Financial Crisis, Bailouts and Financial Reforms

In This Chapter

EXECUTIVE SUMMARY

Over the years, federal policy played a central role in making residential loans cheaper and easier to get and in encouraging people to purchase homes. At the beginning of the 2000s, the Federal Reserve kept interest rates consistently low and the federal regulation of loans, especially a new class of subprime mortgages aimed at borrowers with poor credit histories, was lax. In this environment, Fannie Mae and Freddie Mac bought up hundreds of billions of dollars of risky mortgages, feeding the market for them.

With interest rates low and homeownership viewed as a safe investment as housing prices continued to climb higher through the decade, more and more first-time buyers bought homes. Those who owned homes bought bigger and more expensive houses and they were willing and able to go deeper into debt to get them.

Of course, as most people today are familiar with, a nightmare scenario unfolded. A rash of defaults and foreclosures that began with subprime loans occurred. The foreclosures then infected borrowers with stronger credit histories by pushing down the median price of an existing house – people owed more on their home than they were worth. As foreclosures mounted and home prices continued to drop precipitously, the results were catastrophic. Throughout 2008, investors were losing confidence in the newly created, complex packages of mortgage loans called mortgage-backed securities, or MBSs. They began to lose value and became "toxic assets." Banks, unable to package their loans to MBSs and sell them, did not have the capital available to continue making new loans, nor could they swallow the amount of loans that were in default. The system began unraveling and no backstop had been created to protect any of the players. The collapse virtually halted all forms of lending. This, coupled with plunging MBS values, ignited raising fears that major financial institutions could fail which sent shockwave through the economy that are still being felt today.

In March 2008, Bear Stearns – the nation's fifth largest investment banking firm at the time – was suffering and requested assistance from the Federal Reserve to avoid bankruptcy. The Fed and JPMorgan Chase both provided Bear Stearns with loans to prop it up. Eventually, JPMorgan Chase completely took over Bear Stearns. Following the Bear Stearns fiasco, IndyMac, the seventh largest thrift in the United States, was closed by the Office of Thrift Supervision and the Federal Deposit Insurance Corporation (FDIC) in June 2008. This was one of the largest bank failures in American history with IndyMac having $32 billion in total assets.

In July 2008, Congress passed and President Bush signed into law the Housing and Economic Recovery Act of 2008 (HERA) which authorized Treasury to extend credit to or buy any obligations of either Fannie Mae or Freddie Mac. This was done because a default by either of the two could have caused severe disruptions in global financial markets and had negative repercussions throughout the economy. By September 2008, both Fannie Mae and Freddie Mac were placed in conservatorship of the federal government and remain there today.

In September 2008, Lehman Brothers Holdings, Inc., the fourth largest U.S. investment bank with $639 billion in assets filed for Chapter 11 bankruptcy. This was the largest failure of an investment bank since 1990. Around the same time that Lehman Brothers failed, Bank of America bought Merrill Lynch which was also failing. Additionally, within days of the Lehman collapse and the Bank of America purchase of Merrill Lynch, American International Group (AIG), one of the world's largest insurers, was near bankruptcy and received a loan from the Fed up to $85 billion.

Following this chain of disastrous events, Congress passed and President Bush signed into law the Troubled Asset Relief Program (TARP) with the intent to allow the federal government to buy up to $700 billion worth of toxic assets with taxpayer money and to hold those securities for some time with the idea that they would hopefully sell them back to private buyers when the markets had calmed. This was the initial plan. But, Treasury quickly concluded that this would not work and instead changed the approach to allow the government to make direct equity investments in banks to help stabilize their balance sheets.

With the Dodd-Frank Wall Street Reform law reducing the amount authorized for TARP to $475 billion, as of this writing, the government has committed bailout money to 926 recipients who have received a total of $414 billion. 315 recipients have returned all of their TARP money, leaving 611 with money still on their books. A total of $308 billion in TARP funds has been returned.

TARP was also used to bail out the U.S. auto companies Chrysler and GM and their respective financing companies beginning at the very end of 2008 and into 2009. At this time, the government still owns portions of Chrysler and GM following President Obama's expansion of the programs to rescue the failing companies.

In the wake of all of this, Democrats and President Obama opted to enact the Dodd-Frank Wall Street Reform law which was a sweeping overhaul of the U.S. financial regulatory structure. Republicans do not disagree with the ideal of preventing another financial crisis or with taking appropriate measures to provide oversight of the economy. But, Republicans have generally considered Dodd-Frank a dramatic government overreach into the financial sector.

WHAT HAPPENED

Federal Policy

Over the years, federal policy played a central role in making residential loans cheaper and easier to get and in encouraging people to purchase homes. The shift started during the Great Depression, when Congress and the administration of President Franklin D. Roosevelt responded to a wave of foreclosures by establishing the Federal Housing Administration (FHA) to insure mortgages and Fannie Mae (then known as the National Mortgage Association of Washington) to stimulate lending by buying mortgages from lenders. The FHA transformed the mortgage industry and made financing available and affordable for more people by requiring relatively long terms and fixed rates for the loans it covered. Fannie Mae, which became a shareholder-owned company in the late 1960s, provided lenders with the cash they needed to originate more mortgages. Other government efforts, such as allowing homebuyers to deduct mortgage interest payments from their federal income taxes, also encouraged borrowing for home ownership.

Borrowing was accelerated further over the years by "fair housing" legislation that pushed the government to require lenders to make more loans using lower standards with the social goal of increasing home ownership in poorer neighborhoods. The legislation sought to reverse a trend where poorer and largely minority communities were not achieving loans at the same rate as the rest of the country. The backers of the legislation said that this was not because the people in those communities could not pay or were not qualified but that they simply had been denied access.

At the beginning of the 2000s, after the economic shocks caused by the terrorist attacks and the bursting of a bubble in technology stocks, the Federal Reserve kept interest rates consistently low. Federal regulation of loans, especially a new class of subprime mortgages aimed at borrowers with poor credit histories, was lax. In this environment, Fannie Mae and Freddie Mac bought up hundreds of billions of dollars of risky mortgages, feeding the market for them.

Increased Borrowing, Increased Lending

With interest rates low and homeownership viewed as a safe investment as housing prices continued to climb higher throughout the decade, more and more first-time buyers bought homes. Those who owned homes bought bigger and more expensive houses, and they were willing and able to go deeper into debt to get them. Additionally, people began to see houses as a way to get rich rather than as a place to live, buying investment properties or second homes. Eventually, homeowners refinanced their mortgages or took out home equity loans to use the value of their houses to pay for everything from cars to vacations to college.

Lenders became more willing to extend bad loans (mortgages financed at a rate below the "prime" rate or "subprime loans") to borrowers with questionable credit histories. Lenders and borrowers worried little about the ability of the borrower to pay back the loan because either: 1) the mortgage would likely be refinanced before any rate adjustment, and the borrower would profit from the price appreciation; or 2) if a borrower could not make the mortgage payments, the thought was the lender could sell the home at a profit at foreclosure.

Mortgage Backed Securities: Mortgages were typically repackaged into a complex tradable asset called a mortgage-backed security (MBS) in a process called securitization. In the past, securitization served as the driving force behind all types of finance and was considered a responsible and profitable idea until the financial crisis hit. Lenders could make all types of loans, sell them for cash to those who market asset-backed securities and then lend anew without having to worry about a future default. Credit was extended far and wide, and risk was just as widely dispersed, allowing financial markets to move at a faster and smoother pace.

As MBSs increased accessibility to credit and led to a surge in profits, banks could not issue new loans fast enough. The standards for writing mortgage loans became seemingly non-existent as banks used financial models that assumed almost no chance of a decline in home prices. Credit rating companies, which judged the risk of securities backed by these mortgages, gave them high ratings despite an influx of ever-riskier loans. Wall Street investors rushed to buy up the new securities in an effort to cash in on what was seen as a sure thing.

The MBSs were built upon complex formulas that drew on historical patterns of housing finance. When MBSs were performing well, they allowed additional capital to be freed up for banks to fund even more higher-risk mortgages, which created a vicious cycle with no one paying attention to what would happen if it were suddenly broken. The continuing financing cycle created by MBSs was completely dependent upon housing prices always appreciating. It was considered extremely rare for home prices to decline, and certainly they never had done so nationwide.

The System Collapses

Of course, as most people today are familiar with, a nightmare scenario unfolded. A rash of defaults and foreclosures that began with subprime loans (again, loans to those that in hindsight did not have the ability to pay back the loan) occurred. The foreclosures then infected borrowers with stronger credit histories by pushing down the median price of an existing house, people owed more on their home than they were worth. Those that took out equity lines of credit against their homes bought second properties or investment properties found themselves "underwater" and many of these borrowers began to default as well.

As foreclosures mounted and home prices began to drop precipitously, the results were catastrophic. The MBSs began to lose value. Throughout 2008, investors were losing confidence in these newly created, complex packages and they became 'toxic assets.' They therefore stopped buying them as they came to be viewed as essentially worthless. Banks, unable to package their loans to MBSs and sell them, did not have the capital available to continue making new loans, nor could they swallow the amount of loans that were in default. The system began unraveling and no backstop had been created to protect any of the players. As a result, banks became increasingly wary of lending even to each other, and instead held on to any capital they had, causing a tightening of credit conditions throughout the market. The collapse virtually halted all forms of lending. This, coupled with plunging MBS values, ignited raising fears that major financial institutions could fail, which sent shockwaves throughout the economy that are still being felt today.

The majority of the next section of this chapter provides a timeline of sorts regarding what occurred in 2008 leading directly up to the Troubled Asset Relief Program (TARP) beginning with the acquisition of Bear Stearns by JPMorgan Chase.

2008 FINANCIAL TURMOIL LEADING UP TO TARP

Liquidity Crunch

Firms are said to be "liquid" when they are able to meet current obligations or short-term demand for funds. A firm is said to be solvent but illiquid when its assets exceed its liabilities but it is unable to liquidate assets rapidly enough to meet current obligations. Markets are said to be liquid when a large volume of financial securities can be traded without price distortions because there is a ready and willing supply of buyers and sellers. Liquid markets are a sign of normalcy.

On Aug. 9, 2007, liquidity abruptly dried up for many financial firms and securities markets. Suddenly some firms were able to borrow and investors were able to sell certain securities only at prohibitive rates and prices, if at all. This "liquidity crunch" was most extreme for firms and securities with links to subprime mortgages (as previously discussed in this chapter), but it also spread rapidly into seemingly unrelated areas.

The Fed and the Federal Funds Rate: The Federal Reserve (Fed) was drawn into the liquidity crunch from the very beginning. Open market operations are carried out through the purchase and sale of U.S. Treasury securities in the secondary market to alter the reserves of the banking system. By altering bank reserves, the Fed can influence short-term interest rates and hence, overall credit conditions. The Fed's target for open market operations is the federal funds rate – the rate at which banks lend to one another on an overnight basis. The federal funds rate is market determined meaning the rate fluctuates as supply and demand for bank reserves change. The Fed announces a target for the federal funds rate and pushes the market rate toward this target by altering the supply of reserves in the market through the purchase and sale of Treasury securities. More reserves increase the liquidity in the banking system and, in theory, should make banks more willing to lend spreading greater liquidity throughout the financial system. So, when the Fed wants to stimulate economic activity, it lowers the federal funds target. This stimulates interest-sensitive spending which includes physical capital investment (e.g. plant and equipment) by firms, residential investment (housing construction) and consumer durable spending (e.g. automobiles and appliances) by households. Lower rates would also be expected to lead to a lower value of the dollar, all else equal. A depreciated dollar would stimulate exports and the output of U.S. import-competing firms. Conversely, to reduce spending in the economy, the Fed raises interest rates and the process works in reverse.

On Aug. 9, 2007, it injected unusually large quantities of reserves into the banking system to prevent the federal funds rate from exceeding its target. In a series of steps between September 2007 and December 2008, the Fed reduced the federal funds rate from 5.25 percent to a target range of zero percent to 0.25 percent. When this proved to not be enough, the Fed greatly expanded its direct lending to the financial sector through several new lending programs, some of which can be seen as adaptations of traditional tools and other which can be seen as more than fundamental departures from the status quo.

For current amounts of Fed lending outstanding, click here for the Fed's weekly report, "Factors Affecting Reserve Balances of Depository Institutions."

The Fed's Discount Window: The Fed can also provide liquidity directly through discount window lending. Discount window lending dates back to the early days of the Fed and was originally the Fed's main policy tool. Loans made at the discount window are backed by collateral in excess of the loan value. A wide array of assets can be used as collateral – loans and asset-backed securities are the most frequently posted collateral. Although not all collateral has a credit rating, those that are rated typically have the highest rating.

Most discount window lending is done on an overnight basis. Unlike the federal funds rate, the Fed sets the discount rate directly through fiat.

On Aug. 17, 2007, the Fed began reducing the discount rate – about a month before it first reduced the federal funds rate. Since then, the discount rate has been lowered several times, typically at the same time as the federal funds rate.

Over the course of 2008, several financial firms that were deemed "too big to fail" received financial assistance from the Fed in the form of loans, trouble asset purchases and asset guarantees. This assistance went beyond the Fed's traditional role of acting as a lender of last resort by providing loans to illiquid but solvent firms. "Too big to fail" actually meant that companies that were "propped up" or "saved" by action taken by the Fed were taken care of stemming from the fear of systemic risk – which meant that there was concern for how interconnected some of these firms were and that if they collapsed individually, the financial system as a whole would cease to function.

Bear Stearns

In March 2008, the Fed helped Bear Stearns, the nation's fifth largest investment banking firm, avoid bankruptcy even though Bear Stearns was not a member bank of the Fed system (because it was not a depository institution) and, therefore, not part of the regulatory regime that accompanies membership. Bear Stearns was suffering from what its officials described as a sudden liquidity squeeze related to its large exposure to devalued MBSs.

With the collapse of the housing market, Bear Stearns began facing very dramatic financial travails in June 2007 – it announced that two of its hedge funds that were significantly invested in subprime mortgages were in trouble. In an attempt to keep them afloat, Bear poured $1.6 billion into the funds. Nonetheless, soon afterwards, the funds lost all of their value and were allowed to wind down. By various accounts, the funds' meltdown signaled the start of a collapse in the vital element of trust that must exist between a firm like Bear Stearns and its many customers.

In October 2007, Bear Stearns agreed to a needed $1 billion capital investment from China's government-controlled Citic Securities. In the fourth fiscal quarter of 2007, having written down more than $2 billion in devalued mortgage securities, Bear Stearns reported its first-ever quarterly loss – an unexpectedly high deficit of $859 million.

On March 14, 2008, JPMorgan Chase announced that in conjunction with the Fed, it had agreed to provide secured funding to Bear Stearns, as necessary. Through its discount window, the Fed agreed to purchase up to $30 billion of Bear Stearns' assets through Maiden Lane I, a new Limited Liability Corporation (LLC) based in Delaware that it created and controls. After the merger was completed, the loan was finalized on June 26, 2008. Two loans were made to the LLC: the Fed lent the LLC $28.82 billion and JPMorgan Chase made a subordinate loan to the LLC worth $1.15 billion, based on assets initially valued at $29.97 billion.

Using the proceeds from that loan, the LLC purchased assets from Bear Stearns worth $29.97 billion at marked to market prices by Bear Stearns on March 14, 2008. These assets will eventually be liquidated by the LLC to pay back the principal and interest owed to the Fed and JPMorgan Chase. The LLC's assets (purchased from Bear Stearns) were the collateral backing the loans from the Fed and JPMorgan Chase. A private company, BlackRock Financial Management, was hired to manage the portfolio.

The Fed's statutory authority for its role in both Bear Stearns transactions comes from the Federal Reserve Act. The Fed did not have authority to acquire an equity interest in Bear Stearns or JPMorgan Chase, but the LLC controlled by the Fed acquired assets from Bear Stearns and the profits or losses from that acquisition will ultimately accrue to the Fed. It is still unclear why the Fed decided to create and lend to a LLC to complete the transaction, rather than engaged in the transaction directly. Although the Fed did not buy Bear Stearns' assets directly, there were certainly important policy questions raised by the Fed's creation and financing of an LLC in order to buy Bear Stearns' assets. Typically, the Fed lends money to institutions and receives collateral in return to reduce the risk of suffering a loss. When the loan is repaid, the collateral is returned to the institution. In this case, the Fed made a loan, but to a LLC they created and controlled – not a financial institution. From the perspective of JPMorgan Chase or Bear Stearns, the transaction was a sale (to the LLC) not a loan, regardless of whether the Fed or the LLC was the principal.

IndyMac

IndyMac Bancorp, Inc. was a thrift holding company which meant it was regulated on a consolidated basis by the Office of Thrift Supervision (OTS). It held four subsidiaries, including IndyMac Bank F.S.B. (IndyMac Bank), a federally chartered thrift. IndyMac Bank was largely engaged in residential mortgage activities and was the seventh largest thrift in the United States, the eighth largest mortgage servicer and the ninth largest originator of residential mortgages. By the end of March 2008, it held a total of more than $30 billion in assets and more than $19 billion in deposits (the majority of which were Federal Deposit Insurance Corporation, or FDIC,-insured).

