RESPONSES TO QUESTIONS

OF THE FIRST REPORT OF THE CONGRESSIONAL OVERSIGHT PANEL

FOR ECONOMIC STABILIZATION

Department of the Treasury

December 30, 2008

Question 1: What is Treasury's strategy?

Answer:
The Nation has been experiencing an unprecedented period of financial market turmoil with market events occurring rapidly and unpredictably. The Treasury Department has responded and adapted quickly to these events. Throughout the crisis, Treasury's strategy has been to work in coordination with all government agencies to use all the tools available to the government to achieve the following critical objectives:

- Stabilize financial markets and reduce systemic risk
- Support the housing market by avoiding preventable foreclosures and supporting mortgage finance
- Protect taxpayers.

The measures taken by Treasury under the Emergency Economic stabilization Act (EESA) are part of a comprehensive strategy by Treasury and the federal regulators since the onset of the crisis to stabilize the financial system and housing markets, and strengthen our financial institutions. Treasury has acted quickly and creatively in coordination with the Federal Reserve, the FDIC, OTS, and the OCC to help stabilize the financial system. In addition, because the crisis is global in nature, Treasury and the Federal Reserve have also worked in close coordination with Finance Ministries and major Central Banks around the world, which have taken similar measures to stabilize their financial systems. It is clear that our coordinated actions have made an impact. Our coordinated effort to strengthen our financial institutions so they can support our economy is critical to working through the current economic downturn.

The following is a list of many of the actions taken by Treasury and other federal agencies as part of our comprehensive approach. Detailed information on all of these programs is available on websites of the respective federal agencies.

a) Actions to Stabilize Financial Markets

- **Term Asset-Backed Securities Loan Facility (TALF):** Treasury is providing TARP support for this program, which was created by the Federal Reserve, to support consumer lending. The TALF will help market participants meet the credit needs of households and small businesses by supporting the issuance of asset-backed securities (ABS) collateralized by student loans, auto loans, credit card loans, and loans guaranteed by the Small Business Administration.
- **Term Auction Facility (TAF):** Under the TAF, the Federal Reserve auctions term funds to depository institutions. All depository institutions that are eligible to borrow under the primary credit program are eligible to participate in TAF auctions. All advances must be fully collateralized.
- **Term Securities Lending Facility (TSLF):** Under the TSLF, the Federal Reserve lends Treasury securities to primary dealers secured by a pledge of other securities, including federal agency debt, federal agency residential mortgage-backed securities, and non-agency AAA/Aaa-rated private-label residential MBS.
- **Primary Dealer Credit Facility (PDCF):** The PDCF is an overnight loan facility that provides funding to primary dealers in exchange for a specified range of eligible

collateral. On September 14, 2008, the Federal Reserve announced that collateral eligible to be pledged at the PDCF had been broadened. The program is intended to foster the functioning of financial markets more generally.

- **Money Market Investor Funding Facility (MMIFF):** The MMIFF supports a private-sector initiative designed to provide liquidity to U.S. money market investors. Under the MMIFF, the Federal Reserve Bank of New York (FRBNY) provides senior secured funding to a series of special purpose vehicles to facilitate an industry-supported private-sector initiative to finance the purchase of eligible assets from eligible investors.
- **Temporary Guarantee Program for Money Market Mutual Funds:** This program offers unprecedented government insurance in order to address concerns about the safety and accessibility of these investments and enhance market confidence. Treasury quickly set this program up after a mutual fund "broke the buck" for the second time in history.
- **Commercial Paper Funding Facility (CPFF)**: The Federal Reserve created the CPFF to provide a liquidity backstop to U.S. issuers of commercial paper. The CPFF is intended to improve liquidity in short-term funding markets and thereby contribute to greater availability of credit for businesses and households. Under the CPFF, FRBNY finances the purchase of highly-rated unsecured and asset-backed commercial paper from eligible issuers via eligible primary dealers.
- **Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility:** The Federal Reserve established this lending facility to provide funding to U.S. depository institutions and bank holding companies to finance their purchases of high-quality asset-backed commercial paper (ABCP) from money market mutual funds under certain conditions. The program is intended to assist money funds that hold such paper in meeting demands for redemptions by investors and to foster liquidity in the ABCP market and money markets more generally.
- **Swap Lines with Foreign Central Banks:** On September 29, 2008 the Federal Reserve authorized a $330 billion expansion of its temporary reciprocal currency arrangements (swap lines). The Federal Reserve enacted this program to improve the distribution of dollar liquidity around the globe and it is available to other central banks through April 30, 2009. The program was enacted because, at the time, dollar funding rates abroad had been elevated relative to dollar funding rates available in the U.S., reflecting a structural dollar funding shortfall outside of the U.S. The increase in the amount of foreign exchange swap authorization limits enabled many foreign central banks to increase the amount of dollar funding that they can provide in their home markets.

