

### **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.<sup>390</sup> 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 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.

---

<sup>390</sup> The Panel’s reports may be found at [cop.senate.gov/reports/](http://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](http://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](http://cop.senate.gov/documents/cop-100909-report-hensarling.pdf).

- 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<sup>391</sup> in estimated subsidies. By its very nature, ring-fencing 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

---

<sup>391</sup> 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](http://www.cbo.gov/ftpdocs/100xx/doc10056/06-29-TARP.pdf)).

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<sup>392</sup>) 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.<sup>393</sup>

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

---

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

<sup>393</sup> 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.

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.<sup>394</sup>

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 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.

---

<sup>394</sup> 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](http://www.federalreserve.gov/newsevents/speech/tarullo20091021a.htm)).

### 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.<sup>395</sup> 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),<sup>396</sup> Treasury is set to chart a new course by providing lower-interest financing for community banks that extend credit to small businesses.<sup>397</sup> 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 under EESA?<sup>398</sup> In addition, the United States government has agreed to

---

<sup>395</sup> 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](http://www.financialstability.gov/docs/transaction-reports/10-30-09%20Transactions%20Report%20as%20of%2010-28-09.pdf)).

<sup>396</sup> 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](http://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/](http://dealbook.blogs.nytimes.com/2009/08/31/are-profits-on-tarp-funds-enough-feel-free-to-change/)) (illustrating the repayment returns)

<sup>397</sup> 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](http://www.whitehouse.gov/assets/documents/small_business_final.pdf))

<sup>398</sup> 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

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.<sup>399</sup> 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.”<sup>400</sup> 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.”<sup>401</sup> 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.<sup>402</sup>

---

happened anyway, regardless of the existence of the program.” See Edmunds.com at [www.edmunds.com/help/about/press/159446/article.html](http://www.edmunds.com/help/about/press/159446/article.html).

<sup>399</sup> “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>).

<sup>400</sup> See SIGTARP, *Quarterly Report to Congress*, at 4 (October 21, 2009), (online at [http://sig tarp.gov/reports/congress/2009/October2009\\_Quarterly\\_Report\\_to\\_Congress.pdf](http://sig tarp.gov/reports/congress/2009/October2009_Quarterly_Report_to_Congress.pdf)).

<sup>401</sup> See *id.*

<sup>402</sup> 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 bailouts. 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;

---

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](http://online.wsj.com/article/SB125677552001414699.html#mod=todays_us_page_one)).

- 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 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.<sup>403</sup>

- 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.<sup>404</sup>
- Were TARP to reach its \$699 billion potential, it would mean a \$5,000 expenditure for each taxpayer.<sup>405</sup> 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

---

<sup>403</sup> SIGTARP, *Quarterly Report to Congress*, (October 21, 2009), (online at [http://sigtarp.gov/reports/congress/2009/October2009\\_Quarterly\\_Report\\_to\\_Congress.pdf](http://sigtarp.gov/reports/congress/2009/October2009_Quarterly_Report_to_Congress.pdf)).

<sup>404</sup> 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.

<sup>405</sup> The \$5,000 “cost” per taxpayer assumes 138.4 million taxpayers are covering the full \$699 billion.



bailout, and (iv) 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.<sup>406</sup>

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.

---

<sup>406</sup> 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>).