When home prices declined in the latter half of 2007 and the secondary mortgage market collapsed, IndyMac was forced to hold $10.7 billion of loans it could not sell in the secondary market. Its reduced liquidity was further exacerbated in late June 2008 when account holders withdrew $1.55 billion, or about 7.5 percent, of IndyMac's deposits. This "run" on the thrift followed the public release of a letter from Senator Charles Schumer (D-N.Y.) to the FDIC and OTS that outlined his concerns for IndyMac. While the run was a contributing factor in the timing of IndyMac's demise, the underlying cause of the failure was how it was operated.

On June 11, 2008, IndyMac Bank was closed by the OTS and the FDIC was appointed its conservator (and, subsequently, receiver) as a result of losses on mortgage-related assets and runs by depositors. When an insured bank or thrift becomes insolvent, the institution's charter, its primary federal regulator or the FDIC is authorized to act ex parte (i.e. without notice or a hearing) to seize the institution and its assets and install the FDIC as conservator or receiver. (The difference between a conservatorship and a receivership is that a conservatorship involves operating the institution as a going concern to protect its assets until it stabilizes or is closed and a receiver appointed. A receiver is charged with liquidating the institution and winding up its affairs.)

The FDIC transferred most of IndyMac Bank's assets, including its FDIC-insured deposits to a newly chartered thrift, IndyMac Federal Bank, F.S.B. On July 14, 2008, IndyMac Federal opened under FDIC control as conservator offering virtually all services that had been provided by IndyMac Bank prior to its closure three days before. IndyMac Bank's failure also brought down the holding company IndyMac Bancorp, Inc. which filed for Chapter 7 bankruptcy liquidation on July 31, 2008. OneWest Bank, FSB acquired most of IndyMac Federal's assets and all of its deposits in a deal that was finalized on March 19, 2009. As part of this deal, the FDIC agreed to guarantee against potential losses on certain loans acquired from IndyMac Federal.

With $32 billion in total assets, IndyMac Bank is one of the largest bank failures in American history – after the 1984 failure of Continental Illinois National Bank ($40 billion of assets) and the 1988 failure of American Savings and Loan Association.

Fannie Mae and Freddie Mac

Fannie Mae (officially named the Federal National Mortgage Association) and Freddie Mac (officially named the Federal Home Loan Mortgage Corporation) are congressionally chartered, but privately owned financial corporations, established to create and maintain a secondary mortgage market. Fannie Mae and Freddie Mac (also called government sponsored enterprises or GSEs) are not mortgage originators or direct lenders. Rather, they purchase mortgages from lenders and either securitize those loans or hold them in their own portfolios. The two enterprises have grown to be two of the largest financial institutions in the world. As GSEs, Fannie and Freddie have special privileges and obligations through they are corporate entities with shareholders. Broadly, the GSEs' role is to ensure appropriate availability of mortgages to creditworthy households. By law, the GSEs purchase mortgages from lenders and either hold the mortgages as investments or pool the mortgages into MBSs, which are sold to institutional investors. The GSEs guarantee that investors in these MBS will receive timely payment of principal and interest even if the borrower becomes delinquent.

Their congressional charters give them a close relationship to the federal government that is widely (but not universally) viewed as providing an implicit federal guarantee of their bonds and MBSs. Many consider their roles to be substantial – in 2010, Fannie Mae and Freddie Mac together with the FHA guaranteed more than 90 percent of new mortgages in 2010. In recent years, Fannie Mae and Freddie Mac jointly have been responsible for approximately 45 percent of residential mortgages outstanding.

In exchange for providing their public policy missions of stabilizing and correcting problems in the U.S. mortgage market, Fannie Mae and Freddie Mac receive a number of government benefits, most notably the presumption by investors of government backing. This government backing was merely presumed, however, this generally allowed these two GSEs to borrow money at rates just slightly higher than that of the federal government.

During the housing turmoil of 2008, Fannie and Freddie guaranteed or owned more than $5 trillion in mortgages. Due to this exposure, there was widespread concern that the two enterprises were insolvent and a subsequent sharp downturn in their stock values in the second quarter of 2008.

Housing and Economic Recovery Act of 2008 (HERA): After nearly a year of the House and Senate passing the legislation back and forth between them, on July 23, 2008, the House finally passed H.R. 3221, the Housing and Economic Recovery Act of 2008 (HERA) and then-President George W. Bush signed it into law (P.L. 110-289) on July 30, 2008. You can see how they voted here.

HERA authorized the Secretary of the Treasury the discretion to extend credit to or buy any obligations of the two enterprises, subject only to the federal debt limit. Basically, if Fannie or Freddie could not sell their debt securities or raise capital in the private market, this law authorized the Treasury to buy unmarketable debt securities or recapitalize the firms by purchasing the GSEs' stock.

This step was taken because a default by either of the two firms, which had been battered by the downturn in housing and credit markets, could have caused severe disruptions in global financial markets, made home mortgages more difficult and expensive to obtain and had negative repercussions throughout the economy. What it really meant was that the U.S. taxpayer now stood behind about $5 trillion of GSE debt.

HERA not only allowed Treasury to purchase stock from Fannie and Freddie, but it also created the new, stronger GSE regulator (replacing the then-in place Office of Federal Housing Enterprise Oversight) the Federal Housing Financing Authority (FHFA).

<u>Below are selected hits on HERA</u>:

- **Voted for a bill that authorized a taxpayer bailout of Fannie Mae and Freddie Mac, allowing the Treasury Department to spend tax dollars to rescue Fannie Mae and Freddie Mac if they are in peril of collapse**

    - Voted for the Rep. Frank (D-Mass.) motion to concur in the Senate amendment with the House amendment that would grant authority to the Treasury Department to extend new credit and buy stock in Fannie Mae and Freddie Mac. It also would create an independent regulator for the two mortgage giants and the Federal Home Loan Bank System. It would overhaul the Federal Housing Administration and allow it to insure up to $300 billion worth of new, refinanced loans for struggling mortgage borrowers. It also includes a $7,500 tax credit to some first-time homebuyers, higher loan limits for FHA-backed loans, a standard tax deduction for property taxes and revenue-raisers to offset part of the costs. It also would authorize $3.92 billion in grants to states and localities to purchase and rehabilitate foreclosed properties, and increase the federal debt limit to $10.6 trillion. (Adopted: 272-152; D: 227-3; R: 45-149)[1]

    - In a July 27, 2008, article, *The Washington Post* reported, "The House sent the Senate a bill (HR 3221) that authorizes a standby taxpayer bailout of the private companies Fannie Mae and Freddie Mac, allows up to 400,000 troubled mortgages to be reworked into government-backed loans, allows $7,500 tax credits to certain first-time home buyers and grants $4 billion to help communities and nonprofit organizations acquire and market vacant, foreclosed properties."[2]

        Editor's Note: *In addition to allowing a bailout of Fannie Mae and Freddie Mac, the legislation also contained a number of relatively popular provisions including a $7,500 first-time homebuyer tax credit, a standard tax deduction for property taxes, and created a number of programs designed to assist homeowners in avoiding foreclosure. For more information on the other provisions of H.R. 3221, please contact the NRCC.*

- **The *Union-Leader*: "Congress is about to rescue mortgage giants Fannie Mae and Freddie Mac from a mess all three institutions created. As usual, the taxpayers will be stuck with the bill"**

    - In a July 25, 2008, editorial headlined, "The bailout; The nanny saves Fannie," the *Union-Leader* wrote, "Congress is about to rescue mortgage giants Fannie Mae and Freddie Mac from a mess all three institutions created. As usual, the taxpayers will be stuck with the bill.

[1] H.R. 3221, CQ Vote #519, July, 23, 2008
[2] "House Votes," *Washington Post*, July 27, 2008

"On Wednesday, the U.S. House passed a monster bill that will leave taxpayers on the hook for a monster debt. The bill authorizes Treasury Secretary Henry Paulson to offer Fannie Mae and Freddie Mac an unlimited line of credit. It then increases the federal government's debt ceiling to $10.6 trillion to free up cash for a bailout. The national debt rests at $9.5 trillion. That's an additional $1.1 trillion of your money to prop up these government-sponsored, private enterprises."[3]

- **The bill was far-reaching government assistance for the nation's housing market, including broad authority for the Treasury Department to protect the nation's two largest mortgage finance companies – Fannie Mae and Freddie Mac – from collapse by potentially spending tens of billions of dollars in federal money**

    - On July 24, 2008, *The New York Times* reported, "The House approved far-reaching government assistance on Wednesday for the nation's housing market, including broad authority for the Treasury Department to protect the nation's two largest mortgage finance companies from collapse.

      "The measure also includes an aggressive plan to help hundreds of thousands of troubled borrowers avoid foreclosure by refinancing their mortgages with more affordable government-insured loans.

      "The White House, citing an urgent need to restore market confidence in the two mortgage giants, Fannie Mae and Freddie Mac, said President Bush would sign the measure despite his opposition to the inclusion of nearly $4 billion in grants for local governments to buy and refurbish foreclosed properties.

      "Mr. Bush's support assures that the bill will become law after final passage by the Senate, possibly on Saturday. The House approved the bill 272 to 152, with just 45 Republicans joining 227 Democrats voting in favor."[4]

    - According to a July 27, 2008, *New York Times* article, "The bill grants the Treasury Department broad authority to safeguard the nation's two mortgage finance giants, Fannie Mae and Freddie Mac, potentially by spending tens of billions of dollars in federal money to prevent the collapse of the companies, which own or guarantee nearly half of the nation's $12 trillion in mortgages.

      "To accommodate the rescue plan for the mortgage companies, the bill raises the national debt ceiling to $10.6 trillion, an increase of $800 billion and the first time that the limit on the government's credit card has grown to 14 digits."[5]

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[3] Editorial, "The bailout; The nanny saves Fannie," *Union-Leader*, July 25, 2008
[4] David M. Herszenhorn, "House Approves Sweeping Effort To Help Housing," *The New York Times*, July 24, 2008 http://www.nytimes.com/2008/07/24/business/24housing.html?pagewanted=all
[5] David M. Herszenhorn, "Congress Sends Housing Relief Bill to President," *The New York Times*, July 27, 2008 http://www.nytimes.com/2008/07/27/washington/27housing.html?pagewanted=all

- **The Fannie and Freddie bailout may have created uncertainty as to the financial health of other firms**

    - According to a Sept. 29, 2008, Congressional Research Service (CRS) report for Congress, "The government sponsored enterprises (GSEs), Fannie Mae and Freddie Mac, were placed in a conservatorship. Arguably, the GSEs were considered too big to fail because their combined portfolios exceeded $1 trillion. In addition, it was believed that their role in mortgage finance was essential in the housing market, which was a source of instability for the rest of the banking system. The terms of this conservatorship included significant commitments of taxpayer financing. The Treasury promised to purchase sufficient preferred stock to insure institutional solvency. In addition, the Federal Reserve promised to directly lend funds to the GSEs at pre-determined interest rates. While the rescue of the GSEs would not affect smaller firms not believed to be too big to fail, the conservatorship of Fannie Mae and Freddie Mac triggered trillions of dollars of credit derivatives that referenced the GSEs. The potential repercussions of these credit derivatives may have created uncertainty as to the financial health of other firms.[6]

- **The bill also increased the federal debt limit by $800 billion from $9.815 trillion to $10.615 trillion in order to accommodate the bailout of Fannie Mae and Freddie Mac**

    - In a Sept. 15, 2008, bill analysis of H.R. 3221, *Congressional Quarterly* found, "The law also increases the statutory limit on the public debt to $10.615 trillion from the current limit of $9.815 trillion."[7]

    - According to a July 27, 2008, *New York Times* article, "The bill grants the Treasury Department broad authority to safeguard the nation's two mortgage finance giants, Fannie Mae and Freddie Mac, potentially by spending tens of billions of dollars in federal money to prevent the collapse of the companies, which own or guarantee nearly half of the nation's $12 trillion in mortgages.

      "To accommodate the rescue plan for the mortgage companies, the bill raises the national debt ceiling to $10.6 trillion, an increase of $800 billion and the first time that the limit on the government's credit card has grown to 14 digits."[8]

- **"The bill also creates significant liabilities and risks for taxpayers, that are virtually impossible to calculate"**

    - According to a July 31, 2008, *New York Times* article, "The law authorizes the Treasury to rescue the mortgage finance giants, Fannie Mae and Freddie Mac, should they verge on collapse, potentially by spending tens of billions in federal monies. Together, the companies own or guarantee nearly half of the nation's $12 trillion in mortgages.

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[6] Jane G. Gravelle, Thomas L. Hungerford, Marc Labonte, Edward V. Murphy, N. Eric Weiss, and Julie M. Whittaker, "Economic Slowdown: Issues and Policies," Congressional Research Service (CRS), Sept. 29, 2008

[7] CQ Bill Analysis, "H.R. 3221," *Congressional Quarterly*, Sept. 15, 2008

[8] David M. Herszenhorn, "Congress Sends Housing Relief Bill to President," *The New York Times*, July 27, 2008, http://www.nytimes.com/2008/07/27/washington/27housing.html?pagewanted=all

"Partly to accommodate the rescue plan for the mortgage companies, the bill raises the national debt ceiling to $10.6 trillion, an increase of $800 billion. The bill also creates significant liabilities and risks for taxpayers that are virtually impossible to calculate."[9]

- **On Sept. 7, 2008, less than two months after the bill was enacted, Fannie and Freddie were placed under conservatorship, overseen by the FHFA, putting the government temporarily in charge of the them and the $5 trillion in home loans they backed**

  - In a Sept. 7, 2008, article, *CNN Money* reported, "Federal officials on Sunday unveiled an extraordinary takeover of Fannie Mae and Freddie Mac, putting the government in charge of the twin mortgage giants and the $5 trillion in home loans they back.

    "The move, which extends as much as $200 billion in Treasury support to the two companies, marks Washington's most dramatic attempt yet to shore up the nation's housing market, which is suffering from record foreclosures and falling prices.

    "The sweeping plan, announced by Treasury Secretary Henry Paulson and James Lockhart, director of the Federal Housing Finance Agency, places the two companies into a 'conservatorship' to be overseen by the Federal Housing Finance Agency. Under conservatorship, the government would temporarily run Fannie and Freddie until they are on stronger footing."[10]

- **The rescue (establishment of a conservatorship) for Fannie Mae and Freddie Mac in September 2008 potentially triggered credit default swap contracts with notional value exceeding $1.2 trillion**

  - According to a Nov. 10, 2008, CRS report for Congress, "Declines in stock market values reflected huge changes in expectations and the flight of capital from assets in countries deemed to have even small increases in risk. Many investors, who not too long ago had heeded financial advisors who were touting the long term returns from investing in the BRICs (Brazil, Russia, India, and China), pulled their money out nearly as fast as they had put it in. Dramatic declines in stock values coincided with new accounting rules that required financial institutions holding stock as part of their capital base to value that stock according to market values (mark-to-market). Suddenly, the capital base of banks shrank and severely curtailed their ability to make more loans (counted as assets) and still remain within required capital-asset ratios. Insurance companies too found their capital reserves diminished right at the time they had to pay buyers of credit default swaps. The rescue (establishment of a conservatorship) for Fannie Mae and Freddie Mac in September 2008 potentially triggered credit default swap contracts with notional value exceeding $1.2 trillion."[11]

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[9] David M. Herszenhorn, "Bush Signs Sweeping Housing Bill," *The New York Times*, July 31, 2008, http://www.nytimes.com/2008/07/31/business/31housing.html
[10] David Ellis, "U.S. seizes Fannie and Freddie," *CNN Money*, Sept. 7, 2008, http://money.cnn.com/2008/09/07/news/companies/fannie_freddie/index.htm/
[11] Dick K. Nanto, Martin A. Weiss, James K. Jackson, Ben Dolven, Wayne M. Morrison, William H. Cooper and J. Michael Donnelly, "The U.S. Financial Crisis: The Global Dimension with Implications for U.S. Policy," CRS, Nov. 10, 2008

- **U.S. Commercial banks were heavily invested in Fannie Mae and Freddie Mac stock, bonds and mortgage backed securities (MBS)**

    - According to a July 15, 2008, CRS report for Congress, "Who invests in the GSEs? There is little information available about who holds GSE stock, bonds, and MBS. The Fed reports statistics for combined ownership of government agency and GSE debt and GSE MBS. At the end of 2007, non-United States investors held $1.479 trillion of $7.397 trillion. Other large investors were U.S. commercial banks ($929 billion), life insurance companies ($388 billion), state and local government retirement funds ($317 billion), mutual funds ($566 billion), asset-backed securities issuers ($378 billion), and the GSEs themselves ($710 billion)."[12]

- **The conservatorship of Fannie and Freddie dealt "tough blows to shareholders of Fannie and Freddie, including mutual funds holding large stakes in the companies"**

    - In a Sept. 8, 2008, posting on its New Money Blog, *U.S. News & World Report* reported, "The government's rescue plan will deal some tough blows to shareholders of Fannie and Freddie, including mutual funds holding large stakes in the companies. These funds most likely include Dodge & Cox Stock, Legg Mason Value, Vanguard Wellington, Fidelity Select Home Finance, and several American funds (Growth Fund of America, Investment Co. of America, and Washington Mutual), which all held a hefty percentage of shares in one or both of the companies as of the end of June."[13]

- **The bailout of Fannie and Freddie diluted their common and preferred stock to near worthless levels; The market price of stock in Freddie Mac plummeted from $63 on Oct. 8, 2007 to $0.88 on Oct. 28, 2008**

    - According to a Nov. 10, 2008, CRS report for Congress, "In addition, the rising rate of defaults and bankruptcies created the prospect that equities would suddenly become valueless. The market price of stock in Freddie Mac plummeted from $63 on October 8, 2007 to $0.88 on October 28, 2008. Hedge funds, whose "rocket scientist" analysts claimed that they could make money whether markets rose or fell, lost vast sums of money. The prospect that even the most seemingly secure company could be bankrupt the next morning caused credit markets to freeze. Lending is based on trust and confidence. Trust and confidence evaporated as lenders reassessed lending practices and borrower risk."[14]

    - In a Sept. 8, 2008, article, the Associated Press reported, "The government's decision Sunday to take control of the two companies – which own or guarantee about half the nation's mortgage debt – removes a huge cloud that has been hovering over skittish markets."[15]

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[12] N. Eric Weiss, "Fannie Mae's and Freddie Mac's Financial Problems: Frequently Asked Questions," CRS, July 15, 2008
[13] Katy Marquardt, "A Primer on Fannie and Freddie: What the Bailout Means," *U.S. News & World Report* New Money Blog, Sept. 8, 2008
http://money.usnews.com/money/blogs/new-money/2008/09/08/a-primer-on-fannie-and-freddie-what-the-bailout-means
[14] Dick K. Nanto, Martin A. Weiss, James K. Jackson, Ben Dolven, Wayne M. Morrison, William H. Cooper and J. Michael Donnelly, "The U.S. Financial Crisis: The Global Dimension with Implications for U.S. Policy," CRS, Nov. 10, 2008
[15] Staff Writer, "Wall Street may cheer Fannie, Freddie bailout," Associated Press, Sept. 8, 2008
http://seattletimes.nwsource.com/html/businesstechnology/2008164579_apmortgagegiantswallstreet.html?syndication=

- According to the same article, "The bailout itself does have its negatives — notably, diluting Fannie's and Freddie's common and preferred shares to near-worthless levels."[16]

➢ **"Under the terms of the government 'conservatorship,' the firms have access to a separate, unlimited credit line from Treasury to backstop their losses"**

- In a May 11, 2010, article, Reuters reported, "While Fannie Mae and Freddie Mac did not receive TARP funds, then Treasury Secretary Henry Paulson took control of the two firms in late 2008 as losses from risky mortgages mounted.