b) Actions to Strengthen U.S. Financial Institutions

- **Temporary Increase in Deposit Insurance:** On October 3, as part of the EESA**,** the FDIC temporarily raised the deposit insurance limit from $100,000 to $250,000 for all deposit categories until December 31, 2009.
- **Temporary Liquidity Guarantee Program (TLGP):** On October 14, 2008, the FDIC established the TLGP in the following two parts:
    - Debt Guarantee Program (DGP): The DGP temporarily guarantees all senior unsecured debt newly issued by FDIC-insured institutions and certain holding companies on or after October 14, 2008, through June 30, 2009.

  - Transaction Account Guarantee Program: the FDIC also temporarily provides full deposit insurance coverage to deposits in non-interest bearing transaction accounts (mainly payment processing accounts) until December 31, 2009.
- **Capital Purchase Program (CPP):** The CPP is a key component of the TARP. Treasury established this voluntary program to stabilize financial markets by providing capital to healthy institutions, increasing the flow of credit to businesses and consumers and supporting the U.S. economy. Under the CPP, Treasury will purchase up to $250 billion of senior preferred shares on standardized terms as described in the program's term sheet. The program is available to qualifying U.S. controlled banks, savings associations, and certain bank and savings and loan holding companies engaged only in financial activities. Institutions participating in the program must adopt the Treasury Department's standards for executive compensation and corporate governance for the period during which Treasury holds equity issued under this program.
- **Systemically Significant Failing Institutions Program (SSFI):** The SSFI program is another key component of the TARP. Treasury will provide capital on a case-by-case basis to systemically significant institutions that are at substantial risk of failure. In determining eligibility, Treasury may consider the following, among other factors: the extent to which the failure of an institution could threaten the viability of its creditors and counterparties; the number and size of financial institutions that are seen by investors or counterparties as similarly situated to the failing institution, or that would otherwise be likely to experience indirect contagion effects from the failure of the institution; whether the institution is sufficiently important to the nation's financial and economic system; or the extent and probability of the institution's ability to access alternative sources of capital and liquidity.

c) Initiatives to Support the U.S. Housing Market

- **FHA*Secure*:** Announced by HUD in August 2007, the FHA*Secure* program offers homeowners who have missed payments an opportunity to refinance into affordable FHA-insured loans. More than 450,000 homeowners have refinanced through FHA*Secure* since the launch of the program.
- **HOPE NOW:** In October 2007, Treasury actively helped facilitate the creation of the HOPE NOW Alliance, a private sector coalition of mortgage market participants and non-profit housing counselors. HOPE NOW servicers represent more than 90 percent of the subprime mortgage market and 70 percent of the prime mortgage market. Since inception, HOPE NOW has kept roughly 2.9 million homeowners in their homes through modifications and repayment plans, and it is currently helping more than 200,000 borrowers per month.
- **Stabilizing Fannie Mae and Freddie Mac**: Treasury took aggressive actions in 2008 to stabilize and strengthen Fannie Mae and Freddie Mac, and prevent the collapse of two institutions with $5.4 trillion in debt and mortgage-backed securities held by investors and financial institutions throughout the United States and the world. The systemic importance of these two enterprises, and the systemic impact of a collapse of either, cannot be overstated. Treasury's efforts to stabilize them by effectively guaranteeing their debt has increased the flow of mortgage credit and insulated mortgage rates from the rapid increases and fluctuations in the cost of other credit.

