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Testimony

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TROUBLED ASSET RELIEF PROGRAM

Status of Efforts to Address Transparency and Accountability Issues

Statement of Gene L. Dodaro
Acting Comptroller General of the United States



GAO

Accountability * Integrity * Reliability

Mr. Chairman, Ranking Member Boustany, and Members of the Subcommittee:

I am pleased to be here today to discuss our work on the Troubled Asset Relief Program (TARP), under which the Department of the Treasury (Treasury) has the authority to purchase and insure up to \$700 billion in troubled assets held by financial institutions through its Office of Financial Stability (OFS).¹ As you know, Treasury was granted this authority in response to the financial crisis that has threatened the stability of the U.S. banking system and the solvency of numerous financial institutions. The Emergency Economic Stabilization Act (the act) that authorized TARP on October 3, 2008, requires GAO to report at least every 60 days on findings resulting from our oversight of the actions taken under the program.² We are also responsible for auditing OFS's annual financial statements and for producing special reports on any issues that emerge from our oversight. To carry out these oversight responsibilities, we have assembled interdisciplinary teams with a wide range of technical skills, including financial market and public policy analysts, accountants, lawyers, and economists who represent combined resources from across GAO. In addition, we are building on our in-house technical expertise with targeted new hires and experts. The act also created additional oversight entities—the Congressional Oversight Panel (COP) and the Special Inspector General for TARP (SIGTARP)—that also have reporting responsibilities. We are coordinating our work with COP and SIGTARP and are meeting with officials from both entities to share information and coordinate our oversight efforts. These meetings help to ensure that we are collaborating as appropriate and not duplicating efforts.

¹GAO, Troubled Asset Relief Program: Status of Efforts to Address Transparency and Accountability Issues, [GAO-09-296](#) (Washington D.C.: Jan. 30, 2009) and Troubled Asset Relief Program: Additional Actions Needed to Better Ensure Integrity, Accountability, and Transparency, [GAO-09-161](#) (Washington, D.C.: Dec. 2, 2008).

²Emergency Economic Stabilization Act of 2008, Pub. L. No. 110-343, 122 Stat. 3765 (2008). The act requires the U.S. Comptroller General to report at least every 60 days, as appropriate, on findings resulting from oversight of TARP's performance in meeting the act's purposes; the financial condition and internal controls of TARP, its representatives, and agents; the characteristics of asset purchases and the disposition of acquired assets, including any related commitments entered into; TARP's efficiency in using the funds appropriated for its operations; its compliance with applicable laws and regulations; and its efforts to prevent, identify, and minimize conflicts of interest among those involved in its operations.

My statement today is based primarily on our January 30, 2009 report, the second under the act's mandate, which covers the actions taken as part of TARP through January 23, 2009, and follows up on the nine recommendations we made in our December 2, 2008 report.³ This statement also provides additional information on some recent program developments, including Treasury's new financial stability plan and, as you requested, provides some insights on our ongoing work on the implications of actions related to the financial crisis on federal debt management. Our oversight work under the act is ongoing, and our next report is due to be issued by March 31, 2009, as required.

Specifically, this statement focuses on (1) the nature and purpose of activities that have been initiated under TARP; (2) the status of OFS's hiring efforts, use of contractors, and development of a system of internal control; (3) implications of TARP and other events on federal debt management, and (4) preliminary indicators of TARP's performance. To do this work, we reviewed documents related to TARP, including contracts, agreements, guidance, and rules. We also met with OFS, contractors, federal agencies, and officials from all eight of the first large institutions to receive disbursements. We plan to continue to monitor the issues highlighted in our prior reports, as well as future and ongoing capital purchases, other more recent transactions undertaken as part of TARP (for example, guarantees on assets of Citigroup and Bank of America), and the status of other aspects of TARP.

We conducted this performance audit between December 2008 and March 2009 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Summary

Treasury has announced a number of new programs to try to stabilize financial markets, but most of its activities during this period have continued to fall under its Capital Purchase Program (CPP). As of March 5, 2009, Treasury had disbursed approximately \$300 billion in TARP funds, about \$197 billion of it for CPP. Treasury has recently announced the

³Information is current as of January 23, 2009, unless otherwise noted in the statement.