  "Under the terms of the government 'conservatorship,' the firms have access to a separate, unlimited credit line from Treasury to backstop their losses."[17]

➢ **The conservatorship of Fannie Mae and Freddie Mac means that the U.S. taxpayer now stands behind about $5 trillion of GSE debt**

- According to a Sept. 15, 2008, CRS report for Congress, "The Housing and Economic Recovery Act of 2008 (P.L. 110-289), enacted July 30, 2008, provides the authority for the government's takeover of the GSEs. The act created a new GSE regulator, the Federal Housing Finance Agency (FHFA), with the authority to take control of either GSE to restore it to a sound financial condition. The new law sets out a process for placing a financially troubled GSE in conservatorship or receivership. This process is generally similar to the Federal bank regulators' handling of insolvent depository institutions, but the FHFA is not bound by the bank regulators' mandate that failing institutions be resolved at the lowest possible cost."[18]

- According to the same CRS report, "On September 7, 2008, the Federal Housing Finance Agency (FHFA) placed Fannie Mae and Freddie Mac, two government-sponsored enterprises (GSEs) that play a critical role in the U.S. home mortgage market, in conservatorship. As conservator, the FHFA has full powers to control the assets and operations of the firms. Dividends to common and preferred shareholders are suspended, but the U.S. Treasury has put in place a set of financing agreements to ensure that the GSEs continue to meet their obligations to holders of bonds that they have issued or guaranteed. This means that the U.S. taxpayer now stands behind about $5 trillion of GSE debt. This step was taken because a default by either of the two firms, which have been battered by the downturn in housing and credit markets, could have caused severe disruptions in global financial markets, made home mortgages more difficult and expensive to obtain, and had negative repercussions throughout the economy."[19]

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[16] Staff Writer, "Wall Street may cheer Fannie, Freddie bailout," Associated Press, Sept. 8, 2008 http://seattletimes.nwsource.com/html/businesstechnology/2008164579_apmortgagegiantswallstreet.html?syndication=
[17] Corbett B. Daly, "Fannie, Freddie aid cost unclear: regulator," Reuters, May 11, 2010 http://www.reuters.com/article/2010/05/11/us-fannie-freddie-taxpayers-idUSTRE64A3ZV20100511
[18] Mark Jickling, "Fannie Mae and Freddie Mac in Conservatorship," CRS, Sept. 15, 2008
[19] Mark Jickling, "Fannie Mae and Freddie Mac in Conservatorship," CRS, Sept. 15, 2008

- **As of Nov. 7, 2011, the FHFA estimates that the net cost to taxpayers for bailing out Fannie and Freddie will be $124 billion through 2014**
  - In a Nov. 7, 2011, article, *CNN Money* reported, "The cost to taxpayers for bailing out mortgage finance giants Fannie Mae and Freddie Mac won't be quite as bad as previous estimates, according to the federal agency overseeing the two companies.

    "The Federal Housing Finance Agency now estimates that the net cost of the bailouts through 2014 will be about $124 billion, down about 19% from an estimate of $154 billion a year ago."[20]

- **Even with recent improved estimates, the net cost of the bailout of Fannie and Freddie will still be the most expensive rescue effort by the federal government during the financial crisis of 2008 and 2009**
  - In a Nov. 7, 2011, article, *CNN Money* reported, "The net estimate subtracts the amount being returned to taxpayers through dividends. The total cost of the bailout -- including the 10% dividends Fannie and Freddie owe to the U.S. Treasury -- is now expected to be $226 billion.

    "The best-case, worst-case range of total costs is between $220 billion and $311 billion.

    "Even with Thursday's improved loss estimates, the net cost of the bailout of the two firms will still be the most expensive rescue effort by the Federal government during the financial crisis of 2008 and 2009."[21]

- **The FHFA also stated that, under the worst case scenario, total costs of the bailout could be $311 billion**
  - In a Nov. 7, 2011, article, *CNN Money* reported, "The agency report said the estimate was lowered because Fannie and Freddie needed less bailout funds over the last year because of their better than expected financial results.

    "The net estimate subtracts the amount being returned to taxpayers through dividends. The total cost of the bailout -- including the 10% dividends Fannie and Freddie owe to the U.S. Treasury -- is now expected to be $226 billion.

    "The best-case, worst-case range of total costs is between $220 billion and $311 billion."[22]

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[20] Chris Isidore, "Cost of Fannie & Freddie bailouts trimmed," *CNN Money*, Nov. 7, 2011, http://money.cnn.com/2011/10/27/news/companies/fannie_freddie_bailout/index.htm
[21] Chris Isidore, "Cost of Fannie & Freddie bailouts trimmed," *CNN Money*, Nov. 7, 2011, http://money.cnn.com/2011/10/27/news/companies/fannie_freddie_bailout/index.htm
[22] Chris Isidore, "Cost of Fannie & Freddie bailouts trimmed," *CNN Money*, Nov. 7, 2011, http://money.cnn.com/2011/10/27/news/companies/fannie_freddie_bailout/index.htm

- **"Mortgage finance giants Fannie Mae and Freddie Mac received the biggest federal bailout of the financial crisis. And nearly $100 million of those tax dollars went to lucrative pay packages for top executives"**

    - In a Nov. 15, 2011, article, *CNN Money* reported, "Mortgage finance giants Fannie Mae and Freddie Mac received the biggest federal bailout of the financial crisis. And nearly $100 million of those tax dollars went to lucrative pay packages for top executives, filings show.

      "The top five executives at Fannie Mae received $33.3 million in 2009 and 2010, while the top five at Freddie Mac received $28.1 million. And each company has set pay targets of as much as $17 million for its top managers for 2011.

      "That's a total of $95.4 million, which will essentially be coming from taxpayers, who have been keeping the mortgage finance giants alive with regular quarterly cash infusions since the Federal Home Finance Agency (FHFA) took control of the companies in September 2008."[23]

      Editor's Note: *The full video report can be viewed here: http://money.cnn.com/2011/11/15/news/companies/fannie_freddie_executive_pay/index.htm*

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- **Steven Linick, Inspector General of the FHFA, said in testimony before the Senate Committee on Banking, Housing, and Urban Affairs that the FHFA did not fully analyze factors related to executive compensation at Fannie Mae and Freddie Mac**

    - According to the Dec. 31, 2011 testimony of Steve A. Linick, Inspector General of the Federal Housing Finance Agency before the Senate Committee on Banking, Housing, and

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[23] Chris Isidore, "Fannie, Freddie execs score $100 million payday," *CNN Money*, Nov. 15, 2011, http://money.cnn.com/2011/11/15/news/companies/fannie_freddie_executive_pay/index.htm
[24] Chris Isidore, "Fannie, Freddie execs score $100 million payday," *CNN Money*, Nov. 15, 2011, http://money.cnn.com/2011/11/15/news/companies/fannie_freddie_executive_pay/index.htm

Urban Affairs, "FHFA Did Not Fully Analyze Factors Related to Executive Compensation at Fannie Mae and Freddie Mac

"For 2009 and 2010, the Enterprises awarded their top six officers a cumulative total of over $35 million in compensation. FHFA reviewed and approved these compensation awards based on the Enterprises' determinations and recommendations. However, an FHFA-OIG report found that FHFA did not independently test or validate the means by which the Enterprises calculated their recommended compensation levels and did not consider factors that might have resulted in reduced executive compensation costs. These factors included the lower compensation levels paid to senior officials at federal agencies supporting the housing market and the extent to which federal support for the Enterprises may facilitate the ability of Enterprise officers to meet individual and corporate performance targets."[25]

2010: Failing to Include Fannie Mae and Freddie Mac in Financial Services Overhaul

- **Voted for the Wall Street Reform and Consumer Protection Act, legislation that would overhaul the regulation of the financial services industry, …**

  - Voted for adoption of the conference report on the bill that would overhaul the regulation of the financial services industry. The measure would create new regulatory mechanisms to assess risks posed by very large financial institutions and facilitate the orderly dissolution of failing firms that pose a threat to the economy. It would create a new federal agency to oversee consumer financial products, bring the derivatives market under significant federal regulation for the first time and give company shareholders and regulators greater say on executive pay packages. The costs would be offset by terminating the Trouble Asset Relief Program and increasing deposit insurance premiums paid by some banks. (Adopted 237-192; D: 234-19; R: 3-173)[26]

  - On July 1, 2010, *The Wall Street Journal* reported, "The financial legislation was approved 237-192 after a sharp debate that highlighted partisan tensions on Capitol Hill. Ultimately, 19 Democrats joined most Republicans in opposition, while three Republican broke ranks to support the bill, which beefs up the powers of federal regulators and puts a tight leash on large U.S. banks. No House Republicans supported the bill when it was first brought to the floor last year.

    "The legislation is a pillar of President Barack Obama's first-term agenda and could be the last major bill enacted before November's midterm elections.

    "The measure would give regulators new powers to seize and dismantle failing financial companies; bolster the Federal Reserve's authority over the country's largest firms; toughen scrutiny over exotic financial instruments known as derivatives; and create a new regulator to police mortgages and credit cards among other things."[27]

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[25] Testimony of FHFA Inspector General Steve A. Linick Hearing on "Oversight of the Federal Housing Finance Agency Part II" Senate Committee on Banking, Housing, and Urban Affairs, Dec. 13, 2011, http://www.fhfaoig.gov/Content/Files/Senate-12-13-2011.pdf
[26] H.R. 4173, CQ Vote #413, June 30, 2010
[27] Damian Paletta and Greg Hitt, "House Vote Sends Finance Overhaul to Senate," *The Wall Street Journal*, July 1, 2010

- **… But the bill did nothing to address Fannie Mae and Freddie Mac**

  - In a June 28, 2010, WebMemo, The Heritage Foundation wrote, "Despite much rhetoric about ending bailouts, the bill does nothing to address Fannie Mae and Freddie Mac, two of the largest recipients of federal bailout money. These two government-sponsored enterprises, now in federal receivership, helped fuel the housing bubble. When it popped, taxpayers found themselves on the hook for some $150 billion in bailout money.

    "The failure to address their future is a serious error and shows just how hollow are claims that this agreement will prevent future crises." [28]

- **Government-controlled Fannie Mae and Freddie Mac, which together own or guarantee half of all U.S. mortgages, were largely untouched by the legislation, and it could take years before they are reformed**

  - In a June 25, 2010, article, *The Wall Street Journal* reported, "Government-controlled Fannie Mae and Freddie Mac remain a multibillion dollar drain on the U.S. Treasury, and largely untouched by this proposal. And the banking sector in parts of Europe remains fragile."[29]

  - In a June 25, 2010, article, Reuters reported, "Here is a look at some proposals that were left behind: Fixing Fannie and Freddie: the two giants of U.S. mortgage finance – Fannie Mae and Freddie Mac – need a major overhaul. That much both political parties in Congress can agree on. But the consensus ends there.

    "Fixing Fannie and Freddie, which together own or guarantee half of all U.S. mortgages, is such a contentious problem that Democrats set it aside for the time being.

    "The Obama administration has asked for public input on what to do about the housing finance system, a classic Washington tactic to buy more time.

    "A more detailed proposal on housing finance is not expected until 2011, and it could take years before lawmakers agree on a new framework."[30]

- **After two weeks of negotiations, major components of the bill were negotiated in the hallway of a Senate Office Building in the middle of the night; the final agreement was reached a little after 5:00 a.m.**

  - In a June 25, 2010, article, *The Wall Street Journal* reported, "A panel of 43 lawmakers spent two weeks reconciling differences between a bill that passed the House in December and the Senate in May. They concluded their negotiations along party lines at a little after 5 a.m. ET

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[28] David C. John and James Gattuso, "Financial Reform in Congress: A Disorderly Failure," The Heritage Foundation, June 28, 2010
http://www.heritage.org/research/reports/2010/06/financial-reform-in-congress-a-disorderly-failure
[29] Damian Paletta, "U.S. lawmakers reach accord on new finance rules," *The Wall Street Journal*, June 25, 2010
http://online.wsj.com/article/SB10001424052748703615104575328020013164184.html
[30] Kevin Drawbaugh and Corbett Daly, "Factbox: Some financial reforms missing from U.S. legislation," June 25, 2010
http://www.reuters.com/article/2010/06/25/us-financial-regulation-missing-idUSTRE65O1BK20100625

in a Capitol Hill conference room marked by tension, levity and exhaustion. Senior administration officials, including Treasury Department Deputy Secretary Neal Wolin, arrived late in the afternoon to try and quell the feud between the New York delegation and Ms. Lincoln.

"Major components of the bill, including the derivatives provisions, were negotiated in the hallway of the Dirksen Senate Office Building as the clock neared midnight. At one point, after hearing of an offer from Senate Democrats, Rep. Melissa Bean (D., Ill.) exclaimed: 'Are you flipping kidding me? Are you flipping kidding me?'"[31]

- **"By far the most significant error of omission in the bill is the failure to reform Fannie Mae and Freddie Mac, the government sponsored enterprises that encouraged the origination of risky mortgages in the first place by purchasing them with the support of many in Congress"**

  - In a July 1, 2010, opinion, John Taylor, a professor of economics at Stanford and a senior fellow at the Hoover Institution, wrote in *The Wall Street Journal*, "By far the most significant error of omission in the bill is the failure to reform Fannie Mae and Freddie Mac, the government sponsored enterprises that encouraged the origination of risky mortgages in the first place by purchasing them with the support of many in Congress. Some excuse this omission by saying that it can be handled later. But the purpose of 'comprehensive reform' is to balance competing political interests and reach compromise; that will be much harder to do if the Frank-Dodd bill becomes law. For example, many of the same activists who supported proxy-access provisions are those that also favor the Fannie and Freddie subsidies."[32]

- **"They're big, they're bad, they're sucking up billions of taxpayer dollars and they're not even addressed in the most sweeping overhaul of the financial system since the Great Depression," and "Unfortunately, the new law has a gigantic hole in it – there's nothing in it dealing with struggling mortgage giants Fannie Mae and Freddie Mac"**

  - According to a July 15, 2010, John Schoen column on MSNBC.com, "They're big, they're bad, they're sucking up billions of taxpayer dollars and they're not even addressed in the most sweeping overhaul of the financial system since the Great Depression.

    "Two years after a wave of rogue mortgage lending sent the global financial system to the brink of collapse, Congress has put the finishing touches on a hotly-debated set of regulations to try to prevent it from happening again. The Senate passed the regulatory reform bill Thursday, paving the way for President Barack Obama to sign into law his administration's third piece of major legislation.