- **Hope for Homeowners**: On October 1, 2008, HUD implemented Hope for Homeowners, a new FHA program, available to lenders and borrowers on a voluntary basis, that insures refinanced affordable mortgage loans for distressed borrowers to support long-term sustainable homeownership.
- **Streamlined Loan Modification Program:** On November 11, 2008, Treasury joined with the FHFA, the GSEs, and HOPE NOW to announce a major streamlined loan modification program to move struggling homeowners into affordable mortgages. The program, implemented on December 15, 2008, creates sustainable monthly mortgage payments by targeting a benchmark ratio of housing payments to monthly gross household income (38%). Additionally, on November 20, 2008, Fannie Mae and Freddie Mac announced that they would suspend foreclosure sales and cease evictions of owner-occupied homes to allow time for implementation of the modification program.
- **Subprime Fast-Track Loan Modification Framework:** Treasury worked with the American Securitization Forum to develop a loan modification framework to allow servicers to modify or refinance loans more quickly and systematically. Subprime ARM borrowers who are current but ineligible to refinance may be offered a loan modification freezing the loan at the introductory rate for five years.

Treasury, working with the Federal Reserve, the FDIC and other regulators, has taken the necessary steps to prevent a financial collapse. The authorities and flexibility granted to the Treasury Department by Congress have been essential to developing the programs necessary to meet these objectives. Strong financial institutions and a stable financial system will smooth the path to economic recovery and an eventual return to prosperity.

Question 1b: What specific facts changed that led to your change in strategy?

Answer:
In the discussions with the Congress in mid-September during consideration of the financial rescue package legislation, Treasury focused on an initial plan to purchase illiquid mortgage assets in order to remove the uncertainty regarding banks' capital strength. At the same time, Treasury worked hard with the Congress to build maximum flexibility into the law to enable Treasury to adapt our policies and strategies to address market challenges that may arise.

In the weeks after Secretary Paulson and Chairman Bernanke first went to the Congress, market conditions deteriorated at an unprecedented and accelerating rate. One key measure Treasury assessed was the LIBOR-OIS spread – a key gauge of funding pressures and perceived counterparty credit risk. Typically between 5 – 10 basis points, on September 1, the one month spread was 47 basis points. By September 18th, when Treasury first went to Congress, the spread had climbed 88 basis points to 135 basis points. By the time the bill passed, just two week later on October 3, the spread had climbed another 128 basis points to 263 basis points. By October 10, LIBOR-OIS spread rose another 75 basis points to 338 basis points. During this period, credit markets effectively froze. The commercial paper market shut down, 3-month Treasuries dipped below zero, and a money market mutual fund "broke the buck" for only the second time in history, precipitating a $200 billion net outflow of funds from that market.

Given such market conditions, Secretary Paulson and Chairman Bernanke recognized that Treasury needed to use the authority and flexibility granted under the EESA as aggressively as possible to help stabilize the financial system. They determined the fastest, most direct way was to increase capital in the system by buying equity in healthy banks of all sizes. Illiquid asset purchases, in contrast, require much longer to execute.

Treasury then began immediately designing a capital program to complement the asset purchase programs under development. Since launching the program on October 14, 2008, we have invested $162 billion in 208 institutions of all sizes across the country.

As Treasury continued very serious preparations and exploration of purchasing illiquid assets, scale became a factor; for an asset purchase program to be effective, it must be done in very large scale. With $250 billion allocated for the CPP, Treasury considered whether there was sufficient capacity in the TARP for an asset purchase program to be effective. In addition, each dollar invested in capital can have a bigger impact on the financial system than a dollar of asset purchase; capital injections provide better "bang for the buck."

As markets continued to deteriorate through October, it became clear that the preservation of market stability would require that Treasury support non-bank financial institutions and the securitization market, both of which are crucial sources of lending for consumers and business of all sizes.