Financial Stability Plan, which outlines a set of measures to address the financial crisis and restore confidence in the U.S. financial and housing markets, and the Making Home Affordable program to mitigate foreclosures and preserve homeownership. Treasury also has taken important steps since our first report to implement all nine of our recommendations. However, due in part to the short time that has elapsed since our first report, we continued to identify a number of areas that warrant Treasury's ongoing attention. We recommended in our latest report that Treasury continue to take action to further improve the program's transparency and accountability and more clearly articulate and communicate a strategic vision for TARP. Specifically, we recommended that Treasury:

- expand the scope of the monthly CPP surveys for the 20 largest banks to include collecting at least some information from all institutions participating in the program;
- ensure that future CPP agreements include a mechanism that will better enable Treasury to track the use of the capital infusions and seek to obtain similar information from existing CPP participants;
- establish a process to ensure compliance with all CPP requirements, including those associated with limitations on dividends and stock repurchase restrictions;
- communicate a clearly articulated vision for TARP and how all individual programs are intended to work in concert to achieve that vision, which incorporates actions to preserve homeownership; and once this vision is clearly articulated, document the skills and competencies needed within the department to carry it out;
- continue to expeditiously hire personnel needed to carry out and oversee TARP;
- expedite efforts to ensure that sufficient personnel are assigned and properly trained to oversee the performance of all contractors, especially for contracts priced on a time-and-materials basis, and move toward fixed-price arrangements whenever possible as program requirements are better defined over time;
- develop a comprehensive system of internal controls over TARP, including policies, procedures, and guidance for program activities that are robust enough to ensure that the program's objectives and requirements are met;

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- develop and implement a well-defined and disciplined risk-assessment process, which is essential to monitoring program status and identifying any risks of potential inadequate funding of announced programs; and
 - review and renegotiate existing conflict-of-interest mitigation plans, as necessary, to enhance specificity and conformity with the new interim conflict-of-interest regulation and take continued steps to manage and monitor conflicts of interest and enforce mitigation plans.

Consistent with our recommendations, the recently announced Financial Stability Plan outlined some steps Treasury is taking to improve the transparency and accountability of new programs going forward. But Treasury still faces several challenges. First, our December 2008 report emphasized the lack of monitoring and reporting for CPP investments and recommended stronger measures for ensuring that participating institutions use the funds to meet the program's purpose and comply with CPP requirements on, for example, executive compensation and dividend payments. In response to our recommendation, Treasury completed its initial survey of the 20 largest institutions to monitor lending and other activities and announced plans to analyze quarterly monitoring data (call reports) for all reporting institutions.⁴ In addition, Treasury is developing a more limited monthly survey of lending by smaller institutions participating in the program. These efforts are important steps toward strengthening CPP's transparency and accountability, and we will continue to examine Treasury's effort to fully implement these monitoring efforts. Second, Treasury has continued to develop a system to ensure compliance with CPP requirements, including executive compensation, dividend payments, and repurchase of stocks, but it has not yet finalized its plans for detecting noncompliance and taking enforcement actions. Third, we noted that Treasury had made limited progress in articulating and communicating an overall strategic vision for TARP and continued to respond to institution-and industry-specific needs. This lack of clarity has complicated Treasury's ability to effectively communicate to Congress, the financial markets, and the public. As Treasury provides more details on its new Financial Stability Plan, its strategic approach to addressing the financial crisis may become clearer.

⁴Call reports are quarterly reports that collect basic financial data of commercial banks in the form of a balance sheet and income statement (formally known as Report of Condition and Income).

Treasury had taken steps to help ensure a smooth transition to the new administration by keeping positions filled and using an expedited hiring process. However, it continues to face difficulty providing competitive salaries to attract skilled employees. Also, given the program's evolving nature and the changes under the new administration, Treasury needs to identify OFS's long-term organizational needs. Additionally, consistent with our recommendation about contracting oversight, Treasury has enhanced such oversight by tracking costs, schedules, and performance and addressing the training requirements of personnel who oversee the contracts. As we previously recommended, Treasury needs to continue to identify and mitigate conflicts of interest in contracting. Similarly, OFS has adopted a framework for developing and implementing its system of internal control for TARP activities that is consistent with our recommendation. However, as of our January report, OFS had yet to implement a disciplined risk-assessment process.

Given that TARP activities have only recently been implemented and that time lags occur in the reporting of available data, it is too soon to see measurable results in many areas. Even with more time and better data, it will remain difficult to separate the impact of TARP activities from the effects of other economic forces. Credit market indicators we have identified demonstrate that between our December and January reports, the cost of credit declined in interbank, mortgage, and corporate debt markets. Conversely, while perceptions of risk (as measured by premiums over Treasury bonds) have declined in interbank markets, they appeared to have changed little in the corporate bond and mortgage markets. However, attributing any of these changes directly to TARP continues to be problematic because of the range of actions that have been and are being taken to address the current crisis. While our indicators may be suggestive of TARP's ongoing impact, no single indicator or set of indicators can provide a definitive determination of the program's impact.

Finally, these financial stability efforts, as well as the economic slowdown and the government's policy response to the slowdown, all add to the borrowing needs of the government. Treasury's outstanding debt has increased significantly, and the share of it that is short-term has grown. The drop in interest rates—especially for shorter-term debt—has lowered Treasury's cost of borrowing, but having such a large share of debt maturing in the short term presents challenges to Treasury. Market experts believe Treasury would benefit from lengthening its maturity profile. To support Congress' oversight of the use of TARP funds we have work underway looking at how Treasury has financed borrowing

associated with the recent financial crisis and at additional ideas for debt management that might make sense going forward.

