U.S. Senate Committee on Banking

"TARP Oversight: Evaluating Returns on Taxpayer Investments"

Testimony of Sen. Ted Kaufman

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Thank you, Chairman Johnson, Ranking Member Shelby, and members of the Committee for inviting me to testify today. It is a pleasure to see so many former colleagues, and it is a privilege to offer my perspective on the Troubled Asset Relief Program (TARP).

I am the chairman of the Congressional Oversight Panel, which was established by the Emergency Economic Stabilization Act of 2008 (EESA). The Panel is one of three organizations, along with the Government Accountability Office and the Special Inspector General for TARP, charged by law with overseeing the TARP. In particular, Congress instructed the Panel to oversee Treasury's actions, assess the impact of spending to stabilize the economy, evaluate market transparency, ensure effective foreclosure mitigation efforts, and guarantee that Treasury acted in the best interests of the American people. The Panel has pursued these goals through 30 oversight reports, including our March 2011 report, which we issued to Congress just yesterday.

Our former chair last testified in front of this committee in September 2009. Since then, much has changed in the financial markets and in TARP itself. The Panel has issued nearly 20 reports in the ensuing months, including four reports on Treasury's foreclosure mitigation efforts. Additionally, the Panel has looked at issues such as TARP support for the domestic automotive industry, the rescue of AIG, commercial real estate, small banks and small business lending, government contracting, and executive compensation restrictions under the TARP.

Treasury's authority under the TARP expired on October 3, 2010. By statute, the Panel terminates six months after the expiration of the TARP. Thus, the Panel's most recent report concludes our oversight work.

I believe that, in order to evaluate the TARP's impact, one must first recall the extreme fear and uncertainty that infected the financial system in late 2008. The stock market had endured triple-digit swings. Major financial institutions, including Bear Stearns, Fannie Mae, Freddie Mac, and Lehman Brothers, had collapsed, sowing panic throughout the financial markets. The economy was hemorrhaging jobs, and foreclosures were escalating with no end in sight. Federal Reserve Chairman Ben Bernanke has said that the nation was on course for "a cataclysm that could have rivaled or surpassed the Great Depression."

It was in this climate that the Congressional Oversight Panel began its oversight work. The unprecedented financial crisis and the corresponding government intervention left many questions. What steps would be taken to ensure accountability from TARP recipients? How would Treasury make certain that its actions were transparent and that the taxpayer would be fairly compensated for the risk they were taking? What steps would Treasury take to stem the tide of foreclosures that was having a debilitating effect on American families and neighborhoods? These questions have informed all of our work.

It is now clear that, although America has endured a wrenching recession, it has not experienced a second Great Depression. The TARP does not deserve full credit for this outcome, but it did provide critical support to markets at a moment of profound uncertainty. It achieved this effect in part by providing capital to banks but, more significantly, by demonstrating that the United States would take any action necessary to prevent the collapse of its financial system.

The Cost of the TARP. The Congressional Budget Office (CBO) today estimates that the TARP will cost taxpayers $25 billion – an enormous sum, but vastly less than the $356 billion that CBO initially estimated. Although this much-reduced cost estimate is encouraging, it does not necessarily validate Treasury's administration of the TARP. Treasury deserves credit for lowering costs through its diligent management of TARP assets and, in particular, its careful restructuring of AIG, Chrysler, and GM. However, a separate reason for the TARP's falling cost is that Treasury's foreclosure prevention programs, which could have cost $50 billion, have largely failed to get off the ground. Viewed from this perspective, the TARP will cost less than expected in part because it will accomplish far less than envisioned for American homeowners. In addition, non-TARP government programs, including efforts by the FDIC and the Federal Reserve, have shifted some of the costs of the financial rescue away from the TARP's balance sheet. Further, accounting for the TARP from today's vantage point – at a time when the financial system has made great strides toward recovery – obscures the risk that existed in the depths of the financial crisis. At one point, the federal government guaranteed or insured $4.4 trillion in face value of financial assets. If the financial system had suffered another shock on the road to recovery, taxpayers would have faced staggering losses.

"Too Big to Fail." The Panel has always emphasized that the TARP's cost cannot be measured merely in dollars. Other costs include its distortion of the financial marketplace through its implicit guarantee of "too big to fail" banks. At the height of the financial crisis, 18 very large financial institutions received $208.6 billion in TARP funding almost overnight, in many cases without having to apply for funding or to demonstrate an ability to repay taxpayers. In light of these events, it is not surprising that markets have assumed that "too big to fail" banks are safer than their "small enough to fail" counterparts. Credit rating agencies continue to adjust the credit ratings of very large banks to reflect their implicit government guarantee. Smaller banks receive no such adjustment, and as a result, they pay more to borrow relative to very large banks.

By protecting very large banks from insolvency and collapse, the TARP also created moral hazard: very large financial institutions may now rationally decide to take inflated risks because they expect that if their gamble fails, taxpayers will bear the loss. These inflated risks may create even greater systemic risk and increase the likelihood of future crises and bailouts.

