assets securing a Federal Reserve loan realize a decline in value greater than the "haircut," the Federal Reserve is able to demand more collateral from the borrower. Similarly, should a borrower default on a recourse loan, the Federal Reserve can turn to the borrower's other assets to make the Federal Reserve whole. In this way, the risk to the taxpayer on recourse loans only materializes if the borrower enters bankruptcy. The only loans currently "underwater"—where the outstanding principal amount exceeds the current market value of the collateral—are two of the three non-recourse loans to the Maiden Lane SPVs (used to purchase Bear Stearns and AIG assets).

FIGURE 26: FEDERAL GOVERNMENT FINANCIAL STABILITY EFFORT (AS OF OCTOBER 28, 2009)

[Dollars in billions]

Program	Treasury (TARP)	Federal Reserve	FDIC	Total
Total	$698.7	$1,651.8	$846.7	[iii] $3,028.2
Outlays [i]	387.3	0	47.7	435
Loans	43.7	1,431.4	0	1,475.1
Guarantees [ii]	25	220.4	630	875.4
Uncommitted TARP Funds	242.7	0	0	242.7
AIG	69.8	95.3	0	165.1
Outlays	[iv] 69.8	0	0	69.8
Loans	0	[v] 95.3	0	95.3
Guarantees	0	0	0	0
Bank of America	45	0	0	45
Outlays	[vii] 45	0	0	45
Loans	0	0	0	0
Guarantees [vi]	0	0	0	0
Citigroup	50	220.4	10	280.4
Outlays	[viii] 45	0	0	45
Loans	0	0	0	0
Guarantees	[ix] 5	[x] 220.4	[xi] 10	235.4
Capital Purchase Program (Other)	97.3	0	0	97.3
Outlays	[xii] 97.3	0	0	97.3
Loans	0	0	0	0
Guarantees	0	0	0	0
Capital Assistance Program	TBD	0	0	[xiii] TBD
TALF	20	180	0	200
Outlays	0	0	0	0
Loans	0	[xv] 180	0	180
Guarantees	[xiv] 20	0	0	20
PPIP (Loans) [xvi]	0	0	0	0
Outlays	0	0	0	0

FIGURE 26: FEDERAL GOVERNMENT FINANCIAL STABILITY EFFORT (AS OF OCTOBER 28, 2009)—Continued

[Dollars in billions]

Program	Treasury (TARP)	Federal Reserve	FDIC	Total
Loans	0	0	0	0
Guarantees	0	0	0	0
PPIP (Securities)	[xvii] 30	0	0	30
Outlays	10	0	0	10
Loans	20	0	0	20
Guarantees	0	0	0	0
Home Affordable Modification Program	50	0	0	[xix] 50
Outlays	[xviii] 50	0	0	50
Loans	0	0	0	0
Guarantees	0	0	0	0
Automotive Industry Financing Program	75.4	0	0	75.4
Outlays	[xx] 55.2	0	0	55.2
Loans	20.2	0	0	20.2
Guarantees	0	0	0	0
Auto Supplier Support Program	3.5	0	0	3.5
Outlays	0	0	0	0
Loans	[xxi] 3.5	0	0	3.5
Guarantees	0	0	0	0
Unlocking SBA Lending	15	0	0	15
Outlays	[xxii] 15	0	0	15
Loans	0	0	0	0
Guarantees	0	0	0	0
Temporary Liquidity Guarantee Program	0	0	620	620
Outlays	0	0	0	0
Loans	0	0	0	0
Guarantees	0	0	[xxiii] 620	620
Deposit Insurance Fund	0	0	47.7	47.7
Outlays	0	0	[xxiv] 47.7	47.7
Loans	0	0	0	0
Guarantees	0	0	0	0
Other Federal Reserve Credit Expansion	0	1,156.1	0	1,156.1
Outlays	0	0	0	0
Loans	0	[xxv] 1,156.1	0	1,156.1
Guarantees	0	0	0	0
Uncommitted TARP Funds	242.7	0	0	242.7

[i] The term ''outlays'' is used here to describe the use of Treasury funds under the TARP, which are broadly classifiable as purchases of debt or equity securities (e.g., debentures, preferred stock, exercised warrants, etc.). The outlays figures are based on: (1) Treasury's actual reported expenditures; and (2) Treasury's anticipated funding levels as estimated by a variety of sources, including Treasury pronouncements and GAO estimates. Anticipated funding levels are set at Treasury's discretion, have changed from initial announcements, and are subject to further change. Outlays as used here represent investments and assets purchases and commitments to make investments and asset purchases and are not the same as budget outlays, which under section 123 of EESA are recorded on a ''credit reform'' basis.