Treasury Has Continued to Focus On CPP, but a Variety of Other Programs Have Been Created or Are Being Planned

Treasury has continued to focus on CPP, but a variety of other programs have been created or are in progress, as shown in table 1. As of March 5, 2009, Treasury had disbursed almost 80 percent of the \$250 billion it had allocated for CPP to purchase almost \$197 billion in preferred shares of 467 qualified financial institutions (table 1).⁵ Treasury also has begun to receive dividend payments relating to capital purchases under CPP and other programs. According to Treasury, as of February 17, 2009, it had received about \$2.4 billion.

Table 1: Status of TARP Funds as of March 5, 2009 (dollars in billions)

| Program | Disbursed |
|---|------------------|
| Capital Purchase Program | \$ 196.8 |
| Systemically Significant Failing Institutions | 40.0 |
| Targeted Investment Program | 40.0 |
| Automotive Industry Financing Program | 23.7 |
| Citigroup Asset Guarantee | 0.0 |
| Bank of America Asset Guarantee | 0.0 |
| Making Home Affordable Program | 0.0 |
| Term Asset-backed Securities Loan Facility | 0.0 |
| Consumer & Business Lending Initiative | 0.0 |
| Totals | \$ 300.5 |

Source: Treasury OFS, unaudited.

Initially, Treasury approved \$125 billion in capital purchases for nine of the largest public financial institutions that federal banking regulators and

⁵Through December 31, 2008, TARP capital purchases and loans totaled \$247 billion. Congressional Budget Office (CBO) estimated the subsidy cost for these transactions at \$64 billion, or 26 percent, using valuation procedures similar to those specified in the Federal Credit Reform Act and adjusted for market risk as specified in the Emergency Economic Stabilization Act. See Congressional Budget Office, *The Troubled Asset Relief Program: Report on Transactions Through December 31, 2008* (Jan. 2009). COP estimated the subsidy cost at \$78 billion, or 31 percent, using multiple valuation methods and an evaluation of similar private transactions. See Congressional Oversight Panel, *February Oversight Report: Valuing Treasury's Acquisitions* (Feb. 6, 2009). In connection with our audit of TARP's financial statements, we will be evaluating and testing the credit subsidy model that TARP uses to value capital purchases and loans for financial reporting purposes.

Treasury considered to be systemically significant to the operation of the financial system.⁶ At the time, these nine institutions held about 55 percent of U.S. banking assets. Subsequent purchases were made in qualified institutions of various sizes (in terms of total assets) and types. As we noted in our January report, most of the institutions that received CPP capital were publicly held institutions, although a limited number of privately held institutions and community development financial institutions (CDFI) also received funds.⁷

Treasury has taken a number of important steps toward better reporting on and monitoring of CPP. These steps are in keeping with our prior recommendations that Treasury bolster its ability to determine whether institutions are using CPP proceeds in ways that are consistent with the act's purposes and establish mechanisms to monitor compliance with program requirements. However, Treasury needs to take further steps in this area. Treasury has done an initial survey of the largest institutions to monitor their lending and other activities and announced plans to analyze quarterly monitoring data (call reports) for all reporting institutions. In addition, Treasury is developing a more limited monthly survey of lending by smaller institutions participating in the program. These efforts are important steps toward ensuring that all participating institutions are held accountable for their use of the funds and are consistent with our past recommendation that Treasury seek similar information from existing CPP participants.. We will continue to monitor Treasury's oversight efforts as well as the consistency of the approval process in future work.

Treasury has also continued to take steps to increase its planned oversight of compliance with terms of the CPP agreements including limitations on executive compensation, dividends, and stock repurchases. Among these steps, Treasury has named an Interim Chief Compliance Officer. However, Treasury has not finalized its plans for detecting noncompliance with CPP requirements or for taking enforcement actions. Without a more

⁶While Treasury approved \$125 billion to the nine largest institutions, it initially disbursed funds to eight. The \$10 billion to Merrill Lynch was not disbursed until January 9, 2009, after its merger with Bank of America was completed.

⁷CDFIs are specialized financial institution working in market niches that are underserved by traditional financial institutions. CDFIs provide a range of financial products and services such as mortgage financing for low-income and first-time homebuyers and not-for-profit developers; flexible underwriting and risk capital for needed community facilities; and technical assistance, commercial loans and investments to small start-up or expanding businesses in low-income areas.

structured mechanism in place to ensure compliance with all CPP requirements, and as more institutions continue to participate in the program, ensuring compliance with these aspects of the program will become increasingly important and challenging. In its recently announced Financial Stability Plan, Treasury called for banks receiving future government funds to be held responsible for appropriate use of those funds through (1) stronger restrictions on dividend payment and executive compensation, and (2) enhanced reporting to the public, including reporting on lending activity. In addition, Treasury is in the process of drafting new regulations to implement the executive compensation requirements in the American Recovery and Reinvestment Act of 2009 (the Recovery Act).⁸ We will also continue to monitor the system that Treasury develops to ensure compliance with the agreements and the implementation of additional oversight and accountability efforts under its new plan.