Question 2: Is the strategy working to stabilize markets?

Answer:
Yes. The most important evidence that our strategy is working is that Treasury's actions, in combination with other actions, stemmed a series of financial institution failures. The financial system is fundamentally more stable than it was when Congress passed the legislation. While it is difficult to isolate one program's effects given policymakers' numerous actions, one indicator that points to reduced risk of default among financial institutions is the average credit default swap spread for the eight largest U.S. banks, which has declined by about 240 basis points since before Congress passed the EESA. Another key indicator of perceived risk is the spread between LIBOR and OIS: 1 month and 3-month LIBOR-OIS spreads have declined about 220 and 145 basis points, respectively, since the law was signed and about 310 and 240 basis points, respectively, from their peak levels before the CPP was announced.

Treasury is also monitoring the effects our strategy is having on lending, although it is important to note that nearly half the money allocated to the Capital Purchase Program has yet to be received by the banks. Treasury is executing at a rapid speed, but it will take some time to review and fund all the remaining applications. Clearly this capital needs to get into the system before it can have the desired effect. In addition, we are still at a point of low confidence – both due to the financial crisis and the economic downturn. As long as confidence remains low, banks will remain cautious about extending credit, and consumers and businesses will remain cautious about taking on new loans. As confidence returns, Treasury expects to see more credit extended.

The increased lending that is vital to our economy will not materialize as fast as anyone would like, but it will happen much faster as a result of deploying resources from the TARP to stabilize the system and increase capital in our banks.

Question 3: Is the strategy helping to reduce foreclosures?

Answer:
Yes. Treasury has moved aggressively to keep mortgage financing available and develop new tools to help homeowners. Specifically, Treasury has achieved the following three key accomplishments:

1. To support the housing and mortgage market, Treasury acted earlier this year to prevent the failure of Fannie Mae and Freddie Mac, the housing GSEs that affect over 70 percent of mortgage originations. These institutions are systemically critical to financial and housing markets, and their failure would have materially exacerbated the recent market turmoil and profoundly impacted household wealth. Mortgage finance is available today on attractive terms because of Treasury's actions with the Federal Reserve and the Federal Housing Finance Agency to stabilize Fannie Mae and Freddie Mac. In addition, Treasury and the Federal Reserve have both announced programs to purchase GSE mortgage-backed securities. These programs are lowering borrowing rates for homeowners, to both purchase homes and to refinance into more affordable mortgages.

2. October 2007, Treasury helped establish the HOPE NOW Alliance, a coalition of mortgage servicers, investors and counselors, to help struggling homeowners avoid preventable foreclosures. HOPE NOW estimates that roughly 2.9 million homeowners have been helped by the industry since July 2007; the industry is now helping more than 200,000 homeowners a month avoid foreclosure. In addition, Treasury worked with HOPE NOW and the ASF to develop a fast-track loan modification program to modify loans of subprime ARM borrowers facing unaffordable rate resets.

3. Treasury worked with HOPE NOW, FHFA and the GSEs to achieve a major industry breakthrough in November 2008 with the announcement of a streamlined loan modification program that builds on the mortgage modification protocol developed by the FDIC for IndyMac. By targeting a benchmark ratio of housing payments to gross monthly household income, HOPE NOW servicers and the GSEs will have greater ability to quickly and efficiently create sustainable monthly mortgage payments for troubled borrowers. Potentially hundreds of thousands more struggling borrowers will be enabled to stay in their homes at an affordable monthly mortgage payment. Many private-label mortgage-backed securities pooling and servicing agreements reference the GSE servicing standards, giving this new program reach far beyond GSE loans.

An important complement to those guidelines was the GSEs' announcement on November 20, 2008 that they will suspend all foreclosures for 90 days. The foreclosure suspension will give homeowners and servicers time to utilize the new streamlined loan modification program and make it possible for more families to work out terms to stay in their homes.

Question 4: What have financial institutions done with the taxpayers' money received so far?