[ii] While many of the guarantees may never be exercised or exercised only partially, the guarantee figures included here represent the federal government's greatest possible financial exposure.

[iii] This figure is roughly comparable to the $3.0 trillion current balance of financial system support reported by SIGTARP in its July report. SIGTARP, *Quarterly Report to Congress*, at 138 (July 21, 2009) (online at www.sigtarp.gov/reports/congress/2009/July2009_Quarterly_Report_to_Congress.pdf). However, the Panel has sought to capture additional anticipated exposure and thus employs a different methodology than SIGTARP.

[iv] This number includes investments under the SSFI Program: a $40 billion investment made on November 25, 2008, and a $30 billion investment committed on April 17, 2009 (less a reduction of $165 million representing bonuses paid to AIG Financial Products employees).

[v] This number represents the full $60 billion that is available to AIG through its revolving credit facility with the Federal Reserve ($42.8 billion had been drawn down as of October 29, 2009) and the outstanding principle of the loans extended to the Maiden Lane II and III SPVs to buy AIG assets (as of October 29, 2009, $16.3 billion and $19 billion respectively). Income from the purchased assets is used to pay down the loans to the SPVs, reducing the taxpayers' exposure to losses over time. Board of Governors of the Federal Reserve System, Federal Reserve System Monthly Report on Credit and Liquidity Programs and the Balance Sheet, at 17 (Oct. 2009) (online at http://www.federalreserve.gov/monetarypolicy/files/monthlyclbsreport200910.pdf) (hereinafter ''Fed October 2009 Credit and Liquidity Report'').

[vi] A further discussion of the Panel's approach to classifying this agreement appears, *infra*.

[vii] October 30 TARP Transactions Report, *supra* note 27. This figure includes: (1) a $15 billion investment made by Treasury on October 28, 2008 under the CPP; (2) a $10 billion investment made by Treasury on January 9, 2009 also under the CPP; and (3) a $20 billion investment made by Treasury under the TIP on January 16, 2009.

[viii] October 30 TARP Transactions Report, *supra* note 27. This figure includes: (1) a $25 billion investment made by Treasury under the CPP on October 28, 2008; and (2) a $20 billion investment made by Treasury under TIP on December 31, 2008.

[ix] U.S. Department of the Treasury, *Summary of Terms: Eligible Asset Guarantee* (Nov. 23, 2008) (online at www.treasury.gov/press/releases/reports/cititermsheet_112308.pdf) (hereinafter ''Citigroup Asset Guarantee'') (granting a 90 percent federal guarantee on all losses over $29 billion after existing reserves (totaling a $39.5 billion first-loss position for Citigroup), of a $306 billion pool of Citigroup assets, with the first $5 billion of the cost of the guarantee borne by Treasury, the next $10 billion by FDIC, and the remainder by the Federal Reserve). See also U.S. Department of the Treasury, *U.S. Government Finalizes Terms of Citi Guarantee Announced in November* (Jan. 16, 2009) (online at www.treas.gov/press/releases/hp1358.htm) (reducing the size of the asset pool from $306 billion to $301 billion).

[x] Citigroup Asset Guarantee, *supra* note ix.

[xi] Citigroup Asset Guarantee, *supra* note ix.

[xii] This figure represents the $218 billion Treasury has anticipated spending under the CPP, minus the $50 billion investment in Citigroup ($25 billion) and Bank of America ($25 billion) identified above, and the $70.7 billion in repayments that are reflected as uncommitted TARP funds. This figure does not account for future repayments of CPP investments, nor does it account for dividend payments from CPP investments.

[xiii] The CAP was announced on February 25, 2009 and as of yet has not been utilized. The Panel will continue to classify the CAP as dormant until a transaction is completed and reported as part of the program.