Treasury has also continued to make some progress in improving the transparency of TARP and a few weeks ago announced its plans for the remaining TARP funds. In our December 2008 report, we first raised questions about the effectiveness of Treasury's communication strategy for TARP with Congress, the financial markets, and the public. These questions were further heightened in the COP's January report, which raised similar questions about Treasury's strategy for TARP. In response to our recommendation about its communication strategy, Treasury noted numerous publicly available reports, testimonies, and speeches. However, even after reviewing these items collectively, we found that Treasury's strategic vision for TARP remained unclear. For example, Treasury initially outlined a strategy to purchase whole loans and mortgage-backed securities from financial institutions, but changed direction to make capital investments in qualifying financial institutions as the global community opted to move in this direction. However, once Treasury determined that capital infusions were preferable to purchasing whole mortgages and mortgage-backed securities, it did not clearly articulate how the various programs—such as CPP, the Systemically Significant Failing Institutions (SSFI) program, and the Targeted Investment Program (TIP)—would work collectively to help stabilize financial markets. For instance, Treasury has used similar approaches—capital infusions—to stabilize healthy institutions under CPP as well as SSFI and TIP, albeit with more stringent requirements. Moreover, with the exception of

⁸Pub. L. No. 111-5, div. B, title VII, § 7001 (Feb. 17, 2009) (amending section 111 of EESA).

institutions selected for TIP being viewed as able to raise private capital, both SSFI and TIP share similar selection criteria. Further, the same institution may be eligible for multiple programs. At least two institutions (Citigroup and Bank of America) currently participate in more than one program, adding to the confusion about Treasury's strategy and vision for implementing TARP. Other actions also have raised additional questions about Treasury's strategy. For example, Treasury announced the first institution under TIP weeks before the program was established. Similarly, the Asset Guarantee Program was established after Treasury announced that it would guarantee assets under such a program, but many of the details of the program have yet to be worked out.

Since our January report, Treasury has taken three key actions related to our recommendation about the need for a clearly articulated vision for the program. On February 10, Treasury announced the Financial Stability Plan, which outlined a set of measures to address the financial crisis and restore confidence in U.S. financial and housing markets. The plan appears to be an approach designed to resolve the credit crisis by restarting the flow of credit to consumers and businesses, strengthening financial institutions, and providing aid to homeowners and small businesses. On February 25, Treasury announced the standardized terms and conditions for eligible financial institutions participating in the Capital Assistance Program (CAP). Under CAP, an eligible institution that is found by its federal banking regulator to need additional capital to continue lending and absorb losses in a severe economic downturn will be eligible to participate in CAP.⁹ Such institutions will be eligible to receive a capital investment from Treasury, with regulatory approval, in the form of preferred securities that are convertible into common equity to help absorb losses and serve as a bridge to receiving private capital. A key element of Treasury's Financial Stability Plan, CAP is designed to ensure that, in severe economic conditions, the largest U.S. bank holding companies have sufficient capital to support lending to creditworthy homeowners and businesses. As part of this effort, the federal banking regulators—the Board of Governors of the Federal Reserve System, Office of the Comptroller of the Currency, Federal Deposit Insurance Corporation, and Office of Thrift Supervision—announced that they will begin conducting a one-time forward-looking capital assessment (or stress

⁹According to Treasury and the federal banking regulators, eligibility will be consistent with the criteria and deliberative process established for identifying qualified financial institutions in the existing Capital Purchase Program.

test) of the balance sheets of the 19 largest bank holding companies with assets exceeding \$100 billion. These institutions are required to participate in the coordinated supervisory capital assessment and may obtain additional capital from CAP if necessary.¹⁰ Regulators noted that the capital assessment process for all eligible institutions is expected to be completed by April 30, 2009.