In addition, Treasury's intervention in the automotive industry, rescuing companies that were not banks and were not particularly interconnected within the financial system, extended the "too big to fail" guarantee and its associated moral hazard to non-financial firms. The implication was that any company in America can receive a government backstop, so long as its collapse would cost enough jobs or deal enough economic damage.

Stigma. As the TARP evolved, Treasury found its options increasingly constrained by public anger about the program. The TARP is now widely perceived as having restored stability to the financial sector by bailing out Wall Street banks and domestic automotive manufacturers while doing little for the 13.9 million workers who are unemployed, the 2.4 million homeowners who are at immediate risk of foreclosure, or the countless families otherwise struggling to make ends meet. As a result of this perception, the TARP is now burdened by a public "stigma."

Because the TARP was designed for an inherently unpopular purpose – rescuing Wall Street banks from the consequences of their own actions – stigmatization was likely inevitable. Treasury's implementation of the program has, however, made this stigma worse. For example, many senior managers of TARP-recipient banks maintained their jobs and their high salaries, and although shareholders suffered dilution of their stock, they were not wiped out. To the public, this may appear to be evidence that Wall Street banks and bankers can retain their profits in boom years but shift their losses to taxpayers during a bust – an arrangement that undermines the market discipline necessary to a free economy.

Transparency, Data Collection, and Accountability. Beginning with its very first report, the Panel has expressed concerns about the lack of transparency in the TARP. In perhaps the most profound violation of the principle of transparency, Treasury decided in the TARP's earliest days to push tens of billions of dollars out the door to very large financial institutions without requiring banks to reveal how the money was used. As a result, the public will never know to what purpose its money was put.

In some cases, public understanding of the TARP has suffered not because Treasury refused to reveal useful information but because relevant data were never collected in the first place. Without adequate data collection, Treasury has flown blind; it has lacked the information needed to spot trends, determine which programs are succeeding and which are failing, and make necessary changes. A related concern is Treasury's failure to articulate clear goals for many of its TARP programs or to update its goals as programs have evolved. For example, when the Home Affordable Modification Program was announced in early 2009, the Administration said that it would prevent three to four million foreclosures. The program now appears on track to help only 700,000 to 800,000 homeowners, yet Treasury has never formally announced a new target. Absent meaningful goals, the public has no meaningful way to hold Treasury accountable, and Treasury has no clear target to strive toward in its own deliberations.

On the Role of Oversight. Between the efforts of the Congressional Oversight Panel, SIGTARP, the GAO, the U.S. Congress, and many journalists and private citizens, the TARP has become one of the most thoroughly scrutinized government programs in U.S. history. Such close scrutiny inevitably begets criticism, and in the case of the TARP – a program born out of ugly necessity – the criticism was always likely to be harsh. After all, in the midst of a crisis, perfect solutions do not exist; every possible action carries regrettable consequences, and even the best decisions will be subject to critiques and second-guessing.

Yet there can be no question that oversight has improved the TARP and increased taxpayer returns. For example, in July 2009, the Panel reported that Treasury's method for selling stock options gained through the CPP appeared to be recovering only 66 percent of the warrants' estimated worth. Due in part to pressure generated by the Panel's work, Treasury changed its approach, and subsequent sales recovered 103 cents on the dollar, contributing to $8.6 billion in returns to taxpayers. Other substantial improvements in the TARP – such as Treasury's heightened focus on the threat to HAMP posed by second liens, the increased transparency of the TARP contracting process, and the greater disclosure of TARP-related data – are all partly the result of pressure exerted by the Panel and other oversight bodies.

Thus, an enduring lesson of the TARP is that extraordinary government programs can benefit from, and indeed may require, extraordinary oversight. This lesson remains relevant in the context of the government's extraordinary actions in the 2008 financial crisis: The public will continue to benefit from intensive, coordinated efforts by public and private organizations to oversee Treasury, the FDIC, the Federal Reserve, and other government actors. Careful, skeptical review of the government's actions and their consequences – even when this review is uncomfortable – is an indispensable step toward preserving the public trust and ensuring the effective use of taxpayer money.

Before I close, I would like to take a moment to acknowledge my fellow Panel members. We were three Democrats and two Republicans, often coming from very different directions in thinking about the issues surrounding TARP. Yet we worked hard to negotiate through our differences, without compromising on our principles, and as a result produced many unanimous reports. It was a pleasure working with such thoughtful, principled, and smart colleagues.

I also want to pay tribute to our excellent bipartisan staff. Their determination to help us reach bipartisan agreements was critical to the success of our work. They worked many, many late nights to help the Panel produce in-depth reports every 30 days, and they did so with tremendous professionalism in their dealings with each other and Treasury. I want to commend them for their deep and varied knowledge, for their attention to detail, and for the dedication they brought to our oversight mandate. Our work would not have been possible without them.

Thank you again for the opportunity to testify. I would be happy to answer any questions you may have. As the chair of the Panel, I will endeavor to convey the views of all the Panel members; however, ultimately, my words are my own.