Answer:
The goal of the Capital Purchase Program is to stabilize the financial system and restore confidence in financial institutions, which will increase the flow of credit. To date, 208 financial institutions of all sizes have received investments through the CPP. These institutions include regional, small and community banks, as well as Community Development Finance Institutions, all of which play a vital role in their communities. We expect communities of all sizes to benefit from the investments into these institutions, which now have an enhanced capacity to perform their vital functions, including lending to U.S. consumers and businesses and promoting economic growth.

As the GAO noted in its report, given the number and variety of financial stability actions being put in place by multiple entities, it will be challenging to view the impact of the Capital Purchase Program in isolation and at the institutional level. Moreover, each individual financial institution's circumstances are different, making comparisons challenging at best, and it is difficult to track where individual dollars flow through an organization. Nonetheless, Treasury is working with the banking regulators to develop appropriate measurements and Treasury is focused on determining the extent to which the CPP is having its desired effect.

The CPP began in October 2008 and the money must work its way into the system before it can have the desired effect. Moreover, we are still at a point of low confidence – both due to the credit crisis and due to the economic downturn, during which lending and borrowing levels normally drop. While confidence is low, banks will remain cautious about extending credit, and consumers and businesses will remain cautious about taking on new loans. As confidence returns, we expect to see more credit extended. This lending won't materialize as fast as anyone would like, but it will happen much faster as a result of having used the TARP to stabilize the system and to increase the capital in our banks.

We also know that credit quality at banks is deteriorating. This has led banks to build up their loan loss reserves and to work with troubled borrowers to restructure loans. The level of loan loss provisioning by banks doubled in the third quarter from one year ago, putting pressure on bank earnings and capital. By injecting new capital into healthy banks, the CPP has helped banks maintain strong balance sheets and eased the pressure on them to scale back their lending and investment activities.

As a direct result of Treasury's actions through TARP, all participating financial institutions in the CPP have stronger capital positions, and with higher capital levels and restored confidence, banks can continue to play their role as financial lenders in our communities. While difficult to achieve during times like this, this lending is essential to economic recovery.

In the case of the SSFI program, Treasury did not provide funds to a financial institution directly. The $40 billion in Treasury funds was paid directly to the FRBNY to restructure AIG's balance sheet. AIG did not receive those funds. The FRBNY credit facility has helped minimize the disorderly collateral effects on healthy banks, which were counterparties that bought insurance from AIG. Treasury's investment in AIG was necessary to preserve stability in the financial system and to give AIG time to sell assets in an orderly manner to pay back taxpayers.

Question 5: Is the public receiving a fair deal?

Answer:
Yes. The American people have benefited from the financial rescue package. The financial crisis, and the ensuing economic downturn, would have been far worse without this legislation and our implementation of it. In addition, Treasury has designed its programs, consistent with EESA, to protect the taxpayer and to provide positive return on investments to the maximum extent possible. For example, under the CPP, Treasury will purchase up to $250 billion of senior preferred shares on standardized terms, including a 5 percent dividend for 5 years, which then increases to 9 percent. The government will not only own shares which we expect to yield a reasonable return, but will also receive warrants for common shares in participating institutions. These warrants allow the taxpayer to benefit from any appreciation in the market value of the institution.

When measured on an accrual basis, the value of the preferred stock is at or near par. Furthermore, Treasury has already started receiving required dividend payments. On a mark-to-market basis, the value of some preferred stock may be judged lower when compared to the date of purchase as equity markets have experienced pressure since the program began. In addition to preferred stock, Treasury also received warrants in the institutions it has invested in to provide further value and protection to taxpayers (other than community development organizations which are exempt from warrant requirements). These warrants also have positive value.

Treasury is investing in banks of all sizes around the country to help stabilize the financial system and get credit flowing to our communities. Treasury is not making these investments for short-term gains – we are not day traders. Over time, Treasury believes the taxpayers will be protected by ensuring the stability of the financial system and by earning a return on these investments when they are eventually liquidated.