On March 4, 2009, Treasury unveiled its Making Home Affordable program, which is based in part on the use of TARP funds. Among other things, the plan is designed to do the following:

- It will use \$75 billion (\$50 billion from TARP funds) to modify the loans of up to 3-4 million homeowners to avoid potential foreclosure. The goal of modifying the mortgages of these homeowners is to reduce the amount owed per month to sustainable levels (a mortgage debt-to-income ratio of 31 percent). Treasury will share the cost of restructuring the mortgages with the other stakeholders (e.g., financial institutions holding whole loans or investors if loans have been securitized). Treasury announced a series of financial incentives for the loan servicers, mortgage holders/investors, and borrowers that are intended to “pay for success,” encourage borrowers to continue paying on time under the modified loan, and encourage servicers and mortgage holders/investors to modify at-risk loans before the borrower falls behind on a payment.
- It includes an initiative to help up to 4-5 million homeowners to refinance loans owned or guaranteed by Freddie Mac and Fannie Mae at current market rates. According to Treasury, these homeowners would not otherwise be able to refinance their loans at the conforming loan rates because the declining value of their homes has left them with little or no equity. Refinancing at current mortgage rates could help homeowners save thousands of dollars on their annual mortgage payments.
- It increases Treasury’s funding commitment to Fannie Mae and Freddie Mac to ensure the strength and security of the mortgage market and to help maintain mortgage affordability. The \$200 billion funding

¹⁰Eligible institutions with less than \$100 billion in risk-weighted assets are also eligible to participate in CAP. Risk-weighted assets are the total of all assets held by the bank that are weighted for credit risk according to a formula established in regulation by the Federal Reserve.

commitment is based on authority granted to Treasury under the Housing and Economic Recovery Act of 2008.¹¹

We will continue to monitor the development and implementation of Treasury's plan, including how its actions address the challenges we have previously identified.¹²

Treasury also established the Auto Industry Financing Program (AIFP) in December 2008 to prevent a disruption of the domestic automotive industry that would pose systemic risk to the nation's economy. Under this program, Treasury has lent \$13.4 billion to GM and \$4 billion to Chrysler to allow the automakers to continue operating while working out details of their plans to become solvent, such as achieving concessions with stakeholders. The loans were designed to allow the automakers to operate through the first quarter of 2009 with recognition that after that point GM and Chrysler would need additional funds or have to take other steps, such as an orderly bankruptcy.¹³ As required by the terms of their loan agreements, GM and Chrysler submitted restructuring plans to Treasury in February that describe the actions the automakers will take to become financially solvent. Because of the continued sluggish economy and lower than expected revenues, GM and Chrysler are requesting an additional \$16.6 billion and \$5 billion in federal financial assistance, respectively. Treasury is currently assessing the automakers' restructuring plans and determining what the government's role will be in future assistance. By March 31, 2009, GM and Chrysler must report to the Secretary of the Treasury on their progress in implementing these restructuring plans. The Secretary will then determine whether the companies have made sufficient progress in implementing the restructuring plans; if they have not, the loans are automatically accelerated and become due 30 days later. As part of our oversight responsibilities for TARP, we are monitoring Treasury's

¹¹Pub. L. No. 110-289, 122 Stat. 2654 (2008).

¹²See GAO, Troubled Asset Relief Program, Status of Efforts to Address Defaults and Foreclosures on Home Mortgages, [GAO-09-231T](#) (Washington, D.C.: Dec. 4, 2008) for a discussion of challenges facing loan modification programs.

¹³Under AIFP, Treasury also lent \$884 million to GM to enable it to participate in GMAC's—a financing company owned in part by GM—new rights offering related to its reorganization as a bank holding company—and bought \$5 billion in preferred stock investment plus warrants from GMAC. In addition, Treasury agreed to lend \$1.5 billion to a special purpose entity created by Chrysler Financial Services Americas LLC (Chrysler Financial) to finance the extension of new consumer automotive loans, of which \$0.4 billion been disbursed to Chrysler Financial.

implementation of AIFP, including the auto manufacturers' use of federal funds and development of the required restructuring plans.

Efforts to Establish OFS Are Ongoing

Treasury has made progress in establishing its management infrastructure for TARP, including in hiring, overseeing contracts, and establishing internal controls. However, hiring for OFS is still ongoing, Treasury is working to improve its oversight of contractors, and its development of a system of internal control is still evolving.

- In the hiring area—one that we highlighted in our first report—Treasury took steps to help maintain continuity of leadership within OFS during and after the transition to the new administration. Specifically, Treasury ensured that interim chief positions would be filled to ensure a smooth transition and used direct-hire authority and various other appointments to bring a number of career staff on board quickly. OFS has increased its overall staff since our December 2008 report from 48 to 90 employees as of January 26, which includes an increase of permanent staff from 5 to 38. Treasury officials recently told us that the number of permanent staff had increased to 60. While progress has been made since our last report, the number of temporary and contract staff who will be needed to serve long-term organizational needs remains unknown. Because TARP has added many new programs since it was first established in October and program activities are changing under the new administration, we recognize that Treasury may find it difficult to determine OFS's long-term organizational needs at this time. However, such considerations will be vital to retaining institutional knowledge in the organization.
- Treasury's use of existing contract flexibilities has enabled it to enter into agreements and award contracts quickly in support of TARP. However, Treasury's use of time-and-materials contracts, although authorized when flexibility is needed, can increase the risk that government dollars will be wasted unless adequate mechanisms are in place to oversee contractor performance. In this regard, Treasury has improved its oversight of contractors, including those using time-and-materials pricing. In addition, while Treasury has taken the important step of recently issuing an interim regulation outlining the process for reviewing and addressing conflicts of interest among new contractors and financial agents, it is still reviewing existing contracts or agreements to ensure conformity with the new regulation. We believe this step is a necessary component of a comprehensive and complete system to ensure that all conflicts are fully identified and appropriately addressed.