[xiv] This figure represents a $20 billion allocation to the TALF SPV on March 3, 2009. October 30 TARP Transactions Report, *supra* note 27. Consistent with the analysis in our August report, only $49.8 billion dollars in TALF loans have been requested as of November 2, 2009, the Panel continues to predict that TALF subscriptions are unlikely to surpass the $200 billion currently available by year's end. Congressional Oversight Panel, *August Oversight Report: The Continued Risk of Troubled Assets*, at 10–22 (August 11, 2009) (discussion of what constitutes a ''troubled asset'') (online at cop.senate.gov/documents/cop-081109-report.pdf).

[xv] This number is derived from the unofficial 1:10 ratio of the value of Treasury loan guarantees to the value of Federal Reserve loans under the TALF. U.S. Department of the Treasury, *Fact Sheet: Financial Stability Plan* (Feb. 10, 2009) (online at www.financialstability.gov/docs/fact-sheet.pdf) (describing the initial $20 billion Treasury contribution tied to $200 billion in Federal Reserve loans and announcing potential expansion to a $100 billion Treasury contribution tied to $1 trillion in Federal Reserve loans). Because Treasury is responsible for reimbursing the Federal Reserve Board for $20 billion of losses on its $200 billion in loans, the Federal Reserve Board's maximum potential exposure under the TALF is $180 billion.

[xvi] It now appears unlikely that resources will be expended under the PPIP Legacy Loans Program in its original design as a joint Treasury-FDIC program to purchase troubled assets from solvent banks. See also Federal Deposit Insurance Corporation, *FDIC Statement on the Status of the Legacy Loans Program* (June 3, 2009) (online at www.fdic.gov/news/news/press/2009/pr09084.html) and Federal Deposit Insurance Corporation, *Legacy Loans Program—Test of Funding Mechanism* (July 31, 2009) (online at www.fdic.gov/news/news/press/2009/pr09131.html). The sales described in these statements do not involve any Treasury participation, and FDIC activity is accounted for here as a component of the FDIC's Deposit Insurance Fund outlays.

[xvii] U.S. Department of the Treasury, *Joint Statement by Secretary of the Treasury Timothy F. Geithner, Chairman of the Board of Governors of The Federal Reserve System Ben S. Bernanke, and Chairman of the Federal Deposit Insurance Corporation Sheila Bair: Legacy Asset Program* (July 8, 2009) (online at www.financialstability.gov/latest/tg—07082009.html) (''Treasury will invest up to $30 billion of equity and debt in PPIFs established with private sector fund managers and private investors for the purpose of purchasing legacy securities.''); U.S. Department of the Treasury, *Fact Sheet: Public-Private Investment Program*, at 4–5 (Mar. 23, 2009) (online at www.treas.gov/press/releases/reports/ppip_fact_sheet.pdf) (hereinafter ''Treasury PPIP Fact Sheet'') (outlining that, for each $1 of private investment into a fund created under the Legacy Securities Program, Treasury will provide a matching $1 in equity to the investment fund; a $1 loan to the fund; and, at Treasury's discretion, an additional loan up to $1). As of October 23, 2009, Treasury reported $11.1 billion in outstanding loans and $5.6 billion in membership interest associated with the program, thus substantiating the Panel's assumption that Treasury may routinely exercise its discretion to provide $2 of financing for every $1 of equity 2:1 ratio. *See*, October 30 TARP Transactions Report, *supra* note 27.

[xviii] U.S. Government Accountability Office, *Troubled Asset Relief Program: June 2009 Status of Efforts to Address Transparency and Accountability Issues*, at 2 (June 17, 2009) (GAO09/658) (online at www.gao.gov/new.items/d09658.pdf) (hereinafter ''GAO June 29 Status Report''). Of the $50 billion in announced TARP funding for this program, $27.3 billion has been allocated as of October 23, 2009. October 30 TARP Transactions Report, *supra* note 27.

[xix] Fannie Mae and Freddie Mac, government-sponsored entities (GSEs) that were placed in conservatorship of the Federal Housing Finance Housing Agency on September 7, 2009, will also contribute up to $25 billion to the Making Home Affordable Program, of which the HAMP is a key component. U.S. Department of the Treasury, *Making Home Affordable: Updated Detailed Program Description* (Mar. 4, 2009) (online at www.treas.gov/press/releases/reports/housing_fact_sheet.pdf).