Question 6: What is Treasury doing to help the American family?

Answer:
Every aspect of the implementation of the financial rescue package has a single purpose – to stabilize the financial system so it can support the financing needs of the American people, as consumers and as owners and employees of businesses. American families rely on the services provided by a wide array of sound financial institutions and financial markets, such as savings and investment for retirement (e.g., 401k accounts), and access to affordable credit for education, business development, and even daily necessities. For example, when financial institutions fail and when various credit markets don't function, every American household is impacted. A bank failure can suspend or end access to basic financial services in a community, and create

enormous anxiety among individuals. As the commercial paper market came under pressure, small and large businesses had difficulty raising money to meet basic needs such as making payroll or purchasing inventory. Consumer credit relies on the securitization market, which froze this year, increasing the costs of credit cards, car loans, and student loans.

All of the steps that Treasury has taken, alone and in coordination with the regulators, are benefiting Americans because they have prevented a further deterioration of the financial system. The problems facing the financial sectors here and abroad arose over a number of years and it will take time for the restoration of normal financial markets. There is no single action the federal government can take to end the financial market turmoil and the economic downturn, but Treasury is confident that we are pursuing the right strategy to stabilize the financial system and support the flow of credit to our economy. The TARP is just one of many policy measures that Treasury has taken to restore the liquidity and capital necessary to support economic growth, protect the savings of millions of individuals and restore the flow of credit to consumers and businesses. In addition, the measures we are taking are allowing the process of financial intermediation to continue- which means that banks and financial institutions can play their vital role in the economy, including providing savings, retirement and lending services. Some of the specific programs we have established to directly help American families are:

- **Term Asset Backed Securities Lending Facility:** Consumer credit is critical for many households as they consider purchasing a car, new appliances, or other big ticket items. Like other forms of credit, the availability of affordable consumer credit depends on ready access to a liquid and affordable secondary market – in this case, the asset backed credit market. Recent credit market stresses essentially brought this market to a halt in October 2008. As a result, millions of Americans cannot find affordable financing for their basic credit needs. And credit card rates are climbing, making it more expensive for families to finance everyday purchases. The Federal Reserve and the Treasury announced an aggressive program to support the normalization of credit markets and the availability of affordable consumer credit to support economic recovery. Treasury will invest $20 billion in a Federal Reserve facility that will provide liquidity to issuers of consumer asset backed paper, enabling a broad range of institutions to step up their lending, and enabling borrowers to have access to lower-cost consumer finance (auto loans, credit cards, student loans) and small business loans. The facility may be expanded over time and eligible asset classes may be expanded later to include other assets, such as commercial mortgage-backed securities, non-agency residential mortgage-backed securities or other asset classes.

- **Guarantee for Money Market Mutual Funds:** In September 2008, after a money market mutual fund "broke the buck" for only the second time in history, Treasury established a temporary Guarantee Program for Money Market Mutual Funds. The program will help protect the savings and pensions of individuals, as well as institutional investors.

- **Fannie Mae and Freddie Mac:** The housing correction has been at the root of the crisis. One of the most important things Treasury can do to mitigate foreclosures and progress through the housing correction is to reduce the cost of mortgage finance, so more families can afford to buy a home, and so homeowners can refinance into more affordable mortgages. Treasury took strong actions in 2008 to stabilize and strengthen Fannie Mae and Freddie Mac, and prevent the collapse of two institutions with $5.4 trillion in debt and mortgage-backed securities held by investors and financial institutions throughout the United States and the world. The systemic importance of these two enterprises, and the systemic impact of a collapse of either, cannot be overstated. Treasury's efforts to stabilize them by effectively guaranteeing their debt has increased the flow of mortgage credit and insulated mortgage rates from the rapid increases and fluctuations in the cost of other credit. Recently, the Federal Reserve announced that it will purchase $100 billion in GSE debt and half a trillion dollars in GSE mortgage backed securities, which should have a strongly positive impact on the cost of mortgage finance. Treasury continues to look for additional ways to make mortgage credit more affordable, which will stimulate home purchases, help to stabilize prices and end this housing correction.