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- OFS has adopted a framework for developing and implementing its system of internal control for TARP activities. OFS plans to use this framework to develop specific policies, drive communications on expectations, and measure compliance with internal control standards and policies. However, it has yet to develop comprehensive written policies and procedures governing TARP activities or implement a disciplined risk-assessment process.

In each of these areas, we made additional recommendations. Specifically, we recommended that Treasury continue to expeditiously hire personnel needed to carry out and oversee TARP. For contracting oversight, we recommended that Treasury expedite efforts to ensure that sufficient personnel are assigned and properly trained to oversee the performance of all contractors, especially for contracts priced on a time-and-materials basis, and move toward fixed-price arrangements whenever possible as program requirements are better defined over time. We also recommended that Treasury review and renegotiate existing conflict-of-interest mitigation plans, as necessary, to enhance specificity and conformity with the new interim conflicts of interest regulation and that it take continued steps to manage and monitor conflicts of interest and enforce mitigation plans. Finally, we recommended that Treasury, in addition to developing a comprehensive system of internal controls, develop and implement a well-defined and disciplined risk-assessment process, because such a process is essential to monitoring the status of TARP programs and identifying any risks that announced programs will not be adequately funded. We will continue to monitor OFS's hiring and contracting practices and implementation of the internal control framework, which is vital to TARP's effectiveness.

Measuring the Impact of TARP on the Credit Markets and the Economy Continues to Be Challenging

It is still too early in TARP's implementation to see measurable results in many areas given that program actions have only recently occurred and there are time lags in the reporting of data. Even with more time and better data, it will remain difficult to separate the impact of TARP activities from the effects of other economic forces. Some indicators suggest that the cost of credit has declined in interbank, mortgage, and corporate debt markets since the December report. However, while perceptions of risk (as measured by premiums over Treasury securities) have declined in interbank markets, they have changed very little in corporate bond and mortgage markets. Finally, as noted in December, these indicators may be suggestive of TARP's ongoing impact, but no single indicator or set of indicators can provide a definitive determination

of its effects because of the range of actions that have been and are being taken to address the current crisis. These include coordinated efforts by U.S. regulators—namely, the Federal Deposit Insurance Corporation, the Board of Governors of the Federal Reserve System, and the Federal Housing Finance Agency—as well as actions by financial institutions to mitigate foreclosures. For example, a large drop in mortgage rates occurred shortly after the Federal Reserve announced it would purchase up to \$500 billion in mortgage-backed securities, highlighting the fact that policies outside of TARP may have important effects on credit markets. We will continue to refine and monitor the indicators. Additionally, we plan to use the Treasury survey data in our efforts to evaluate changes in lending activity resulting from CPP. We recognize that the data has certain limitations primarily that it is self-reported and difficult to benchmark because it is unique. Nonetheless, we think it will prove valuable in future analyses.

Federal Debt Management Challenges

You also asked that I discuss the impact of TARP and related activities on the national debt and borrowing. Congress has assigned to the Treasury Department the responsibility to borrow the funds necessary to finance the gap between cash in and cash out subject to a statutory limit. Since the onset of the current recession in December 2007, the gap between revenues and outlays has grown. Because the Treasury must borrow the funds disbursed, TARP and other actions taken to stabilize the financial markets increase the need to borrow so adding to the federal debt. Also, federal borrowing needs typically increase during an economic downturn—largely because tax revenues decline while expenditures increase for programs to assist those affected by the downturn. In addition, the American Recovery and Reinvestment Act enacted on February 17, 2009 contains both decreases in revenues and increases in spending. Further, all of this takes place in the context of the longer-term fiscal outlook, which will present Treasury with continued financing challenges even after the return of financial stability and economic growth.