[xx] October 30 TARP Transactions Report, *supra* note 27. A substantial portion of the total $80 billion in loans extended under the AIFP have since been converted to common equity and preferred shares in restructured companies. $20.2 billion has been retained as first lien debt (with $7.7 billion committed to GM and $12.5 billion to Chrysler). This figure represents Treasury's current obligation under the AIFP. There have been $2.1 billion in repayments and $2.4 billion in de-obligated funds under the AIFP.

[xxi] October 30 TARP Transactions Report, *supra* note 27.

[xxii] Treasury PPIP Fact Sheet, *supra* note xvii.

[xxiii] This figure represents the current maximum aggregate debt guarantees that could be made under the program, which, in turn, is a function of the number and size of individual financial institutions participating. $307 billion of debt subject to the guarantee has been issued to date, which represents about 50 percent of the current cap. Federal Deposit Insurance Corporation, *Monthly Reports on Debt Issuance Under the Temporary Liquidity Guarantee Program: Debt Issuance Under Guarantee Program* (Sept. 30, 2009) (online at http://www.fdic.gov/regulations/resources/TLGP/total_issuance9_09.html) (updated Oct. 28, 2009). The FDIC has collected $9.64 billion in fees and surcharges from this program since its inception in the fourth quarter of 2008. Federal Deposit Insurance Corporation, *Monthly Reports on Debt Issuance Under the Temporary Liquidity Guarantee Program* (Sept. 30, 2009) (online at www.fdic.gov/regulations/resources/TLGP/fees.html) (updated Oct. 23, 2009).

[xxiv] This figure represents the FDIC's provision for losses to its deposit insurance fund attributable to bank failures in the third and fourth quarters of 2008 and the first and second quarters of 2009. Federal Deposit Insurance Corporation, *Chief Financial Officer's (CFO) Report to the Board: DIF Income Statement (Fourth Quarter 2008)* (online at www.fdic.gov/about/strategic/corporate/cfo_report_4qtr_08/income.html); Federal Deposit Insurance Corporation, *Chief Financial Officer's (CFO) Report to the Board: DIF Income Statement (Third Quarter 2008)* (online at www.fdic.gov/about/strategic/corporate/cfo_report_3rdqtr_08/income.html); Federal Deposit Insurance Corporation, *Chief Financial Officer's (CFO) Report to the Board: DIF Income Statement (First Quarter 2009)* (online at www.fdic.gov/about/strategic/corporate/cfo_report_1stqtr_09/income.html); Federal Deposit Insurance Corporation, *Chief Financial Officer's (CFO) Report to the Board: DIF Income Statement (Second Quarter 2009)* (online at www.fdic.gov/about/strategic/corporate/cfo_report_2ndqtr_09/income.html). This figure includes the FDIC's estimates of its future losses under loss share agreements that it has entered into with banks acquiring assets of insolvent banks during these four quarters. Under a loss sharing agreement, as a condition of an acquiring bank's agreement to purchase the assets of an insolvent bank, the FDIC typically agrees to cover 80 percent of an acquiring bank's future losses on an initial portion of these assets and 95 percent of losses of another portion of assets. *See*, for example Federal Deposit Insurance Corporation, *Purchase and Assumption Agreement Among FDIC, Receiver of Guaranty Bank, Austin, Texas, FDIC and Compass Bank* at 65–66 (Aug. 21, 2009) (online at www.fdic.gov/bank/individual/failed/guaranty-tx_p_and_a_w_addendum.pdf). In information provided to Panel staff, the FDIC disclosed that there were approximately $82 billion in assets covered under loss-share agreements as of September 4, 2009. Furthermore, the FDIC estimates the total cost of a payout under these agreements to be $36.2 billion. Since there is a published loss estimate for these agreements, the Panel continues to reflect them as outlays rather than as guarantees.

[xxv] This figure is derived from adding the total credit the Federal Reserve Board has extended as of October 23, 2009 through the Term Auction Facility (Term Auction Credit), Discount Window (Primary Credit), Primary Dealer Credit Facility (Primary Dealer and Other Broker-Dealer Credit), Central Bank Liquidity Swaps, loans outstanding to Bear Stearns (Maiden Lane I LLC), GSE Debt Securities (Federal Agency Debt Securities), Mortgage Backed Securities Issued by GSEs, Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility, and Commercial Paper Funding Facility LLC. The level of Federal Reserve lending under these facilities will fluctuate in response to market conditions. Fed Report on Credit and Liquidity, *supra* note v.