[31] Damian Paletta, "U.S. lawmakers reach accord on new finance rules," *The Wall Street Journal*, June 25, 2010 http://online.wsj.com/article/SB10001424052748703615104575328020013164184.html
[32] John B. Taylor opinion, "The Dodd-Frank financial fiasco," *The Wall Street Journal*, July 1, 2010 http://online.wsj.com/article/SB10001424052748703426004575338732174405398.html

"Unfortunately, the new law has a gigantic hole in it – there's nothing in it dealing with struggling mortgage giants Fannie Mae and Freddie Mac."[33]

Editor's Note: *John Schoen has reported and written about business and financial news for more than 25 years. He is senior business producer for MSNBC.*

- **"In the name of responding to a crisis, the bill greatly increases the power of politicians and regulators without addressing the real causes of that crisis"**
  - In a June 28, 2010, editorial, *The Wall Street Journal* wrote, "We could go on, but perhaps the best summary is to hail Dodd-Frank as the crowning achievement of the Obama "reform" method. In the name of responding to a crisis, the bill greatly increases the power of politicians and regulators without addressing the real causes of that crisis. It makes credit more expensive and punishes business without reducing the chances of a future panic or bailouts.

    "The only certain result is that when the next mania and panic arrive, and they will, Congress and the regulators will claim they were all someone else's fault."[34]

Conservatorship of Fannie and Freddie: Following enactment of HERA in July 2008, the GSEs individually agreed with the FHFA that unexpected mortgage delinquencies and resulting losses jeopardized their solvency. In September 2008, Fannie and Freddie agreed to direct government control known as conservatorship which is the equivalent of bankruptcy reorganization for financial companies. As part of the agreement to conservatorship, the Treasury Department agreed to provide financial support to keep the GSEs solvent. As amended, the agreement required Treasury to provide whatever funds are necessary to keep the FSEs afloat through December 2012. Treasury is to provide additional support after 2012, subject to a complex formula that depends in part on Fannie and Freddie's condition at the end of 2012. In return for this support, Treasury receives special stock and other considerations.

So, each GSE sold to Treasury $1 billion of senior preferred stock and gave Treasury warrants to purchase 79.9 percent of its common stock. Treasury agreed to purchase a maximum of $100 billion (later raised to $200 billion) additional senior preferred stock to maintain a positive net worth of each GSE. This senior preferred stock pays a ten percent cash dividend. Treasury also purchased MBSs from the GSEs. On Dec. 24, 2009, the contracts were amended to provide the GSEs with unlimited financial support from Treasury for 2009 through 2012. In addition, the Fed has extended financial assistance to the GSEs by purchasing MBSs and bonds. The initial contracts to purchase a maximum of $100 billion from each GSE were amended twice and currently provide for unlimited support to maintain each GSEs solvency through the end of 2012, and limited support beyond 2012.

By law, conservatorship will end when the GSEs return to a safe and solvent condition. Click here for an FHFA fact sheet on conservatorship.

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[33] John W. Schoen column, "No end in sight to Fannie, Freddie bailout," MSNBC.com, July 15, 2010 http://mny.mobile.msn.com/en-us/articles.aspx?aid=38250967&acid=1&afid=1&pg1=5001
[34] Editorial, "Triumph of the regulators," *The Wall Street Journal*, June 28, 2010 http://online.wsj.com/article/SB10001424052748703615104575328993006115992.html

Since the third quarter of 2007, increased and unexpected delinquency and foreclosure rates have resulted in quarterly losses for Fannie Mae and Freddie Mac. Fannie Mae has not reported a profitable quarter since that third quarter and Freddie Mac has reported only one profitable quarter. Taxpayers have a large investment in Fannie Mae and Freddie Mac. Although the government has safeguards in place, no one knows how much taxpayers will get back from their investment. At the time of this writing, the Treasury Department has kept these two insolvent companies in business by providing more than $187 billion in support. In addition to the $187 billion in direct support, Treasury and the Fed purchased nearly $1.4 trillion in GSE-issued and guaranteed MBSs, as previously discussed.

As the wait for a solution drags out, Fannie and Freddie continue to lose money. Their combined losses have cost the federal government $146 billion in tax dollars to date.

> The total amount invested in Fannie and Freddie so far is $187 billion. They have returned none of the money invested so far—and might never do so. The Treasury has been earning a return on its investments. So far Fannie and Freddie have paid $41 billion in dividends to the Treasury.

Editor's Note: *This information is as of the time of this writing. For an updated look at these amounts, please click here for ProPublica.org's tracking of bailouts.*

President Obama's Proposal: The Dodd-Frank Wall Street Reform and Consumer Protection Act (P.L. 111-203) required that recommendations be developed regarding ending the GSEs' conservatorship and on the federal government's proper role in the nation's housing finance system. The Obama Administration, through the U.S. Treasury and Department of Housing and Urban Development (HUD), issued a report on Feb. 11, 2011, outlining the options available for overhauling America's housing finance market. The report notes that any changes will take place over years. It recommends that the government "ultimately wind down" Fannie Mae and Freddie Mac, the government-sponsored enterprises that received federal bailouts and were eventually taken over.

In the short-term, the report proposed that:

- Insurance premiums charged by Fannie and Freddie be raised 0.25 percent.
- Both Fannie and Freddie only guarantee mortgages with down payments of 10 percent or more.
- The maximum loan size granted by Fannie and Freddie be reduced to pre-crisis levels.
- The investment portfolios of both Fannie and Freddie be sold at an annual pace of no less than 10 percent.
- These measures will add to an environment in which many borrowers will face difficulty obtaining mortgages.

In the long term, the report proposed three options for the future of the housing finance market. Two of these involve a predominantly privatized mortgage market. The last option allowed for government involvement in the reinsurance market to help low- and middle-income families obtain mortgages.

- According to the report, the two private solutions would lead to a radical change in the structure of the mortgage market. For instance:
    - The 30-year, fixed-rate mortgage could disappear.
    - The cost of mortgages may increase.
    - Small and community banks would find it difficult to remain competitive, as they are now dependent on Fannie and Freddie for cheap funding and mortgage guarantees. Plans to privatize the mortgage market are at odds with proposals that seek to limit the growth of large banks and maintain the fragmented and local banking system in the U.S.

Republican Proposals: This Congress, Republicans are again offering solutions to protect taxpayers and end the bailout of Fannie Mae and Freddie Mac. So far, seven proposals have been presented by House Republicans:

Editor's Note: *The following is courtesy of the House Financial Services Committee.*

1. Prevent Dividend Payment Decrease. The legislation, sponsored by Rep. Don Manzullo, prevents the Treasury Department from lowering the 10% dividend payment that Fannie Mae and Freddie Mac are currently paying to American taxpayers. This will ensure that the two entities continue to repay their debt to the taxpayers and that their ongoing bailout moves towards conclusion.

2. Abolish Affordable Housing Trust Fund. The legislation abolishes the Affordable Housing Trust Fund. With Fannie and Freddie under federal government conservatorship and losing billions of dollars per quarter, there is no need to have an additional requirement on them to send a portion of their revenue to special interest groups at the expense of American taxpayers. The bill is sponsored by Rep. Ed Royce.

3. Ensure an Exact GSE Replica is Not Created. The bill amends the Housing and Economic Recovery Act (HERA) to ensure that if either Fannie Mae or Freddie Mac is placed in federal government receivership, a new quasi-governmental replica is not created in its wake. Under HERA, if Fannie or Freddie is placed into a federal government receivership, by law a new company is created with a government charter and private stockholders. This simply recreates the failed GSE-model. This legislation ensures that if the entities are put into receivership, their businesses are wound down and no new entity with taxpayer backing is set up. The bill is sponsored by Rep. Steve Stivers.

4. Require Disposition of Non-Mission Critical Assets. The legislation, sponsored by Rep. Robert Hurt, directs the Federal Housing Finance Agency (FHFA) Director to require Fannie Mae and Freddie Mac to dispose of all non-mission critical assets, including, but not limited to, patents and data. This would go a long way in helping to provide additional transparency and generate increased flow of private capital into our mortgage market.

5. Set a Bailout Cap for the GSEs. The legislation, introduced by Rep. Michael Fitzpatrick, sets a cap on the amount of money that the American taxpayers will be charged for the bailout of Fannie Mae and Freddie Mac. A cap on Fannie's and Freddie's liabilities will not only protect taxpayers, but will also ensure that the bailout of these entities is not unlimited.

6. Subject Fannie and Freddie to FOIA. The legislation, sponsored by Rep. Jason Chaffetz, subjects Fannie Mae and Freddie Mac to the Freedom of Information Act (FOIA). Since Fannie and Freddie were originally chartered by the federal government, they have been exempt from FOIA. Now that federal government conservatorship has essentially made them government companies, it only makes sense that both companies should be subject to FOIA standards.

7. Prohibit Taxpayer Funding of GSE Employee Legal Fees. The legislation, introduced by Rep. Randy Neugebauer, limits taxpayer exposure to the mounting legal expenses of Fannie Mae and Freddie Mac. Since 2008, the American taxpayers have spent more than $162 million defending Fannie, Freddie and their former top executives in civil lawsuits. This includes tens of millions of dollars for former executives who, according to their regulator, "knowingly and purposely manipulated earnings to increase their own compensation." This bill would minimize taxpayer liability to GSE legal fees by allowing FHFA to put limits on the advancement of legal fees for Fannie and Freddie executives involved in cases of fraud.

Lehman Brothers

Lehman Brothers Holdings, Inc. was a global financial institution providing "services in equity and fixed income sales, trading and research, investment banking, asset management, private investment management and private equity" in 40 different countries. It was the fourth largest U.S. investment bank with $639 billion in assets. The company was structured as a financial conglomerate with numerous subsidiaries and affiliates incorporated across the world. Lehman Brothers employed close to 30,000 people as of the end of November 2007.

In August 2007, Lehman Brothers closed its subprime lender, BNC Mortgage, eliminating 1,200 positions in 23 locations and took an after-tax charge of $25 million and a $27 million reduction in goodwill. In 2008, Lehman faced an unprecedented lost to the continuing subprime mortgage crisis. Lehman's loss was a result of having held on to large positions in subprime and other lower-rated mortgage tranches when securing the underlying mortgages. In the second fiscal quarter of 2008, Lehman reported losses of $2.8 billion and was forced to sell off $6 billion in assets. In the first half of 2008 alone, Lehman stock lost 73 percent of its value as the credit market continued to tighten. In August 2008, Lehman reported that it intended to release six percent of its workforce.

Investor confidence continued to erode as Lehman's stock lost roughly half its value and pushed the Standard and Poor's 500 down 3.4 percent on Sept. 9, 2008. The Dow Jones lost 300 points the same day on investors' concerns about the security of the bank. The U.S. government did not announce any plans to assist with any possible financial crisis that emerged at Lehman. The very next day (Sept. 10, 2008), Lehman announced a loss of $3.9 billion and its intent to sell off a majority stake in its investment-management business.

On Sept. 15, 2008, Lehman Brothers filed for Chapter 11 bankruptcy. Lehman's bankruptcy was the largest failure of an investment bank since Drexel Burnham Lambert collapsed amid fraud allegations in 1990.

Merrill Lynch and Bank of America

Merrill Lynch, like many other banks, became heavily involved in the mortgage-based collateralized debt obligation (CDO) market in the early 2000s. Many of the assets held by these Merrill Lynch CDOs had been subprime mortgage-backed bonds. Significant losses for Merrill Lynch were attributed to the drop in value of its large and unhedged mortgage portfolio in the form of DCOs. Trading partners' loss of confidence in its solvency and ability to refinance short-term debt ultimately led to its sale. During the week of Sept. 8, 2008, while Lehman Brothers was under severe liquidity pressures, there was great concern that Lehman's failure could spread to the other surviving investment banks.

On Sept. 14, 2008, (the day before Lehman filed bankruptcy) Bank of America announced that it was in talks to buy Merrill Lynch for $38.25 billion in stock. It was reported later that day that Merrill Lynch was sold to Bank of America for 0.8595 shares of Bank of America common stock for each Merrill Lynch common share, or about $50 billion or $29 per share. This price represented a 70.1 percent premium over its Sept. 12, 2008, closing price or a 38 percent premium over Merrill's book value of $21 a share, but it also meant a 61 percent discount from its September 2007 price.

It was later revealed by Bank of America CEO Kenneth Lewis during congressional testimony, as well as through internal emails released by the House Oversight Committee, that Bank of America was threatened with the firings of its management and board as well as damaging the relationship between the bank and federal regulators if Bank of America did not go through with the acquisition of Merrill Lynch.

American International Group (AIG)

In the beginning of 2008, American International Group (AIG) was one of the world's largest insurers, generally considered to be financially sound with an AA credit rating. By the end of the year, it was near bankruptcy and had been forced to seek up to $173.4 billion in financial assistance from the U.S. government. The CEO had been replaced at the government's behest, executive compensation was under limits and shareholders in AIG saw their equity diluted by a new 79.9 percent stake held by the government.

On Sept. 16, 2008, the Fed announced that it would lend up to $85 billion to the financial institution American International Group (AIG). AIG had experienced a significant decline in its stock price and was facing immediate demands for $14 billion to $15 billion in collateral payments due to recent downgrades by credit rating agencies. The Fed announced that AIG could borrow up to $85 billion from the Fed over the next two years. On Sept. 18, 2008, the Fed announced that it had initially lent $28 billion to AIG. In return, the government agreed to receive warrants that, if exercised, would give the government a 79.9 percent ownership stake in AIG. The Fed named three independent trustees to oversee the firm for the duration of the loan and a new CEO was installed after this initial intervention.

On Oct. 8, 2008, the Fed announced that it was expanding its assistance to AIG by swapping cash for up to $37.8 billion of AIG's investment-grade, fixed-income securities. These securities stemmed from the AIG securities lending program. As some counterparties stopped participating in the lending program, AIG was forced to incur losses on its securities lending investments. AIG needed liquidity from the Fed to cover these losses and counterparty withdrawals.

Following this action by the Fed, TARP was enacted and AIG received more assistance through that program, too.

TROUBLED ASSET RELIEF PROGRAM (TARP)

In 2008, experts both on Wall Street and at the Treasury Department feared that many affected financial institutions were so intertwined in the marketplace that they could set off a domino effect which could bring down the entire U.S. economy.

Fear of a potential economic disaster prompted the U.S. Treasury Department, along with the Federal Reserve, to try to fix the market through bailouts and loans to several Wall Street firms and financial institutions. This had mixed results. Concerned that a long-term freeze in the credit markets could damage the economy, then-Treasury Secretary Hank Paulson and Fed Chairman Ben S. Bernanke asked Congress to approve vast new powers to remove those toxic assets from the financial system. Subsequently, Congress passed the Emergency Economic Stabilization Act of 2008 (EESA) that established a new Troubled Asset Relief Program (TARP), giving the federal government the ability to buy up to $700 billion worth of toxic assets with taxpayer money, and to hold those securities for some time, possibly years, with the idea that they would hopefully sell them back to private buyers when the markets had calmed, thus repaying the taxpayer, hopefully with gains.

At the time, the question of whether to give the U.S. Treasury Department the authority to use taxpayer dollars to nationalize mortgage-related and other troubled assets was not an easy one. Financial markets were clearly in turmoil, and many financial firms had crashed, while others were failing. There was significant concern that without some federal action to bolster market confidence, there would be devastating consequences.

Many in Congress believed, given the circumstances, that the risk of inaction was so grave that the $700 billion TARP was necessary. Others, while equally concerned with the turmoil in the marketplace, were also concerned at the enormous price tag of the effort and its cost to the American taxpayers, as well as fears that the effort would likely forever change the landscape of the nation's free-market system and that struggling companies should be allowed to fail and the market to replace them.

You can see how they voted on TARP here.