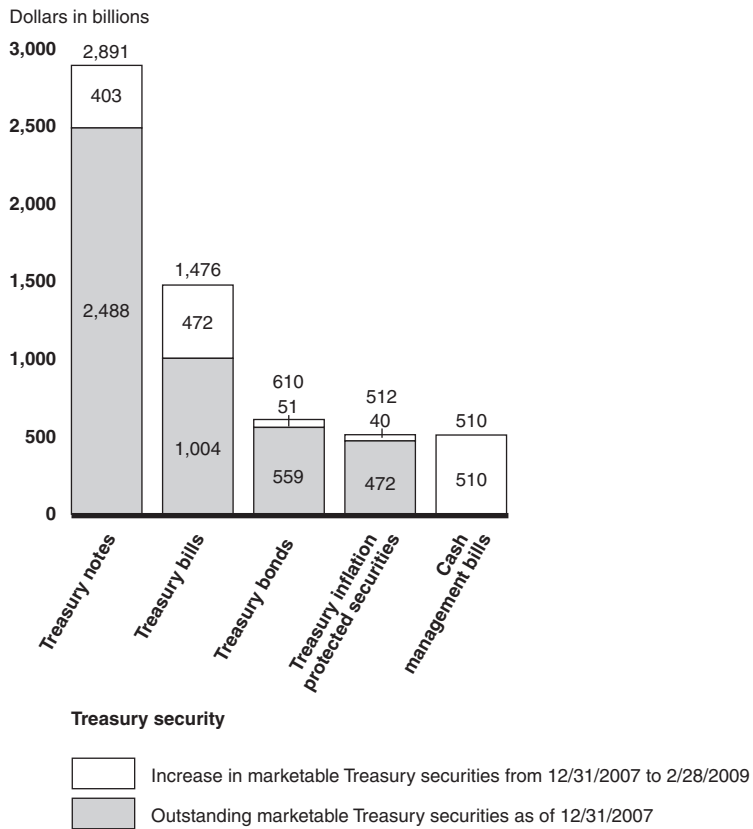
Treasury's primary debt management goal is to finance the government's borrowing needs at the lowest cost over time. Issuing debt through regularly scheduled auctions lowers borrowing costs because investors and dealers value liquidity and certainty of supply. Treasury issues marketable securities that range in maturity from one month to 30 years

and sells them at auction on a pre-announced schedule.¹⁴ The mix of securities that Treasury has outstanding changes regularly as new debt is issued. The mix of securities is important because it can have a significant influence on the federal government's interest payments. Longer-term securities typically carry higher interest rates—or cost to the government—primarily due to concerns about future inflation. However, these longer-term securities offer the government the certainty of knowing what the Treasury's payments will be over a longer period.

At the end of February 2009, Treasury's outstanding marketable securities stood at just under \$6 trillion—an increase of \$1.476 trillion since December 31, 2007. As shown in figure 1, a large portion of this debt increase was in the form of short-term cash management bills (CM bills). Between October 1, 2008 and February 28, 2009 Treasury issued \$1.035 trillion in CM bills, of which \$510 billion were outstanding at the end of February.

¹⁴ Cash management bills are not auctioned on a regular schedule, rather they are announced, auctioned, and have maturity dates based on the Treasury's immediate cash needs.

Figure 1: Changes in Outstanding Marketable Treasury Securities from Dec. 31, 2007 to Feb. 28, 2009 (Total Outstanding as of February 28, 2009 = \$5,989 billion)



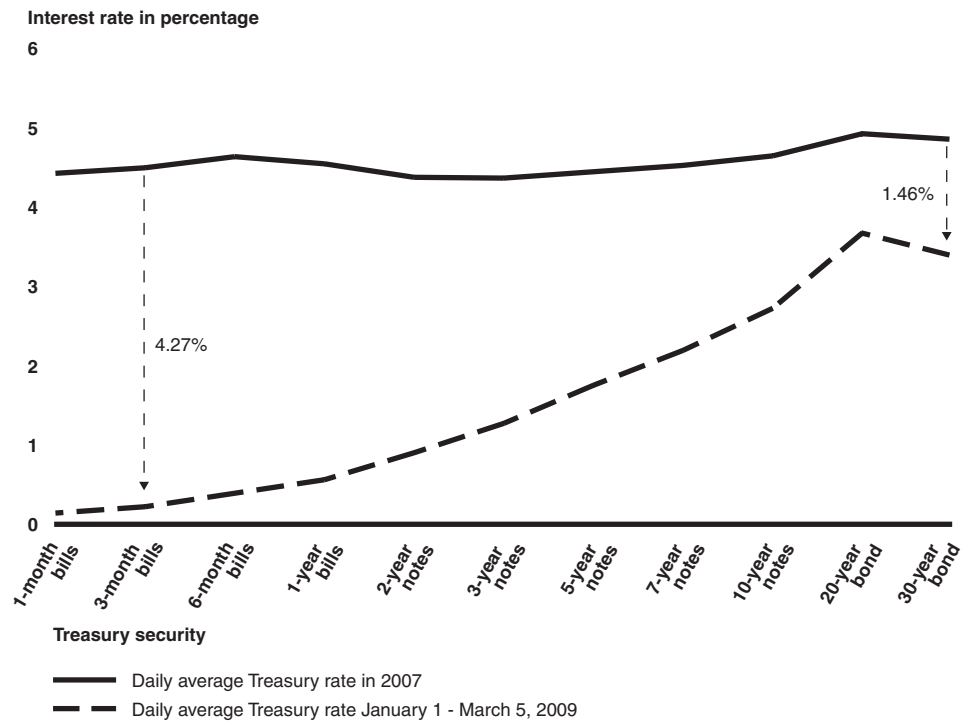
Source: GAO analysis of Treasury data.