SECTION FOUR: OVERSIGHT ACTIVITIES

The Congressional Oversight Panel was established as part of the Emergency Economic Stabilization Act (EESA) and formed on November 26, 2008. Since then, the Panel has produced eleven oversight reports, as well as a special report on regulatory reform, issued on January 29, 2009, and a special report on farm credit, issued on July 21, 2009. Since the release of the Panel's October oversight report assessing foreclosure mitigation efforts, the following developments pertaining to the Panel's oversight of the Troubled Asset Relief Program (TARP) took place:

- The Panel received a letter from Ben S. Bernanke, Chairman of the Board of Governors of the Federal Reserve System, dated October 8, 2009,[449] providing commentary on a July Report from the Government Accountability Office, titled Financial Crisis Highlights Need to Improve Oversight of Leverage at Financial Institutions and Across System.
- The Panel held a hearing in Washington, D.C. with Assistant Secretary of the Treasury for Financial Stability Herbert M. Allison, Jr. on October 22. Assistant Secretary Allison answered questions relating to the Panel's recent report on foreclosure mitigation efforts, compensation issues for executives of firms that had received TARP funds, and the Administration's recent proposed program to assist small businesses and community banks.

Upcoming Reports and Hearings

The Panel will release its next oversight report in December. The report will assess TARP's overall performance since its inception.

The Panel is planning a hearing with leading economic experts on November 19, 2009. The Panel will seek the perspective of these experts on TARP performance to help inform the upcoming December report.

The Panel is planning its third hearing with Secretary Geithner on December 10, 2009. The Secretary has agreed to testify before the Panel once per quarter. His most recent hearing was on September 10, 2009.

[449] *See* Appendix I of this report, *infra*.

SECTION FIVE: ABOUT THE CONGRESSIONAL OVERSIGHT PANEL

In response to the escalating crisis, on October 3, 2008, Congress provided Treasury with the authority to spend $700 billion to stabilize the U.S. economy, preserve home ownership, and promote economic growth. Congress created the Office of Financial Stabilization (OFS) within Treasury to implement a Troubled Asset Relief Program. At the same time, Congress created the Congressional Oversight Panel to "review the current state of financial markets and the regulatory system." The Panel is empowered to hold hearings, review official data, and write reports on actions taken by Treasury and financial institutions and their effect on the economy. Through regular reports, the Panel must oversee Treasury's actions, assess the impact of spending to stabilize the economy, evaluate market transparency, ensure effective foreclosure mitigation efforts, and guarantee that Treasury's actions are in the best interests of the American people. In addition, Congress instructed the Panel to produce a special report on regulatory reform that analyzes "the current state of the regulatory system and its effectiveness at overseeing the participants in the financial system and protecting consumers." The Panel issued this report in January 2009. Congress subsequently expanded the Panel's mandate by directing it to produce a special report on the availability of credit in the agricultural sector. The report was issued on July 21, 2009.

On November 14, 2008, Senate Majority Leader Harry Reid and the Speaker of the House Nancy Pelosi appointed Richard H. Neiman, Superintendent of Banks for the State of New York, Damon Silvers, Director of Policy and Special Counsel of the American Federation of Labor and Congress of Industrial Organizations (AFL–CIO), and Elizabeth Warren, Leo Gottlieb Professor of Law at Harvard Law School to the Panel. With the appointment on November 19, 2008 of Congressman Jeb Hensarling to the Panel by House Minority Leader John Boehner, the Panel had a quorum and met for the first time on November 26, 2008, electing Professor Warren as its chair. On December 16, 2008, Senate Minority Leader Mitch McConnell named Senator John E. Sununu to the Panel. Effective August 10, 2009, Senator Sununu resigned from the Panel and on August 20, Senator McConnell announced the appointment of Paul Atkins, former Commissioner of the U.S. Securities and Exchange Commission, to fill the vacant seat.