The 2008 TARP legislation:

- **The bailout, which gave the government broad authority to buy up toxic mortgage-related investments and other distressed assets from financial institutions, was seen by many as a huge giveaway to the very financial institutions that helped cause the subprime mortgage meltdown at the root of the economic crisis with nothing to help its ordinary victims**
    - In an Oct. 4, 2008, article, the Associated Press reported, "The bailout, which gives the government broad authority to buy up toxic mortgage-related investments and other distressed assets from tottering financial institutions, is designed to ease a credit crunch that began on Wall Street but is engulfing businesses around the nation."[35]
    - The same article went on to say, "As lawmakers scrambled to draft a bill, they were barraged by angry calls from constituents to reject what many saw as a huge giveaway to the very

[35] Julie Hirschfeld Davis, "Historic bailout bill passes Congress; Bush signs," Associated Press, Oct. 4, 2008

financial institutions that helped cause the subprime mortgage meltdown at the root of the economic crisis with nothing to help its ordinary victims."[36]

- **It is extremely unlikely that the taxpayers will see a full return on their TARP investments**

    - In its October 2009, quarterly report to Congress, the Office of the Special Inspector General for the Troubled Asset Relief Program (SIGTARP) wrote, "Although several TARP recipients have repaid funds for what has widely been reported as a 17% profit, it is extremely unlikely that the taxpayers will see a full return on their TARP investments. Certain TARP programs, such as the mortgage modification component of the Making Home Affordable ("MHA") program, which is scheduled to use $50 billion of TARP funds, will yield no direct return; for others, including the extraordinary assistance to American International Group, Inc. ("AIG") and the auto companies, full recovery is far from certain."[37]

- **The TARP program could create "moral hazard" where those who were at the heart of the financial crisis may behave more recklessly, believing that the government has insulated them from the risks of their actions**

    - In its October 2009, quarterly report to Congress, the Office of the Special Inspector General for the Troubled Asset Relief Program (SIGTARP) wrote, "Moral Hazard: A term used in economics and insurance to describe the lack of incentive individuals have to guard against a risk when they are protected against that risk (for example, through an insurance policy). In the context of TARP, it refers to the danger that private-sector executives/investors/lenders may behave more recklessly, believing that the government has insulated them from the risks of their actions."[38]

    - The report goes on to say, "Market behavior is bound to be impacted by the massive infusions of government capital into the very institutions that caused the crisis; by the modifications of mortgages for homeowners who may have borrowed irresponsibly; and by the provision of cheap, non-recourse loans to incentivize the purchase of the same volatile and over-valued asset-backed securities ('ABS') that were a major cause of the current crisis. The firms that were 'too big to fail' last October are in many cases bigger still, many as a result of Government supported and sponsored mergers and acquisitions; the inherently conflicted rating agencies that failed to warn of the risks leading up to the financial crisis are still just as conflicted; and the recent rebound in big bank stock prices risks removing the urgency of dealing with the system's fundamental problems. Absent meaningful regulatory reform, TARP runs the risk of merely re-animating markets that had collapsed under the weight of reckless behavior."[39]

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[36] Julie Hirschfeld Davis, "Historic bailout bill passes Congress; Bush signs," Associated Press, Oct. 4, 2008
[37] "Quarterly Report to Congress," the Office of the Special Inspector General for the Troubled Asset Relief Program, Oct. 21, 2009
[38] "Quarterly Report to Congress," the Office of the Special Inspector General for the Troubled Asset Relief Program, Oct. 21, 2009
[39] "Quarterly Report to Congress," the Office of the Special Inspector General for the Troubled Asset Relief Program, Oct. 21, 2009

- **The government'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 diminished its ability to handle future crises**

    - In its October 2009, quarterly report to Congress, the Office of the Special Inspector General for the Troubled Asset Relief Program (SIGTARP) wrote, "The Government's capacity to address financial crises depends in no small measure on its credibility, both with market participants whose confidence is essential to stabilize the financial system and with the American public whose confidence is essential to underpin the political support required to take the difficult (and often expensive) steps that are needed. Unfortunately, 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. Notwithstanding TARP's role in bringing the financial system back from the brink of collapse, it has been widely reported that the American people view TARP with anger, cynicism, and distrust. These views are fueled by the lack of transparency in the program. The beliefs of some, for example, that TARP funds went into a "black hole"; that TARP was created in secrecy to transfer wealth from taxpayers to Wall Street insiders (exacerbated by the announcement of billions of dollars of profits and record-setting bonus pools at TARP recipients while unemployment and foreclosures continue to rise); or that Treasury is just too closely aligned with the interests of Wall Street are only reinforced by Treasury's failures of transparency. Despite the aspects of TARP that could reasonably be viewed as a substantial success, Treasury's actions in this regard have contributed to damage the credibility of the program and of the Government itself, and the anger, cynicism, and distrust created must be chalked up as one of the substantial, albeit unnecessary, costs of TARP."[40]

- **The original purpose of TARP was to allow government purchases of up to $700 billion in mortgage-related securities, in the hope that normal functioning of the financial markets could be restored**

    - In a Nov. 25, 2008, memo, the non-partisan Congressional Research Service wrote, "On September 19, 2008, the Secretary of the Treasury proposed a broad program of financial intervention to stabilize markets. The Treasury plan called for government purchases of up to $700 billion in mortgage-related securities, in the hope that, by partially purging the system of these troubled assets, normal functioning of the financial markets could be restored."[41]

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[40] "Quarterly Report to Congress," the Office of the Special Inspector General for the Troubled Asset Relief Program, Oct. 21, 2009

[41] Barid Webel and Edward V. Murphy, "The Emergency Economic Stabilization Act and Current Financial Turmoil: Issues and Analysis," Congressional Research Service, Nov. 25, 2008

- **The final legislation included broad discretion for use of TARP funds by the Secretary of the Treasury**

    - In a Nov. 25, 2008, memo, the non-partisan Congressional Research Service wrote, "Although the original discussion of the three-page draft Treasury plan focused on removing bad assets from financial institution balance sheets, some policymakers urged, and H.R. 1424/P.L. 110-343 included, broad discretion for the use of TARP funds. The potential scope of the program can be found in Part (B) of the definition of a troubled asset, which includes

        '... any other financial instrument that the Secretary, after consultation with the Chairman of the Board of Governors of the Federal Reserve System, determines the purchase of which is necessary to promote financial market stability, but only upon transmittal of such determination, in writing, to the appropriate committees of Congress.'"[42]

- **After the bill passed, then-Secretary of the Treasury Henry Paulson announced that he no longer planned on using TARP funds for their original purpose of purchasing mortgage backed securities**

    - In a Nov. 14, 2008, memo, The Heritage Foundation wrote, "The ink was barely dry on the legislation, however, when Treasury adopted a new--and more problematic--approach: directly infusing selected U.S. banks with capital by purchasing non-voting preferred equity shares. Granted, Treasury's hand in this was in part forced by European governments, which paved the way with massive capital infusions into their own banking systems. However, the original TARP plan, as envisioned when Congress adopted the authorizing legislation, never went forward.

    "On November 12, Paulson announced that Treasury no longer planned to buy any mortgage-backed securities, except perhaps in certain targeted instances. Instead, he put forth a number of other possible initiatives the Treasury might pursue with the $700 billion that Congress authorized, as well as other authorities such as: purchases of stock in non-bank financial firms; federal financing for investors in securities backed by consumer debt such as car loans, student loans, and credit cards; and subsidies to mitigate mortgage foreclosures."[43]

    In a Dec. 26, 2008, opinion, Edwin Feulner, President of The Heritage Foundation, wrote in *The Washington Times*, "But Treasury decided not to use TARP money (about $15 billion of the original $350 billion hasn't been spent yet) to buy bad assets, but on other approaches to the financial crisis. On Nov. 12, Mr. Paulson announced the executive branch would use TARP money to guarantee securities backed by student loans and credit card debt. The Bush administration also wants to refinance troubled mortgages and now plans to use TARP

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[42] Barid Webel and Edward V. Murphy, "The Emergency Economic Stabilization Act and Current Financial Turmoil: Issues and Analysis," Congressional Research Service, Nov. 25, 2008

[43] James L. Gattuso, David C. John and J.D. Foster, Ph.D., "TARP and the Treasury: time to allow markets to work," The Heritage Foundation, Nov. 14, 2008.

money to prop up the unprofitable segments of the auto industry - in direct defiance of Congress."[44]

The Evolution of TARP

The appropriate way to address the problem of toxic assets, the securities and loans held by financial institutions whose value is uncertain in the wake of the financial crisis, has been an ongoing debate which has resulted in several initiatives under TARP that have had mixed results.

Originally, the TARP program was intended to allow the federal government to purchase toxic assets and hold the securities for a period of time before selling them back to private buyers when the markets had calmed. Instead, TARP's scope, size, and complexity have dramatically increased in the short time since it was created.

After concluding that a program to buy bad assets would not work, the Treasury Department under then-Secretary Paulson changed its approach to allow the government to make direct equity investments in banks to help stabilize their balance sheets. The new approach was called the Capital Purchase Plan (CPP). Under the CPP, Treasury planned to support U.S. financial institutions, companies, and individual borrowers through a combination of 12 separate TARP programs with a scope that has reached far beyond the financial sector resulting in the largest government intervention in the marketplace since the Great Depression.

The CPP has produced mixed results and has raised significant policy concerns. Under the original approach to TARP, the government buys the toxic asset from a financial institution and the relationship between the government and the financial institution ends. Under the approach of direct investment, the government has an ongoing relationship with the bank, which brings about expected policy tension and concern over the abandonment of free-market principles derived from the ongoing linkage between Uncle Sam and previously private banks that normally would operate under the rules of a free market.

Yet another approach for TARP has been proposed by Treasury Sec. Tim Geithner and is now being implemented by the Obama Administration. Under this plan, the Obama Administration expanded the CPP to include a new Capital Assistance Program. Under this program the Administration administered "stress tests" to many of the nation's largest banks. Based on those stress tests, regulators would require some of these big banks to raise more capital. These banks would then be given a six month period to raise any additional capital needed. If the bank cannot raise this capital privately, then Treasury will provide it from the TARP.

Finally, the Obama Administration has established the Public-Private Investment Program (PPIP) under TARP. While the Obama Administration is keeping in place the expansion of TARP to directly invest in financial institutions, the PPIP is in many ways a return to TARP as it was original envisioned. Essentially, the idea of the PPIP is to use federal funds to facilitate, or in some cases subsidize, the purchase of toxic (or what Treasury now calls "legacy") assets by public-private investment groups, which would bid against each other for the assets. While the government would share profits equally with the private-sector partner, taxpayers bear most of the risk of losses. In other words, the private-sector partner cannot lose more than its investment. Any further losses after the private capital is gone would be covered by the taxpayers. To its

[44] Edwin J. Feulner, Ph.D., opinion, "Bale up the bailouts," *The Washington Times,* Dec. 26, 2008

credit, at least this approach involves the private sector in making the investments necessary to address the toxic asset problem.

The American public, however, has justifiably grown skeptical of interventions that have show mixed results or have created more problems than they solve. Entangling the federal government further in the management of private-sector businesses may not be the wisest course of action.

__TARP Legislation in the 111th Congress__

Under the 2008 law, the release of the second $350 billion was contingent on the president submitting a written request to Congress. Even before taking office, President Obama pressed his former Senate colleagues to ensure that – despite the public unpopularity of the TARP law – his Administration would have access to all of the funding. At Obama's urging, President George W. Bush did so on Jan. 12, 2009. Sen. David Vitter, R-La., then introduced a joint resolution of disapproval (S.J. Res. 5), which the law required Congress to act on by Jan. 18.

Ultimately, the Senate rejected the resolution, thus releasing the second half of the TARP funds. The House later voted to block the release of the second half of the TARP funds (H.J. Res. 3), but the Senate's action made that merely a symbolic vote.

There have also been multiple legislative attempts and proposals to utilize unspent or returned TARP funds (those that are being paid back by the companies that received bailout funding) to fund other Democrat priorities.

This was never the intention of TARP. TARP, as described above, was originally intended to act as a type of loan from the taxpayer to private industry to help prop up the economy. That loan was to be paid back, hopefully with interest, and the returned money used to pay down the deficit and reduce the debt (which of course was increased due to TARP in the first place). The TARP legislation is quite clear: "Revenues of, and proceeds from the sale of troubled assets purchased under this Act, or from the sale, exercise, or surrender of warrants or senior debt instruments acquired under section 113 shall be paid into the general fund of the Treasury for reduction of the public debt." However, this did not stop the Democrat leadership in the previous 111th Congress from looking at creative ways to get around this provision and utilize returned TARP funds as a piggy bank for other priorities.

In December 2009, the House unanimously passed a bill (H.R. 1242) to broaden government oversight of the bailout program. It would require the Treasury Department to provide continuous data on money spent under the program to the TARP special inspector general, the comptroller general and a congressional oversight panel. The Senate did not take up this bill.

Finally, in July of 2010, the Dodd-Frank financial regulation overhaul reduced the amount authorized for TARP to $475 billion (more on this and Dodd-Frank later). The Dodd-Frank bill did not use the reduction to pay down the deficit or debt - instead the "savings" were used to finance other portions of the financial services overhaul.

__SIGARP and Continued Concerns__

The Office of the Special Inspector General for the Troubled Asset Relief Program (SIGTARP) was created by the Emergency Economic Stabilization Act of 2008 (EESA). SIGTARP has the responsibility to conduct, supervise, and coordinate audits and investigations of the purchase, management, and sale of assets under the Troubled Asset Relief Program (TARP). SIGTARP is required to report quarterly to Congress.

According to the SIGTARP, and as discussed earlier in this chapter, Treasury has utilized TARP funds differently than had been anticipated at the time of the enactment of EESA in October 2008. As initially envisioned, Treasury would have purchased or insured specific troubled assets, such as mortgages and mortgage backed securities, but instead has concluded that such an asset purchase program would not be effective or expedient. The SIGTARP states that TARP's scope, size, and complexity have dramatically increased since the enactment of the EESA. Treasury is now in the process of supporting U.S. financial institutions, companies, the American automotive industry and individual borrowers through a combination of 12 separate TARP programs that involve a total that could reach nearly $3 trillion (including TARP funds, Federal Reserve loans, Federal Deposit Insurance Corporation (FDIC) guarantees, and private money).

The formal extension of TARP by the Secretary Geithner on Dec. 9, 2009, ensured the program would continue well into 2010. The focus of TARP has begun to shift, however, as the early TARP programs that invested huge sums in banks are now closed to further investments and most of the largest bank recipients have repaid their TARP funds. Treasury has stated that, going forward, TARP will focus on foreclosure mitigation efforts, small-business lending, and a continuation of support for the asset-backed securities ("ABS") markets, ironically adhering very closely to what was supposed to be the original intent of TARP in 2008.

The following excerpt from the Jan. 30, 2010 quarterly report of the SIGTARP provides a great summary of the evolution of TARP and where concerns remained:

> This time of transition provides an opportunity to take a step back and examine whether Treasury's efforts in TARP thus far have met the goals of the program. On the positive side, there are clear signs that aspects of the financial system are far more stable than they were at the height of the crisis in the fall of 2008. Many large banks have once again been able to raise funds in the capital markets, and some institutions — including some that appeared to be on the verge of collapse — have recovered sufficiently to repay their TARP investments years earlier than most would have predicted. These repayments and the sales of the warrants associated with them have meant that Treasury (and thus the taxpayer) has turned a profit on some of the individual TARP investments; as a result of these repayments, among other positive developments, it now appears that the ultimate cost of TARP to the American taxpayer, while still substantial, might be significantly less than initially estimated.
>
> Many of TARP's stated goals, however, have simply not been met. Despite the fact that the explicit goal of the Capital Purchase Program ("CPP") was to increase financing to U.S. businesses and consumers, lending continues to decrease, month after month, and the TARP program designed specifically to address small-business lending — announced in March 2009 — has still not been implemented by Treasury. Notwithstanding the fact that preserving homeownership and promoting jobs were explicit purposes of the Emergency Economic Stabilization Act of 2008 ("EESA"), the statute that created TARP, nearly 16 months later, home foreclosures remain at record levels, the TARP foreclosure prevention program has only permanently modified a small fraction of eligible mortgages, and unemployment is the highest it has been in a generation. Whether these goals can effectively be met through existing TARP programs is very much an open question at this time. And to

the extent that the Government had leverage through its status as a significant preferred shareholder to influence the largest TARP recipients to carry out such policy goals, it was lost with their exit from TARP. As important as assessing the effectiveness of TARP programs is, in the final analysis, TARP can truly only be a success if TARP is both managed well and its positive effects are enduring. The substantial costs of TARP — in money, moral hazard effects on the market, and Government credibility — will have been for naught if we do nothing to correct the fundamental problems in our financial system and end up in a similar or even greater crisis in two, or five, or ten years' time. It is hard to see how any of the fundamental problems in the system have been addressed to date.

- To the extent that huge, interconnected, "too big to fail" institutions contributed to the crisis, those institutions are now even larger, in part because of the substantial subsidies provided by TARP and other bailout programs.

- To the extent that institutions were previously incentivized to take reckless risks through a "heads, I win; tails, the Government will bail me out" mentality, the market is more convinced than ever that the Government will step in as necessary to save systemically significant institutions. This perception was reinforced when TARP was extended until October 3, 2010, thus permitting Treasury to maintain a war chest of potential rescue funding at the same time that banks that have shown questionable ability to return to profitability (and in some cases are posting multi-billion-dollar losses) are exiting TARP programs.

- To the extent that large institutions' risky behavior resulted from the desire to justify ever-greater bonuses — and indeed, the race appears to be on for TARP recipients to exit the program in order to avoid its pay restrictions — the current bonus season demonstrates that although there have been some improvements in the form that bonus compensation takes for some executives, there has been little fundamental change in the excessive compensation culture on Wall Street.

- To the extent that the crisis was fueled by a "bubble" in the housing market, the Federal Government's concerted efforts to support home prices — as discussed more fully in Section 3 of this report — risk re-inflating that bubble in light of the Government's effective takeover of the housing market through purchases and guarantees, either direct or implicit, of nearly all of the residential mortgage market.

Stated another way, even if TARP saved our financial system from driving off a cliff back in 2008, absent meaningful reform, we are still driving on the same winding mountain road, but this time in a faster car.

--Office of the Special Inspector General for the Troubled Asset Relief Program, "Quarterly Report to Congress," January 30, 2010.

Editor's Note: *Those candidates that wish to read the comprehensive quarterly reports created by the SIGTARP may do so by visiting http://www.sigtarp.gov/reports.shtml*

Is TARP Winding Down?

Yes and no. Recent events, including the expiration of Treasury's authority to initiate new TARP investments, the continued repayment of TARP funds by larger banks, and the issuance by the Congressional Oversight Panel ("COP") of its final TARP report, have contributed to the perception that TARP is drawing to a close.

In reality, this is simply not the case. TARP may have entered a new phase, but it is far from over. As of this writing, approximately $106 billion in TARP funds was still outstanding. TARP programs, extraordinary in their scope, scale and complexity, were designed to last years.