- **HOPE NOW:** October 2007, Treasury helped establish the HOPE NOW Alliance, a coalition of mortgage servicers, investors and counselors, to help struggling homeowners avoid preventable foreclosures. HOPE NOW estimates that roughly 2.9 million homeowners have been helped by the industry since July 2007; the industry is now helping more than 200,000 homeowners a month avoid foreclosure. In addition, Treasury worked with HOPE NOW and the ASF to develop a fast-track loan modification program to modify loans of subprime ARM borrowers facing unaffordable rate resets.

- **Streamlined Loan Modification Program:** On November 11, 2008, Treasury joined with the FHFA, the GSEs, and HOPE NOW to announce a major streamlined loan modification program to move struggling homeowners into affordable mortgages. The program, implemented on December 15, creates sustainable monthly mortgage payments by targeting a benchmark ratio of housing payments to monthly gross household income (38%). Additionally, on November 20, 2008, Fannie Mae and Freddie Mac announced that they would suspend foreclosure sales and cease evictions of owner-occupied homes to allow time for implementation of the modification program.

Question 7: **Is Treasury imposing reforms on financial institutions that are taking taxpayer money?**

Answer:
The CPP is a voluntary program for viable institutions. The program was designed to be attractive to financial institutions of all sizes as a mechanism to increase capital in the financial system while also protecting the taxpayer. Treasury established strict executive compensation requirements on all participating institutions, as per the requirements set out in the EESA. Treasury barred any increase in dividends for 3 years and restricted share repurchases. Increasing dividends or buying back shares would undermine our policy objective by taking capital out of the financial system. In addition, Treasury is taking warrants in participating institutions so that taxpayers benefit from any appreciation in the value of these firms' stock.

Under the Systemically Significant Failing Institution program, additional terms and conditions were established for AIG. As a condition of extending an $85 billion line of credit to AIG, the Fed required a change in management at AIG. Also as a condition for Treasury assistance under TARP, AIG must meet stringent executive compensation, corporate expenses and lobbying restrictions.

Treasury is committed to rigorous oversight of the restrictions pertaining to executive compensation and is continuing to develop a comprehensive compliance program to ensure that institutions adhere to executive compensation provisions.

Question 8: How is Treasury deciding which institutions receive the money?

Answer:
All information about the terms and conditions of the CPP, including the formal application process and forms, is publically available on the Treasury website, as well as on the websites of all the primary federal regulators.

- *Institutions:* The Capital Purchase Program is available to a broad array of private and publically held- financial institutions of all sizes- including qualifying U.S. controlled banks, savings associations, and certain bank and savings and loan holding companies. The program is designed for healthy banks – banks that are considered viable without government investment. It is designed to have attractive terms to encourage healthy banks to participate; they are best positioned to increase the flow of credit in their communities.

- *Terms:* The terms for this program are the same for all institutions. Treasury issued a term sheet for publically held banks and followed with term sheet for private depositories. The minimum subscription amount available to a participating institution is 1 percent of risk-weighted assets. The maximum subscription amount in this program is the lesser of $25 billion or 3 percent of risk-weighted assets. Treasury also created a standard investment agreement for all banks, regardless of size.

- *Application Process:* There is one common application form that all qualified and interested financial institutions used to submit to their primary regulator – the Federal Reserve, the FDIC, the OCC or the OTS. This common application form is available on the websites of all the regulatory agencies.

- *Evaluation Process*: Treasury worked closely with the banking regulators to establish a standardized evaluation process; this means that all regulators use the same standards to review all applications to ensure consistency. Once a Federal regulator has reviewed an application, it will take one of the following three actions:
  1. For applications the regulator does not recommend, it may encourage the institution to withdraw the application.
  2. For applications the regulator strongly believes should be included in the program, it directly sends the application and its recommendation to the TARP Investment Committee at the Treasury Department.