Note (1): Does not include \$14 billion in marketable securities outstanding for the Federal Financing Bank.

Note (2): Treasury bills have maturities of 1 year or less. Notes have maturities of a year or more to 10 years and bonds have maturities of greater than 10 years. Currently Treasury issues Treasury Inflation Protected Securities with maturities ranging from 5 to 20 years.

Interest rates have decreased dramatically since the start of the financial crisis, particularly for short-term debt. Figure 2 below illustrates the size of that drop.

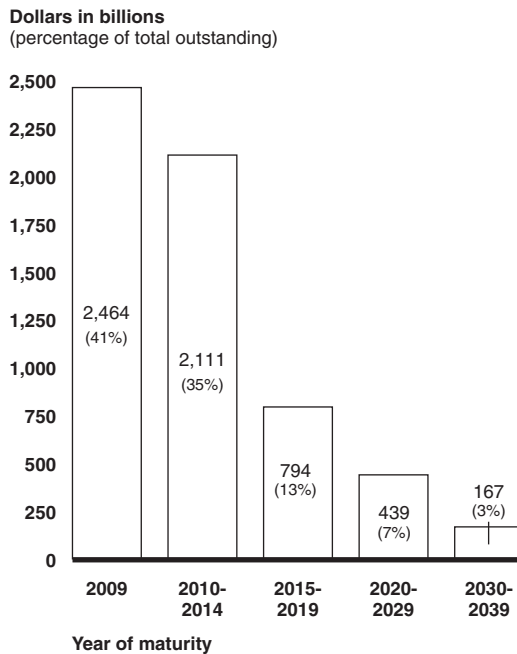
Figure 2: Interest Rates on Treasury Securities



Source: GAO analysis of Federal Reserve data.

The impact of this drop can be seen in lower borrowing costs—indeed, the budget shows net interest declining in fiscal year 2009. Although these relatively low interest rates have reduced Treasury’s borrowing costs, the increasing amount of short-term debt that needs to be rolled over does present challenges. As shown in figure 3, approximately \$2.5 trillion—or 41 percent of total outstanding marketable securities will mature in 2009—and will have to be refinanced. As Treasury borrows to meet its current needs, Treasury must also plan for rolling over large amounts of debt in the short term.

Figure 3: Marketable Securities by Year of Maturity, as of February 28, 2009 (Total Outstanding - \$5, 989 billion)



Source: GAO analysis of Treasury data.

Note: Does not include \$14 billion in marketable securities outstanding for the Federal Financing Bank.

Treasury has said that it “recognizes the need to monitor short-term issuance versus longer dated issuance.” Market experts generally believe that Treasury needs to increase the average maturity of its debt portfolio in part to lock in relatively low long-term rates and to ensure adequate borrowing capacity in the coming years. To support Congress’ oversight of the use of TARP funds we have work underway looking at how Treasury has financed borrowing associated with the recent financial crisis and at additional ideas for debt management that might make sense going forward.

Total borrowing will increase by trillions of dollars this year, not solely due to TARP and other activities aimed at stabilizing the financial system. Debt also grows in response to the economic slowdown as revenues fall and spending for some programs grows. Further, both the tax and spending provisions of the Recovery Act will also increase debt. All of this contributes to the borrowing challenge faced by the Treasury. As this Committee well knows, debt is also held in governmental accounts—such

as the Social Security Trust Fund. This debt is included in the total debt subject to limit.¹⁵ The debt limit was increased by the Emergency Economic Stabilization Act of 2008 and the Recovery Act, but with only \$1.2 trillion remaining under the limit, it will have to be raised again.

The combination of slower growth and greater debt lead to increases in publicly-held debt as a share of our economy—The President’s budget projects debt reaching 65 percent of gross domestic product in 2010 and remaining at that level for the rest of the decade. Today Congress, the executive branch and the American people are understandably focused on restoring financial stability and economic growth. At some point, however, the nation’s leaders will need to apply the same level of intensity to the serious long-term fiscal challenges facing the federal government.

Mr. Chairman and Members of the Subcommittee, I appreciate the opportunity to discuss this critically important issue and would be happy to answer any questions that you may have. Thank you.

Contact

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¹⁵ Debt held by the public—and the interest paid on it—represents a burden on current taxpayers; debt held in government accounts represents a claim on future resources. Together they equal total debt.

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