The following excerpt from the April 28, 2011 quarterly report of the SIGTARP provides a great summary of where TARP stands today:

> TARP's financial outlook is improving, with more institutions repaying TARP and cost estimates continuing to decline. Nevertheless, it bears repeating that Treasury's ultimate return on its TARP investments depends on many variables that are largely unknowable at this time, including the ability to sell certain securities in the market (such as American International Group, Inc. and General Motors Company), the ability of many banks to repay (over 550 banks have yet to repay TARP's Capital Purchase Program investment), and the extent to which Treasury will spend funds allocated to its housing programs. TARP's costs, of course, involve more than just dollars and cents. It will take many years to assess the full extent of all costs associated with TARP. As SIGTARP and others have documented, the non-financial costs include TARP's contribution to the moral hazard associated with massive infusions of Government funds into some of the very institutions that engaged in risky behavior that contributed to the financial crisis. Many of those institutions remain "too big to fail." Today, the biggest banks are bigger than ever. These banks continue to enjoy unwarranted advantages over their smaller competitors such as better access to capital and cheaper credit. These advantages exist just by virtue of the pervasive belief —shared by their executives, counterparties, creditors, and the credit rating agencies —that the Government will bail them out if necessary. While the underlying problem may have pre-dated TARP, it is now more severe than ever. And in terms of market perception, it has not yet been solved by the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act"). As regulators work to implement the Dodd-Frank Act's reforms, continued oversight will be critical in determining the extent to which the Act ultimately meets its promise of ending the concept of "too big to fail." The integrity of our financial system is still at risk. Indeed, the stakes could not be higher.
>
> Further evidence that TARP's end remains distant lies in recent activity related to TARP housing programs. Unfortunately, Treasury's signature program — the Home Affordable Modification Program ("HAMP") — has been beset by problems from the outset. Many of these problems relate to the structure of the program, which puts the ultimate decision to modify a mortgage in the hands of mortgage servicers, whose performance has been extraordinarily poor. SIGTARP, through its Hotline, continues to receive a substantial number of complaints from the public regarding HAMP servicer performance. These complaints include loss of paperwork by the servicer, a lack of servicer communication or contradictory information, trial modification periods that extend six months or more, and negative credit reporting for homeowners enrolled in a trial modification. SIGTARP, along

with TARP's other oversight bodies, has long urged Treasury to get tougher on servicers. Treasury noted recently that it will start requiring all HAMP servicers to assign a single point of contact for homeowners, that it will start grading the largest HAMP servicers on "key performance metrics," and will begin withholding financial incentives for servicers receiving an unsatisfactory grade. These may be encouraging first steps. However, it is too early to tell whether these steps will have a meaningful impact. Treasury's other housing programs and subprograms are in earlier stages of development. These include, for example, the Hardest-Hit Fund, the 2MP Second Lien Modification program, and the FHA Short Refinance program, all of which have yet to produce substantial results. As these programs develop, SIGTARP will continue to conduct strong oversight and make recommendations for improvement where appropriate.

--Office of the Special Inspector General for the Troubled Asset Relief Program, "Quarterly Report to Congress," April 28, 2011.

Where TARP Stands Today

With the $700 billion authorized by Congress in October 2008 via the Emergency Economic Stabilization Act, the Treasury Department has been doling out the money via an alphabet soup of different programs. In July of 2010, the Dodd-Frank financial regulation overhaul reduced the amount authorized for TARP to $475 billion.

Therefore the Treasury is authorized to spend $475 billion of TARP. It has created 13 different programs, to which it has promised $470 billion.

As of this writing, the government has committed bailout money to 926 recipients. Those recipients have received a total of $414 billion. 315 recipients have returned all of their TARP money, leaving 611 with money still on their books (52 of those have returned a portion). A total of $308 billion in TARP funds has been returned.

Additionally, the Treasury has been earning a return on most of the TARP money invested or loaned. So far, the total return is: $41 billion. That includes $21 billion through dividend or interest payments and $9 billion through stock warrants, which Treasury received as part of most of the investments. When companies pay back the TARP investment, the warrants are either sold back to the company or auctioned off. When those revenues are taken into account, $65 billion is the net amount still outstanding.

Editor's Note: *To track the TARP allocations and revenue, feel free to click here.*

TARP Final Thoughts

Congress created SIGTARP to provide vital oversight and law enforcement for as long as Treasury holds an asset under TARP. In other words, SIGTARP will remain "on watch" as long as TARP assets remain outstanding. However, the first person to hold the position, Neil Barofsky, left the position in March 2011. Mr. Barofsky's op-ed in *The New York Times* on the date he left his position as SIGTARP provides meaningful insights into the program.

The New York Times

March 29, 2011

Where the Bailout Went Wrong

By NEIL M. BAROFSKY

Washington

TWO and a half years ago, Congress passed the legislation that bailed out the country's banks. The government has declared its mission accomplished, calling the program remarkably effective "by any objective measure." On my last day as the special inspector general of the bailout program, I regret to say that I strongly disagree. The bank bailout, more formally called the Troubled Asset Relief Program, failed to meet some of its most important goals.

From the perspective of the largest financial institutions, the glowing assessment is warranted: billions of dollars in taxpayer money allowed institutions that were on the brink of collapse not only to survive but even to flourish. These banks now enjoy record profits and the seemingly permanent competitive advantage that accompanies being deemed "too big to fail."

Though there is no question that the country benefited by avoiding a meltdown of the financial system, this cannot be the only yardstick by which TARP's legacy is measured. The legislation that created TARP, the Emergency Economic Stabilization Act, had far broader goals, including protecting home values and preserving homeownership.

These Main Street-oriented goals were not, as the Treasury Department is now suggesting, mere window dressing that needed only to be taken "into account." Rather, they were a central part of the compromise with reluctant members of Congress to cast a vote that in many cases proved to be political suicide.

The act's emphasis on preserving homeownership was particularly vital to passage. Congress was told that TARP would be used to purchase up to $700 billion of mortgages, and, to obtain the necessary votes, Treasury promised that it would modify those mortgages to assist struggling homeowners. Indeed, the act expressly directs the department to do just that.

But it has done little to abide by this legislative bargain. Almost immediately, as permitted by the broad language of the act, Treasury's plan for TARP shifted from the purchase of mortgages to the infusion of hundreds of billions of dollars into the nation's largest financial institutions, a shift that came with the express promise that it would restore lending.

Treasury, however, provided the money to banks with no effective policy or effort to compel the extension of credit. There were no strings attached: no requirement or even incentive to increase lending to home buyers, and against our strong recommendation, not even a request that banks report how they used TARP funds. It was only in April of last year, in response to recommendations from our office, that Treasury asked banks to provide that information, well after the largest banks had already repaid their loans. It was therefore no surprise that lending did not increase but rather continued to decline well into the recovery. (In my job as special inspector general I could not bring about the changes I thought were needed — I could only make recommendations to the Treasury Department.)

Meanwhile, the act's goal of helping struggling homeowners was shelved until February 2009, when the Home Affordable Modification Program was announced with the promise to help up to four million families with mortgage modifications.

That program has been a colossal failure, with far fewer permanent modifications (540,000) than modifications that have failed and been canceled (over 800,000). This is the well-chronicled result of the rush to get the program started, major program design flaws like the failure to remedy mortgage servicers' favoring of foreclosure over permanent modifications, and a refusal to hold those abysmally performing mortgage servicers accountable for their disregard of program guidelines. As the program flounders, foreclosures continue to mount, with 8 million to 13 million filings forecast over the program's lifetime.

Treasury Secretary Timothy Geithner has acknowledged that the program "won't come close" to fulfilling its original expectations, that its incentives are not "powerful enough" and that the mortgage servicers are "still doing a terribly inadequate job." But Treasury officials refuse to address these shortfalls. Instead they continue to stubbornly maintain that the program is a success and needs no material change, effectively assuring that Treasury's most specific Main Street promise will not be honored.

Finally, the country was assured that regulatory reform would address the threat to our financial system posed by large banks that have become effectively guaranteed by the government no matter how reckless their behavior. This promise also appears likely to go unfulfilled. The biggest banks are 20 percent larger than they were before the crisis and control a larger part of our economy than ever. They reasonably assume that the government will rescue them again, if necessary. Indeed, credit rating agencies incorporate future government bailouts into their assessments of the largest banks, exaggerating market distortions that provide them with an unfair advantage over smaller institutions, which continue to struggle.

Worse, Treasury apparently has chosen to ignore rather than support real efforts at reform, such as those advocated by Sheila Bair, the chairwoman of the Federal Deposit Insurance Corporation, to simplify or shrink the most complex financial institutions.

In the final analysis, it has been Treasury's broken promises that have turned TARP — which was instrumental in saving the financial system at a relatively modest cost to taxpayers — into a program commonly viewed as little more than a giveaway to Wall Street executives.

It wasn't meant to be that. Indeed, Treasury's mismanagement of TARP and its disregard for TARP's Main Street goals — whether born of incompetence, timidity in the face of a crisis or a mindset too closely aligned with the banks it was supposed to rein in — may have so damaged the credibility of the government as a whole that future policy makers may be politically unable to take the necessary steps to save the system the next time a crisis arises. This avoidable political reality might just be TARP's most lasting, and unfortunate, legacy.

THE AUTO BAILOUT

Many candidates have many questions about all of the various kinds of bailouts you hear about every day in the news. One of the most common questions people have is about the government bailout of the U.S. auto industry. **The auto bailout is directly tied to TARP – both the Bush and Obama Administrations used TARP to fund assistance for the U.S. auto industry.** Executive of both General Motors and Chrysler testified before congressional committees in the fall of 2008 requesting federal bridge loans. Legislation that would have provided them passed the House, but did not pass the Senate. Therefore, the Bush Administration turned to TARP to provide both automakers and two auto financing companies (GMAC and Chrysler Financial Services) with nearly $25 billion in loans and told the automakers to submit viability plans if they were to seek additional aid. Eventually the amount of government assistance to these four companies through TARP totaled nearly $80 billion.

Treasury, given such broad and ill-defined authority under the original TARP legislation, developed the Automotive Industry Financing Program (AIFP) in December 2008, citing its need as critically necessary to helping the economy. So, while there have been votes in Congress on an auto industry bailout both in 2008 and 2009, none of these ultimately became law and therefore none resulted in the bailout of the auto industry. Instead Treasury was able to act on its own authority under TARP.

Below is information about the AIFP as provided by the Treasury Department:

What is the AIFP?

The Automotive Industry Financing Program (AIFP) was developed in December 2008 to prevent a significant disruption of the U.S. automotive industry, because the potential for such a disruption posed a systemic risk to financial market stability and would have had a negative effect on the economy. AIFP loans have helped to enable General Motors and Chrysler to become more viable auto manufacturing companies.

In the related Auto Supplier Support Program (ASSP), Treasury provides loans to ensure that auto suppliers receive compensation for their services and products, regardless of the condition of the auto companies that purchase their products.

How Does the AIFP Work?

As of the May 2012 Daily TARP Update, Treasury has provided approximately $79 billion in loans and equity investments to General Motors, GMAC (now Ally Financial), Chrysler and Chrysler Financial Services and approximately $35 billion total in incoming revenues from AIFP have come back to the general fund of the Treasury.

Short-term funding was initially provided to GM and Chrysler on the condition that they develop plans to achieve long-term viability. In cooperation with the Administration, GM and Chrysler eventually developed satisfactory viability plans and successfully conducted in bankruptcy proceedings sales of their assets to new entities: Chrysler's sale process was completed in 42 days and GM's was completed in 40 days. Treasury provided additional assistance during the respective periods.

The terms of the assistance impose a number of restrictions on the recipients. Among other things, they must adhere to rigorous executive compensation standards and other measures to protect the taxpayer's interests, including limits on the institution's expenditures and other corporate governance requirements.

Table 1. Summary of TARP Assistance for U.S. Motor Vehicle Industry

Company	Current Government Ownership Share	Total TARP Assistance	Principal Recouped to Date by the Treasury	Income/Revenue Received from TARP Assistance	Outstanding TARP Assistance
Chrysler	0%	$10.9 billion	$7.9 billion	$1.66 billion	$0
Chrysler Financial	Not Applicable	$1.5 billion	$1.5 billion	$0.02 billion	$0
GM	32% (New GM)	$50.2 billion	$23.2 billion	$0.86 billion	$22.6 billion
GMAC/Ally Financial	73.8%	$17.2 billion	$2.5 billion	$2.46 billion	$14.6 billion

Source: U.S. Treasury, *Daily TARP Update*, July 22, 2011; *Troubled Asset Relief Program: Monthly 105(a) Report*, various dates.

Notes: At the time the companies were established through bankruptcy proceedings in 2009, the federal ownership stake of New Chrysler was originally 9.9% and New GM 60.8%. New Chrysler was authorized to draw up to $12.9 billion in loans, but approximately $2.1 billion was never used. The Treasury recognized a $4.4 billion loss in principal on the December 2010 sale of equity in GM.

The table below, courtesy of the Congressional Research Service (CRS), summarizes the TARP assistance given to the U.S. motor vehicle and motor vehicle financing industry:

See below to learn how AIFP has helped each participating company.

Editor's Note: *Please refer to the table, courtesy of CRS, at the end of this section which shows the current government ownership share of each of these companies.*

Chrysler

On Jan. 2, 2009, Treasury loaned $4 billion to Chrysler Holding to give it time to implement a viable restructuring plan. In February 2009, Chrysler submitted its viability plan outlining how it planned to restructure its operations including a strategic alliance with Fiat. Questions were raised as to whether Chrysler could even survive as a free-standing company, even with government assistance, because of its relatively small size.

On March 30, the Obama Administration determined that the business plan (which was necessary for additional government support) submitted by Chrysler failed to demonstrate viability and rejected it giving Chrysler 30 days to develop a new plan in an effort to avert bankruptcy. Working with the Obama Administration's Auto Task Force, Chrysler developed a restructuring plan that included a revised labor agreement, cost reductions from dealers and suppliers, reductions in creditor claims and limitations on executive compensation. But, all its creditors did not agree to the restructuring and Chrysler was prompted to file for bankruptcy in April 2009.

With much of the restructuring plan in place, however, the bankruptcy court actually was able to approve the proposals. Many of the assets of Old Chrysler were sold to a new legal entity – Chrysler Group LLC (New Chrysler) – whose largest equity owner was the United Auto Workers' retiree medical trust fund owning 67.7 percent. Then, Fiat took a management role in the new company and a 20 percent equity stake which was deemed central to the survival of New Chrysler. Treasury continued to support Chrysler as it formed an alliance with Fiat. In connection with Chrysler's bankruptcy proceedings filed on April 30, 2009, Treasury provided an additional $1.9 billion under a debtor-in-possession financing agreement to assist Chrysler in an orderly restructuring.

The U.S. government's assistance to Chrysler ultimately resulted in New Chrysler owing the government several billions of dollars in loans and the government having an initial 9.9 percent ownership stake in New Chrysler. Under new Fiat management, New Chrysler revamped nearly its entire fleet of automobiles and light trucks and it turned a profit in the first quarter of 2011 for the first time since bankruptcy. Its commercial and financial success accelerated its plans for repaying federal assistance. In May 2011, New Chrysler repaid a $5.9 billion debt to the U.S. government that was not fully due until 2017. In June 2011, Fiat agreed to purchase the U.S. government common equity interests and options in New Chrysler for $560 million. In addition, the ownership of New Chrysler significantly changed as Fiat met a series of performance benchmarks that has allowed it to raise its equity stake. By the end of 2011, Fiat was a 58.5 percent owner of New Chrysler.

Following this transaction, the U.S. government has no remaining financial interest in New Chrysler. Although roughly $9.6 billion of the assistance given to the company has been recouped, an approximate $1.3 billion shortfall remains. Ownership of Chrysler equity has turned out less positively for the government than some of the other "bailouts" with the government realizing a $1.33 billion loss after the sale to Fiat in May 2011.

Keep in mind that this was not the first time that Chrysler received financial assistance from the government. Facing possible bankruptcy after losing market share as successive oil price shocks raised the price of gasoline and many Americans began deserting large American cars for small, more fuel-efficient German and Japanese imports, in December 1979, Congress approved a $1.5 billion federal loan guarantee proposed by the Carter Administration. The loan was eventually repaid and the warrants received by the federal government as part of the assistance were sold at auction for $311 million.

Chrysler Financial

On Jan. 16, 2009, Treasury announced that it would lend up to $1.5 billion to a special purpose vehicle (SPV) created by Chrysler Financial to enable the company to finance the purchase of Chrysler vehicles by consumers. To satisfy the TARP warrant requirement, the Chrysler Financial SPV issued additional notes entitling Treasury to an amount equal to five percent of the maximum loan amount. Twenty percent of those notes vested upon the closing of the transaction, and additional notes were to vest on each anniversary of the transaction closing date. The loan was fully drawn by April 9, 2009. On July 14, 2009, Chrysler Financial fully repaid the loan, including the vested additional notes and interest, and required no additional aid, unlike the other four companies.

General Motors (GM)

General Motors Corporation (Old GM) was a publicly traded company from 1916 until its bankruptcy in 2009. As part of restructuring, Old GM and its successor General Motors Company (New GM) together received more than $50 billion in federal assistance through TARP. In exchange for this financial support, Treasury received 60.8 percent of the new company with the rest of New GM held by the United Auto Workers retiree health care trust fund, the governments of Canada and Ontario and holders of Old GM's bonds. In its restructuring, GM closed plants, cut its hourly and salaried workforce, shed three brands, reduced debt, introduced popular new vehicles and implemented changes in retiree legacy costs that had been major financial drain.