3. For cases that are less clear, the regulator will forward the application to a Regulatory Council, made up of senior representatives of the four banking regulators for a joint review and recommendation. Treasury is an observer on the Council. The Regulatory Council will make a joint recommendation of either withdrawal or approval.

The Treasury TARP Investment Committee reviews all recommendations from the regulators and recommendations for CPP investment are made based on all of the information received from the above process. The Investment Committee gives considerable weight to the recommendations of the banking regulators. In some cases, the Committee will send the application back to the primary regulator for additional information, or even remand it to the Regulatory Council for further review. At the end of the evaluation process, Treasury notifies all approved institutions.

Institutions then have 30 days to complete the required documents before Treasury funds the transaction. All completed transactions will be publicly announced within 2 business days of execution, as required by the law. Treasury will not, however, announce any applications that are withdrawn or denied.

Treasury's investment committee includes senior officials on financial markets, economic policy, financial institutions, and financial stability, as well as the Chief Investment Officer for the TARP. For SSFI and other programs, Treasury makes the decision on a case-by-case basis.

The goal of TARP is to stabilize the financial system and restore confidence in and of financial institutions, enabling credit to flow to consumers and businesses. In March of 2008, Treasury published an extensive Blueprint for a Modernized Regulatory Structure that proposes a framework and many specific recommendations for reforming our financial regulatory system. Our current system is a patchwork quilt that developed over many decades and is not optimal for our complex financial system today. Treasury is using TARP to stabilize the financial system today, while regulatory modernization will likely take several years to complete.

Question 9: What is the scope of Treasury's statutory authority?

Answer:
The Emergency Economic Stabilization Act of 2008 ("EESA") was enacted by Congress and signed by the President with the stated purposes *"(1) to immediately provide authority and facilities that the Secretary of the Treasury can use to restore liquidity and stability to the financial system of the United States; and (2) to ensure that such authority and such facilities are used in a manner that (A) protects home values, college funds, retirement accounts, and life savings: (B) preserves homeownership and promotes jobs and economic growth; (C) maximizes overall returns to the taxpayers of the United States; and, (D) provides public accountability for the exercise of such authority."*[1] In order to achieve these purposes, Congress provided broad authority to the Secretary of the Treasury to establish the Troubled Asset Relief Program to purchase, and to make and fund commitments to purchase, troubled assets from any financial

[1] Emergency Economic Stabilization Act of 2008 ("EESA"), Sec. 2.

institution, on terms and conditions determined by the Secretary in accordance with EESA and applicable policies and procedures.

Recognizing the severity of the economic challenges facing the U.S. financial system, Congress incorporated a broad definition of financial institutions which covers any institution established and regulated in the United States or its territories and which has significant operations in the Unites States; the definition of financial institutions includes, but by its express terms is not limited to, banks, savings associations, credit unions, security broker or dealers and insurance companies.[2] The definition of "troubled asset" provides authority to the Secretary, in consultation with the Chairman of the Board of Governors of the Federal Reserve System, to define a "troubled asset" as any financial instrument the purchase of which is necessary to promote financial market stability."[3]

In exercising this authority, Treasury is limited by a series of requirements and directions set out in EESA. These requirements, which are found in a variety of sections of EESA including sections 101, 103, 104, 105, 107, 108, 109, 110, 111, 113, 115, 121, and 125, encompass, among other things, requirements related to transactions, conflicts of interest, executive compensation, maximizing taxpayers returns, reporting, oversight, and coordination.

Treasury is working on developing an insurance program under section 102. Treasury will submit a report on Dec. 31, 2008 regarding the status of that program.

Question 10: Is Treasury looking ahead?

Answer:
Yes. Treasury is actively engaged in developing additional programs to strengthen our financial system so that credit flows to our communities. Treasury believes that the new authorities Congress provided in October dramatically expanded the tools available to address the needs of our system. We have made significant progress, but there is no single action the federal government can take to end the financial market turmoil and the economic downturn. We are confident that we are pursuing the right strategy to stabilize the financial system and support the flow of credit to our economy.

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[2] EESA Sec. 3(5).
[3] EESA Sec. 3(9).