APPENDIX I: LETTER FROM FEDERAL RESERVE BOARD CHAIRMAN BEN S. BERNANKE TO PANEL MEMBERS, RE: COMMENTARY ON JULY GAO REPORT ON FINANCIAL CRISIS, DATED OCTOBER 8, 2009

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

October 8, 2009

BEN S. BERNANKE
CHAIRMAN

The Honorable Elizabeth Warren
Chair
Congressional Oversight Panel
732 North Capitol Street, N.W.
Room C-320 and C-617
Washington, D.C. 20401

Dear Ms. Warren:

With respect to the report issued by the Government Accountability Office (GAO) entitled *Financial Crisis Highlights Need to Improve Oversight of Leverage at Financial Institutions and across System* (July 2009), the Federal Reserve Board agrees with the GAO's recommendation that, in light of lessons learned from the current financial crisis, it assess the extent to which proposed reforms to the Basel Capital Accord (Basel II) address risk evaluation and regulatory oversight concerns associated with advanced risk modeling approaches. This recommendation is consistent with the Federal Reserve's ongoing efforts to address the potential shortcomings of the Basel II framework and determine whether, and to what degree, fundamental changes to the framework are warranted.

Among the lessons learned from the financial crisis is the degree to which banking organizations' internal risk measurement models may fail to work as intended or may be used inappropriately for purposes not considered in their initial design. To help mitigate these potential issues, the U.S. rule implementing the Basel II advanced approaches (Basel II rule) imposes specific model validation, stress testing, internal control, and supervisory approval requirements that a banking organization must meet in order to use advanced models to calculate its regulatory capital requirements and determine the risk parameters that factor into those calculations.[17] Nonetheless, use of internal models to determine capital requirements for credit and operational risk remains largely untested in practice. The Federal Reserve will continue to assess the risk evaluation and regulatory oversight aspects of the advanced approaches as banking organizations implement the risk assessment and other systems required by the Basel II rule. It will also maintain the leverage capital requirement as a complement to the risk-based capital requirements. In addition, as described in the Basel II rule, before any banking organization may rely on the rule to determine its risk-based capital requirement, the federal banking agencies will publish the conclusions from a study that evaluates the advanced approaches of the Basel II rule to determine if there are any material deficiencies in its function as a regulatory capital framework.

[17] See 72 Fed. Reg. 69288, 69396 (Dec. 7, 2007).

Another lesson learned from the crisis is that firms that adopted a comprehensive view of their risk exposures tended to deal more successfully with market turmoil by using information developed across the firm to adjust their business strategy, risk management practices, and exposures proactively in response to changing market conditions. In institutions that experienced greater difficulty in responding to the crisis, business line and senior management often did not adequately coordinate the firms' risks in light of evolving conditions in the marketplace, leaving the business lines to make decisions in isolation. In some cases, this further increased the institutions exposures to risk. Supervisors must therefore emphasize the importance of a firm's assessment of its overall capital adequacy--incorporating among other things the uncertainty around model outputs, correlations across risk types, and risks not easily subject to quantification--in addition to focusing on its micro-level risk measurement models. Moreover, minimum regulatory capital requirements alone cannot achieve safety and soundness. In particular, more attention must be given to liquidity requirements and the overall effectiveness of the risk management systems of financial institutions. In this vein, the Board and the other federal banking agencies recently issued for public comment proposed guidance on funding and liquidity risk management.[18]

The Board will continue to incorporate the lessons of the recent crisis into its domestic supervisory agenda as well as the work of the Basel Committee. Federal Reserve staff participate in, and in several cases lead, Basel Committee working groups tasked with evaluating and addressing weaknesses in Basel II. As a result of this work, in July 2009, the Basel Committee published revisions to the Basel II treatment of market risk and of certain securitization exposures. Ongoing work includes a broader review of the treatment of securitization, counterparty credit risk, the definition of capital, a leverage capital requirement to supplement the risk-based capital requirements, and assessment of the procyclical effects of Basel II.

Thank you for the opportunity to comment on this important matter. The Board appreciates the professionalism of, and the careful analysis performed by, the GAO review team.

Sincerely,

cc: The Honorable Jeb Hensarling
Mr. Richard H. Neiman
The Honorable Paul Atkins
Mr. Damon A. Silvers

[18] 74 Fed. Reg. 32035 (July 6, 2009)