On Dec. 31, 2008, Treasury agreed to make loans of $13.4 billion to Old GM through TARP to fund working capital. Under the loan agreement, GM was also required to implement a viable restructuring plan by March 30. The first plan GM submitted failed to establish a credible path to viability, and the deadline was extended to June 1. Treasury loaned an additional $6 billion to fund GM during this period - $2 billion in April 2009 and $4 billion in May 2009. These two loans kept Old GM's operations alive as it went through a drastic restructuring overseen by the Obama Administration's Auto Task Force. To achieve an orderly restructuring, GM filed bankruptcy proceedings on June 1, 2009. Treasury provided $30.1 billion in TARP funds under a debtor-in-possession financing agreement to assist GM through the restructuring period. The new entity, General Motors Company (New GM), began operating on July 10, 2009, following its purchase of most of the assets of the Old GM.

When the sale to New GM was completed on July 10, Treasury converted most of its loans to 60.8 percent of the common equity in the New GM and $2.1 billion in preferred stock. Treasury continues to hold loans in the amount of $6.7 billion. The New GM currently has the following ownership: Treasury (60.8 percent), GM Voluntary Employee Benefit Association (VEBA) (17.5 percent), the Canadian Government (11.7 percent), and Old GM's unsecured bondholders (10 percent).

In November 2009, General Motors agreed, subject to certain conditions, to begin quarterly repayments in December 2009 of its $6.7 billion loan. In November 2010, New GM conducted an initial public offering (IPO) of stock to investors, once again becoming a publicly traded company, although the post-bankruptcy owners, including the government, continue to hold significant stakes in the company. In the IPO, 550 million common shares were sold by GM shareholders at a market price of $33 a share, raising more than $18 billion. The Treasury sold more than 400 million shares in the IPO and received approximately $13.5 billion from it. In addition, it continues to own 32 percent of New GM's common stock. The only capital New GM raised through the IPO was $4.9 billion from the simultaneous sale of preferred stock.

So, in summary, the government through TARP has aided the combined Old GM and New GM with more than $50 billion in loans since December 2008. Of this amount, $7.4 billion was repaid in installments. An additional $2.1 billion was converted into shares of preferred stock held by the U.S. Treasury and redeemed in December 2010. The approximately $40.7 billion remaining was effectively converted into an initial 60.8 percent equity stake. The TARP authorization to purchase new assets or make new commitments expired on Oct. 3, 2010, but the U.S. Treasury has continuing authority to manage the government's equity in GM and its other TARP assets.

The November 2010 IPO returned $13.5 billion to the government. Income received by the Treasury from dividends, interest and other gains totals approximately $0.85 billion, leaving approximately $26.2 billion to be recovered. The government now holds approximately 500 million shares, or 32 percent of GM's common equity. In order for the government's 32 percent of the company to be worth $26.2 billion, GM's market capitalization would have to be about $81.9 billion. To achieve this, the price of GM stock would have to exceed $52 per share – a significant increase from the current share prices.

General Motors Acceptance Corporation (GMAC)/Ally Financial

While GM was experiencing financial difficulties, so was General Motors Acceptance Corporation (GMAC) – the separate company that financed GM. GMAC was suffering from large losses in the mortgage markets as well. With 91 percent of U.S. passenger vehicle sales depending on financial intermediaries to provide loans or leases, the auto financing companies' inability to lend damaged the prospects of Old GM and Old Chrysler pulling out of the slump.

Compared to Chrysler Financial, GMAC ultimately required much more extensive assistance which resulted in the federal government taking a majority ownership stake in the company. In addition, during the financial crisis, GMAC converted from an industrial loan company into a bank holding company.

GMAC applied for the Treasury's TARP Capital Purchase Program (since it was actually a bank) in 2008 at the same time it applied to the Fed to convert itself from an industrial loan company into a bank holding company. By the time the application was approved, Treasury had announced the AIFP and the assistance received by GMAC came under this program rather than the TARP bank assistance programs.

GMAC received three large rounds of assistance through TARP: $5.25 billion on Dec. 30, 2008; $7.5 billion on May 21, 2009; $3.98 billion on Dec. 30, 2009. This assistance was provided through the purchase of various types of preferred equity in GMAC. Treasury received warrants for approximately $825 million in additional preferred equity in conjunction with these transactions and the preferred stock has paid dividends since its purchase. In addition to this direct assistance, GMAC also received indirect TARP assistance in the form of an $884 million loan to Old GM for participation in a December 2008 rights offering for GMAC common stock.

On May 29, 2009, Treasury exercised its option to exchange the $884 million loan it had made to GM in January 2009 for about 35 percent of the common membership interests in GMAC. As of the time of this writing, the government holds 73.8 percent of GMAC (now Ally Financial) common equity and $5.9 billion of preferred equity.

Table 5. Companies with Large Government Common Ownership Stakes

($ in billions)

Company	Current Government Ownership Share	Total TARP Assistance Received[a]	Amount Recouped by the Treasury[b]	Losses Written Off or Realized	Total Outstanding Outlays[c]	Preferred Equity Outlays Outstanding[d]
AIG	61%[e]	$67.8	$32.8	$5.5	$30.4	$0
GM	32.0%	$50.2	$24.0	$4.4	$22.5	$0
GMAC/Ally Financial	73.8%	$17.2	$5.4	$0	$14.6	$5.9
Chrysler	0%	$10.9	$9.6	$2.9	$0	$0
Citigroup[f]	0%	$45 cash; $5 guarantee	$57.0	$0	$0	$0

Sources: March 15, 2012 TARP Daily Update, Various TARP 105(a) Reports, TARP Dividend and Interest Reports, and U.S. Treasury press releases.

Auto Bailout Payback?

GM and Chrysler have since both announced the loans they received under the TARP auto bailout (AIFP) have been paid back in full and ahead of schedule. While the announcement by both companies that they have repaid their government loans is certainly encouraging and goes a long way toward restoring their public image, only a small portion of the federal government's investment in the auto industry was distributed as loans – about 20 percent of the whole bailout of the auto industry was loans.. While it may be true that the two auto giants have settled their outstanding loans, the American taxpayers still have billions of dollars invested in both GM and Chrysler that remains outstanding, and billions more that have already been written off as a loss.

GM: In April 2010, GM CEO Ed Whitacre announced that GM had repaid the full $6.7 billion in loans it had received from the federal government. However, this $6.7 billion represented a small fraction of the approximately $52.4 billion in taxpayer dollars invested in GM by the Obama Administration. The majority of the government's GM investment is in the form of a 60.8 percent common equity stake in the New GM (the company that emerged following the old GM's bankruptcy) as well as $2.1 billion worth of preferred stock which is still outstanding. Since seeing a return on this investment is entirely contingent on the government's ability to sell its shares in GM back on the market it remains to be seen how much the U.S. taxpayers will recover of this outstanding investment.

In addition to the fact that a large portion of the government's GM investment remains in stockholdings, lawmakers such as Senator Chuck Grassley (R-Iowa) have pointed out that the billions used to repay the loans did not come from actual GM earnings but rather from another TARP funded escrow account. Treasury acknowledged that the money GM used to repay the loan came from TARP funds, but insisted that the public knew that GM would use the escrow funds to repay the loan if the funds were not needed to cover operating expenses. Both Treasury and GM insist that this move should be viewed as "a positive sign for the company and a great development for the taxpayer."

While GM's recovery has shown some promise, its performance still lags behind many of its domestic and foreign competitors and it is still nowhere near the level of profitability that would allow the U.S. government to recover the outstanding $45.7 billion it has invested in the company. New GM has repaid its "loans," while old GM may fail to repay $850 million.

Chrysler Group LLC: In an announcement similar to that of GM, on May 24, 2011, Chrysler Group LLC's (the new company that emerged following the old Chrysler's bankruptcy) CEO Sergio Marchionne put out a press release stating the Chrysler Group LLC had completed its refinancing and repaid the U.S. and Canadian government loans in full. In fact, the auto maker had paid back the remaining $5.1 billion in TARP loans it had received as well as relinquished its ability to draw on a further $2.1 billion line of credit extended to it through TARP. This, along with previous payments, meant that Chrysler Group LLC had returned or relinquished roughly $10.6 billion of the taxpayer's investment in the company.

While this is undoubtedly a positive indicator for the company's future, it is important to note that while Chrysler may no longer have debt to the taxpayer which it is liable for, that does not mean that taxpayers have recouped their investment in the company. Over the course of the Chrysler bailout and bankruptcy proceedings, the U.S. Treasury loaned the old Chrysler $4 billion to cover its operating costs. When the old Chrysler completed its bankruptcy and was reorganized as Chrysler Group LLC, $1.3 billion of the Old Chrysler loan was written off, leaving the taxpayer on the hook with no chance of recouping that investment.

SMALL BUSINESS LENDING FUND

In addition to the 2009 economic stimulus package, several laws were enacted in the 111th Congress with the purpose of enhancing small business access to capital. One of these was H.R. 5297, the Small Business Jobs Act of 2010 (P.L. 111-240). You can see how they voted here. President Obama signed it into law on Sept. 27, 2010. This law authorized Treasury to establish:

- a $30 billion Small Business Lending Fund (SBLF) to encourage community banks with less than $10 billion in assets to increase their lending to small businesses;
- a $1.5 billion State Small Business Credit Initiative to provide funding to participating states with small business capital access programs;
- numerous changes to the Small Business Administration's (SBA's) loan guaranty and contracting programs;
- funding to continue the SBA's fee subsidies and the 7(a) program's 90 percent maximum loan guaranty percentage through Dec. 31, 2010 (this was then further extended through March 4, 2011, but available funding was exhausted prior to that dealing on Jan. 3, 2011);and
- about $12 billion in tax relief for small businesses:
  - allows small businesses to carry back general tax credits to offset their tax burdens from the previous five years
  - investors are allowed to exclude the gains from the sale of certain small-business stock from their income for tax purposes if they hold the stock for more than five years

But, the SBLF fell far short of what the Obama Administration had anticipated and predicted. The creation of a $30 billion SBLF was actually proposed by President Obama in his January 2010 State of the Union address:

> "Tonight, I'm proposing that we take $30 billion of the money Wall Street banks have repaid and use it to help community banks give small businesses the credit they need to stay afloat."

President Obama finalized and sent to Congress his legislative proposal to do so on May 7, 2010. And, as previously mentioned, it was passed and signed into law as P.L. 111-240.

Republican Concerns

House Republicans argued against establishing the SBLF saying that it did not properly deal with the lack of financing for small businesses and also characterized it as a smaller version of TARP. According to the House Committee on Financial Services Republicans in their dissenting view following the Committee's approval of H.R. 5297:

> "Instead of addressing the problem by stimulating demand for credit by small businesses, H.R. 5297 injects capital into banks with no guarantees that they will actually lend. The bill allows a qualifying bank to obtain a capital infusion from the government without even requiring the bank to make a loan for two years. In fact, if a bank reduces or fails to increase

> lending to small business during those first two years, it would not face any penalty. It defies logic that the Majority would support a bill to increase lending that does not actually require increased lending. A more effective response to the challenges facing America's small businesses was offered by Representatives Biggert, Paulsen, Castle, Gerlach, and King, whose amendment would have extended a series of small business tax credits before implementing the Small Business Lending Fund."

Committee Republican also argued that even if the SBLF was authorized, "…the program probably would not be fully operational for months; banks could shun the program for fear of being stigmatized by its association with TARP; and many banks would avoid taking on new liabilities when their existing assets are troubled." Additionally, Republicans also argued that the bill did not provide sufficient oversight for effectively monitoring the program because the Inspector General of the Department of the Treasury, who was given that responsibility under the bill, "…might not be able to direct sufficient attention to this task given its other responsibilities." They argued that the SIGTARP would be in a better position to provide effective oversight of the program.

Problems with SBLF

On Feb. 14, 2011, President Obama issued his budget recommendations for FY 2012. It anticipated that the SBLF would provide $17.399 billion in financings, well below its authorized amount of $30 billion. This was the first indication that the SBLF's implementation may not proceed as expected. The second indication was an unanticipated delay (unanticipated, that is, by the Democrats) in the writing of the programs' regulations by Treasury.

The first financing under SBLF took place on June 21, 2011 – about nine months after its enactment. The delay was largely due to Treasury's need to finalize the SBLF's investment decision process with federal banking agencies and the need to create separate SBLF regulations for financial institutions established as C Corporations, Subchapter S Corporations, mutual lending institutions and community development financial institutions (CDFIs).

The application deadline for C corporation banks was May 16, 2011. The application deadline for Subchapter S corporations and mutual lending institutions was June 6, 2011, and the application deadline for CDFIs was June 22, 2011. A total of 926 institutions applied for $11.8 billion in SBLF funding. Of that $11.8 billion applied for, Treasury approved only $4.027 billion in SBLF financing to 332 lending institutions in 47 states and the District of Columbia. The average financing was $12.1 million ranging from $42,000 to $141 million.

Many of the same banks targeted for SBLF had already taken TARP capital from Treasury. The Administration did not want to exclude them from this new "small-business initiative," but the program required that TARP debts be paid back first to Treasury, even if it meant using SBLF funds to do it. Of the 332 lending institutions which received financing, 137 institutions had participated in TARP's Community Development Capital Initiative or its Capital Purchase Program. These institutions received $2.25 billion in SBLF financing – 66.8 percent of the total – and used it to refinance TARP obligations.

On Sept. 6, 2011, Treasury announced that more than 40 percent of applicants had failed to meet the minimum statutory or program requirements and therefore, were not approved for participation. The final amount of disbursements according to Treasury would be only $4.3 billion.

Congressional Budget Office's Updated Estimate of SBLF

On Oct. 12, 2011, the Congressional Budget Office (CBO) released a new analysis of SBLF. You can view this report here. At the time of Congress's consideration of the legislation that created the SBLF, CBO anticipated that "the funding provided by the SBLF would be fully disbursed." At that time, CBO estimated that the provisions in the legislation related to SBLF would reduce net federal outlays by $1.1 billion and, on balance, would reduce deficits by $0.5 billion.

The October 2011 analysis done by CBO stated:

> "…at the time the August 9 estimate was published, CBO expected that the full $30 billion in available funding would be disbursed. However, the volume of applications and the rate of disbursements through July 2011 fell below those initial expectations. As a result, in its most recent baseline, CBO estimated that only $10 billion would be disbursed to financial institutions through the SBLF."

The reality was that only $4.3 billion was disbursed by Treasury to the applicants.

Even worse, CBO stated that it actually estimated that the SBLF would record a *subsidy cost* for the program of roughly $750 million.

The following *Politico* story even further spells out how the SBLF program has fallen short:

> POLITICO
> Oct. 12, 2011
>
> **Small-business program falls short**
> By DAVID ROGERS
>
> "To understand how hard it is for Washington to make a dent in today's economy, look back at Treasury's Small Business Lending Fund, a one-year experiment that closed its window last month after failing to use but a fraction of the $30 billion in capital approved by Congress.
>
> "Gene Sperling, now President Barack Obama's top economic adviser, had championed the idea when he served in Treasury. Despite fierce Republican opposition, community bankers rallied to the 'Main Street' agenda on a bipartisan basis. And like Lucy in Peanuts, Sen. Mary Landrieu (D-La.) turned the tide when she famously stood up to the Senate's old-boy establishment and won a late-night 60-37 vote that saved the initiative in July 2010.
>
> "Yet just $4.03 billion made it out the door before the program shut down Sept. 27. Indeed, the first dollars weren't approved until nine months after enactment and almost a full year after Landrieu's stand. And two-thirds of the 933 applicants came away empty-handed, leaving scores of banks blindsided without time to appeal to Treasury.
>
> "Neither political party escaped untarnished, with lessons for both going into 2012.

“For Obama, who likes to boast of running against a ‘do-nothing Congress,’ this was a case of the president getting what he asked for and then fumbling the ball. At the same time, the administration can argue that it at least tried, and certainly, little supports the claims of Republicans, who fought the proposal tooth and nail, predicting billions in taxpayer losses and the second coming of bank bailouts.

“Alabama’s GOP delegation, led by Sen. Richard Shelby and Rep. Spencer Bachus, top Republicans on the Senate Banking and House Financial Services committees, was adamant in its opposition. But when the first dollars went out the door, Alabama banks got $75 million, or almost 25 percent of the funds released by mid-July.

“‘It is a good program,’ said Tom Broughton, CEO of ServisFirst Bancshares, an Alabama bank that hopes to leverage its $40 million from Treasury into $500 million in small-business loans for trucking, coal and agriculture interests. Broughton told POLITICO he filled out Treasury’s form himself on the first day of December. ‘It was simple enough, took about an hour and a half,’ but the next step — the review by multiple sets of bank supervisors — consumed close to six months.

“‘Too many cooks in the kitchen,’ Broughton said, and from his standpoint, the real flaw in the program was the failure of Treasury to have developed its own metric to measure applicants against more quickly.

“‘It was just incompetence,’ said a more acerbic Massachusetts Rep. Barney Frank, the top Democrat on the Financial Services Committee. ‘The theory was to stimulate the economy. You were in a crisis and wanted to pump this out,’ Frank told POLITICO. ‘They were very late in implementing it, and by the time they implemented it, it was too late to give people time to appeal.’

“Signed into law Sept. 27, 2010, SBLF was part of the Small Business Jobs Act — a hard-fought victory after Senate filibusters and one that Obama and Democrats had hoped would win back independent voters in the 2010 election, which was just weeks away.

“Included were popular tax breaks for employers and to help small manufacturers; the measure authorized the Small Business Administration to back so-called 7(a) loans of up to $5 million, more than double the prior $2 million limit. A new $1.5 billion State Small Business Credit Initiative — essentially a grant program to state-run capital programs — slipped through with little partisan resistance. But the new $30 billion Treasury-back loan facility had become a lightning rod, with the GOP likening it to the Troubled Asset Relief Program begun under former President George W. Bush with the 2008 financial rescue package for Wall Street banks.

“‘Remember TARP?’ Shelby asked with a smirk on the Senate floor. ‘A lot of people wish they had not voted for it. … This is TARP II. In fact, banks could replace original TARP money with funds received from this program.’

“Indeed, TARP’s shadow influenced the debate at many levels.

"Treasury now rues the day that it chose $30 billion, but because of TARP, the ambitious target made a certain political sense — a big commitment to Main Street after the hundreds of billions for prior Wall Street rescues. At the same time, by politicizing the issue and tying in TARP, Republicans made it harder to enlist community banks, fearful of being made subject to new restrictions from Congress.

"Most striking was the often dizzying, Alice in Wonderland world that policymakers found themselves in after the government had gone down the rabbit hole of trying to stabilize and stimulate the economy by inducing banks to accept low-cost capital.

"Many of the same banks targeted for the new loan program had already taken TARP capital from Treasury under the so-called Capital Purchase Program. The administration didn't want to exclude them from the new small-business initiative, but the program required that TARP debts be paid back first to Treasury, even if it meant using SBLF dollars to do it.

"In fact, 137 banks used $2.25 billion of the SBLF awards — more than half the total — to refinance TARP obligations. Critics call it a shell game. Treasury officials say it was fully anticipated. And in fairness, it might be described best as 'trading places,' since all those who took SBLF money are still bound by their commitment to increase their small-business loan portfolios or face higher interest penalties.

"What Treasury could not control was the economy itself — and the department's new partner, the bank regulatory community.

"Small employers need customers before wanting new credit, and with the recovery lagging, the bank applications received by Treasury totaled just $11.8 billion — about a third of the $30 billion in capital. Even then, more than 40 percent of the applicants were rejected for failing to meet minimum statutory requirements. And a second cut — driven largely by bank supervisors — eliminated about 170 more.

"Preliminary approvals for 400 banks and $4.8 billion in SBLF money were issued, but the field narrowed further as only 332 institutions closed their deals before the window came down in late September.

"Any such capital program makes Treasury dependent on bank supervisors — in this case an alphabet soup of state and federal agencies. Officials defend the process, saying the rigor will pay dividends for taxpayers. But the pace was slow given the fatigue after years of financial crisis. Sperling's departure for the White House removed a day-to-day champion inside Treasury, and the administration was late to see all of the ramifications of turning over so much to a set of supervisors when those judgments could not be easily shared with unsuccessful applicants.

"'It is not a simple program, but I don't believe there is an easy program to spur small-business lending,' conceded Don Graves, Treasury's deputy assistant secretary for small business. 'And in the end, getting out $4 billion to leverage small-business lending is pretty significant. Nowhere in the country but for Washington would that investment be considered small.'

"Nonetheless, the experience of the more modest $1.5 billion SSBCI is telling here. In this case, Treasury had a freer hand, and by the end of the fiscal year, it had pumped out about $1.3 billion, or almost 90 percent of the SSBCI funds available.

"By comparison, as the clock ran down on SBLF, Frank was scathing on this point in an exchange of letters with Treasury Secretary Timothy Geithner.

"'The way in which institutions were denied is an example of the sort of thing that undermines confidence in government: Banks were refused without any explanation,' Frank wrote on Sept. 21. When Geithner belatedly replied — after the window had closed — that Treasury was seeking authorization from regulators for more transparency, Frank shot back: 'In other words, no one in your department anticipated that banks who had been told this program was coming to their aid … would be interested in learning why they were turned down.'

"The secretary is slated to testify Oct. 18 before the Senate Small Business and Entrepreneurship Committee, chaired by Landrieu. And watching will be Paul Merski, chief economist for the Independent Community Bankers of America, an industry lobby that pushed hard for the initiative.

"'I don't want to take away from the positive side of the program. It's a success for those who were able to get the capital,' Merski told POLITICO. 'But you have to appreciate the frustration of community bankers. The vast majority were not approved.'

"'You just have to have better implementation, and the program had to be done with great coordination between Treasury and bank regulators,' Merski said. 'Was it properly implemented? Was it as robust as it could have been? It didn't take a year to get the money to the 'too big to fail' banks.'"

Below are selected vote hits on H.R. 5297:

- **Voted to create the Small Business Lending Fund (SBLF), which would allow the Treasury Department to invest up to $30 billion to encourage them to increase lending to small businesses**
    - Voted for passage of a bill that would create a lending fund through which the Treasury Department could make up to $30 billion in investments to encourage certain financial institutions to make credit available for small businesses. It also would create a $2 billion state small-business credit initiative to assist state and municipal programs that provide small businesses access to capital and a $1 billion Small Business Administration program to provide financing to "early stage" small businesses. As amended, it would provide funding to eligible institutions that serve small businesses affected by the Deepwater Horizon oil spill. (Passed 241-182; D: 238-13; R: 3-169)[45]

[45] H.R.5297, CQ Vote #375, June 17, 2010

- In a June 17, 2010, article, *Congressional Quarterly* reported, "The House passed legislation to boost lending to small businesses Thursday, with Democrats framing it as much-needed help for Main Street and Republicans deriding it as a wasteful bailout.

  "The bill (HR 5297), passed 241-182, would establish a $30 billion lending fund to invest in financial institutions like community banks in hopes of expanding the availability of credit to small businesses. The fund would be administered by the Treasury Department."[46]

- In an Oct. 12, 2011 letter to Sen. Olympia Snowe (R-ME) regarding the Small Business Jobs Act, the Congressional Budget Office wrote, "This letter responds to your request for information about the cost estimate the Congressional Budget Office (CBO) prepared for H.R. 5297 in the 111th Congress, which was ultimately enacted as Public Law 111-240, the Small Business Jobs Act of 2010. That act established the Small Business Lending Fund (SBLF) and through it, authorized the Treasury Department to make up to $30 billion of capital investments in certain financial institutions to encourage those institutions to increase lending to small businesses."[47]

➢ **"Creation of the lending fund is a top legislative priority of the Obama administration"**

- In a June 17, 2010, article, *Congressional Quarterly* reported, "Creation of the lending fund is a top legislative priority of the Obama administration; the president praised House action as 'a new and significant step toward getting small businesses the financing they need to start up, expand and hire more workers,' and urged the Senate to clear the measure."[48]

➢ **On Sept. 27, 2011, the SBLF shut down after issuing only $4 billion in SBLF money to only 332 institutions, a fraction of the $30 billion approved by Congress**

- In an Oct. 12, 2011, article, *Politico* reported, "To understand how hard it is for Washington to make a dent in today's economy, look back at Treasury's Small Business Lending Fund, a one-year experiment that closed its window last month after failing to use but a fraction of the $30 billion in capital approved by Congress.

  "Gene Sperling, now President Barack Obama's top economic adviser, had championed the idea when he served in Treasury. Despite fierce Republican opposition, community bankers rallied to the "Main Street" agenda on a bipartisan basis. And like Lucy in Peanuts, Sen. Mary Landrieu (D-La.) turned the tide when she famously stood up to the Senate's old-boy establishment and won a late-night 60-37 vote that saved the initiative in July 2010.

  "Yet just $4.03 billion made it out the door before the program shut down Sept. 27. Indeed, the first dollars weren't approved until nine months after enactment and almost a full year

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46 Ben Weyl, "House Passes $30 Billion Small-Business Lending Fund," *Congressional Quarterly*, June 17, 2010
47 Douglas Elmendorf, "Letter to the Honorable Olympia Snowe regarding H.R. 5297, the Small Business Jobs Act," Congressional Budget Office, Oct. 12, 2011
48 Ben Weyl, "House Passes $30 Billion Small-Business Lending Fund," *Congressional Quarterly*, June 17, 2010

after Landrieu's stand. And two-thirds of the 933 applicants came away empty-handed, leaving scores of banks blindsided without time to appeal to Treasury."[49]

- According to the same article, "Preliminary approvals for 400 banks and $4.8 billion in SBLF money were issued, but the field narrowed further as only 332 institutions closed their deals before the window came down in late September.

  "Any such capital program makes Treasury dependent on bank supervisors — in this case an alphabet soup of state and federal agencies. Officials defend the process, saying the rigor will pay dividends for taxpayers. But the pace was slow given the fatigue after years of financial crisis. Sperling's departure for the White House removed a day-to-day champion inside Treasury, and the administration was late to see all of the ramifications of turning over so much to a set of supervisors when those judgments could not be easily shared with unsuccessful applicants.

  "'It is not a simple program, but I don't believe there is an easy program to spur small-business lending,' conceded Don Graves, Treasury's deputy assistant secretary for small business. 'And in the end, getting out $4 billion to leverage small-business lending is pretty significant. Nowhere in the country but for Washington would that investment be considered small.'"[50]

➢ **The first dollars were not approved to be disbursed until nine months after enactment and two-thirds of the 933 applicants came away empty-handed**

- In an Oct. 12, 2011, article, *Politico* reported, "Yet just $4.03 billion made it out the door before the program shut down Sept. 27. Indeed, the first dollars weren't approved until nine months after enactment and almost a full year after Landrieu's stand. And two-thirds of the 933 applicants came away empty-handed, leaving scores of banks blindsided without time to appeal to Treasury."[51]

➢ **The program required that Troubled Asset Relief Program (TARP) recipients pay back TARP debts to Treasury first, even if it meant using SBLF dollars to do it**

- In an Oct. 12, 2011, article, *Politico* reported, "Many of the same banks targeted for the new loan program had already taken TARP capital from Treasury under the so-called Capital Purchase Program. The administration didn't want to exclude them from the new small-business initiative, but the program required that TARP debts be paid back first to Treasury, even if it meant using SBLF dollars to do it.

  "In fact, 137 banks used $2.25 billion of the SBLF awards — more than half the total — to refinance TARP obligations. Critics call it a shell game. Treasury officials say it was fully

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[49] David Rogers, "Small-Business Program Falls Short," *Politico*, Oct. 12, 2011, http://www.politico.com/news/stories/1011/65686.html
[50] David Rogers, "Small-Business Program Falls Short," *Politico*, Oct. 12, 2011, http://www.politico.com/news/stories/1011/65686.html
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anticipated. And in fairness, it might be described best as "trading places," since all those who took SBLF money are still bound by their commitment to increase their small-business loan portfolios or face higher interest penalties."[52]

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- **In an Oct. 12, 2011 letter, the CBO stated that its most recent baseline shows that SBLF has a subsidy cost of roughly $750 million**

  - In an Oct. 12, 2011 letter to Sen. Olympia Snowe (R-ME) regarding the Small Business Jobs Act, the Congressional Budget Office wrote, "To reflect in the baseline the way the SBLF is actually being treated in the budget, CBO's current estimate of the cost of the SBLF was computed as the net present value of expected disbursements, repayments, and receipts from dividends over the life of the program and was recorded in its baseline as an outlay in 2011 (the year in which the loans were disbursed). CBO estimates that repayments of principal and dividend payments will exceed the amount disbursed. However, because those repayments and dividend payments will occur over the next several years (and a dollar in the future is worth less than a dollar today), their present value is less than the amount disbursed this year. As a result, on a present-value basis, CBO's most recent baseline records a subsidy cost for the program of roughly $750 million."[54]

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[52] David Rogers, "Small-Business Program Falls Short," *Politico*, Oct. 12, 2011, http://www.politico.com/news/stories/1011/65686.html

[53] David Rogers, "Small-Business Program Falls Short," *Politico*, Oct. 12, 2011, http://www.politico.com/news/stories/1011/65686.html

[54] Douglas Elmendorf, "Letter to the Honorable Olympia Snowe regarding H.R. 5297, the Small Business Jobs Act," Congressional Budget Office, Oct. 12, 2011

DODD-FRANK WALL STREET REFORM

In the wake of the banking crisis in 2008 that shook global markets, Treasury Secretary Timothy F. Geithner proposed giving the federal government the authority to "wind down" systemically risky non-bank institutions and increase oversight of the largely unregulated derivatives market and hedge funds. Congress eventually passed a sweeping overhaul of the U.S. financial regulatory structure, taking aim at Wall Street in the first major regulatory response to the banking crisis of 2008.

Editor's Note: *This is a very basic look at the Dodd-Frank Wall Street Reform Law. It is an extraordinarily complex law in both structure and scope, so for any questions please contact the NRCC.*

The Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (named after chief sponsors, Senator Chris Dodd (D-Conn.) and Rep. Barney Frank (D-Mass.) was signed into law by President Barack Obama on July 21, 2010. The law is designed to prevent another financial crisis like the one that occurred in 2008. Federal agencies, including the U.S. Treasury, Securities and Exchange Commission (SEC), Federal Reserve (Fed), and Commodities Futures Trading Commission (CFTC) will implement the law over the next several years by creating and adopting as many as 330 rules and regulations that the law established, according to the Congressional Research Service (CRS). As regulators draft these rules, they will further define important terms affecting the regulation of the U.S. financial system.

Dodd-Frank also creates 122 new councils, advisory committees, other panels and consultation requirements, according to a Dec. 30, 2010, Bloomberg Government Study. Some of these entities, such as the Consumer Financial Protection Bureau (CFPB), have been analyzed and well-documented - scores of others are not as well-known.

Republicans do not disagree with the ideal of preventing another financial crisis or with taking appropriate measures to provide oversight of the economy. However, Republicans have generally considered Dodd-Frank a dramatic government overreach into the financial sector. Further, the law, as noted above, places near unprecedented power in the hands of unelected regulators and out of the hands of elected representatives. The law ignored major factors that contributed to the 2008 crisis in the first place, such as the question of what to do with Fannie Mae and Freddie Mac, the trillion dollar housing giants currently under the conservatorship of the U.S. taxpayer.

The Republican approach to addressing the flaws of the Dodd-Frank financial services law has been a carefully targeted attempt aimed at specific parts of the overhaul.

Consumer Financial Protection Bureau (CFPB)

Title X of the Dodd-Frank Act is entitled the Consumer Financial Protection Act of 2010 (CFP Act). The CFP Act establishes a Bureau of Consumer Financial Protection (CFPB or Bureau) within the Federal Reserve System with rulemaking, enforcement and supervisory powers over many consumer financial products and services and the entities that sell them (including deposit taking, mortgages, credit cards and other extensions of credit, loan servicing, check guaranteeing, collection of consumer report data, debt collection, real estate settlement, money transmitting, and financial data processing). The law also transfers to the Bureau the primary rulemaking and enforcement authority over many federal consumer protection laws enacted prior to the Dodd-Frank Act (the "enumerated consumer laws"), such as the Truth in Lending Act and the Real Estate Settlement Procedures Act.

The CFPB's authority differs for (1) depository institutions with more than $10 billion in assets (i.e., "larger depositories"); (2) depository institutions with $10 billion or less in assets (i.e., "smaller depositories"); and (3) non-depositories. The Dodd-Frank Act also explicitly exempts a number of different entities and consumer financial activities from the CFPA's supervisory and enforcement authority.

Dodd-Frank also placed leadership of the Bureau in a directorship, a single person who supervises federally chartered banks. Democratic lawmakers did this specifically to place it on equal footing with other powerful regulators.

House Financial Services Chairman Spencer Bachus (R-Ala.) has noted the CFPB will be a large and powerful agency with more than 1,000 federal employees. The Bureau's director will have the singular authority to spend hundreds of millions of dollars without Congressional approval and the ability to decide which financial products and services are available to American consumers. The director's mandates can be overturned, but only in extremely limited and highly unlikely circumstances. Therefore, Republicans are targeting the CFPB with three bills:

H.R. 1121, Responsible Consumer Financial Protection Regulations Act: Introduced by Chairman Bachus, it would establish a five-member, bipartisan commission to lead the CFPB. Placing the CFPB under such a commission is exactly what the House voted for when financial regulatory reform was being considered. Virtually all other independent agencies are governed by multi-member commissions, such as the Consumer Product Safety Commission, the FCC, and the SEC.

H.R. 1315, Consumer Financial Protection Safety and Soundness Improvement Act: Introduced by Rep. Sean Duffy (R-Wis.), it would clarify that the Financial Stability Oversight Council *must* set aside any CFPB regulation that is inconsistent with the safe and sound operations of U.S. financial institutions. Under the Dodd-Frank Act, the FSOC can stay CFPB regulations only if two-thirds of the FSOC's 10 voting members decide that the regulation would put the safety and soundness of the country's *entire* financial system at risk. In addition, the bill would change the vote required to set aside regulations from two-thirds of the FSOC's voting members to a simple majority and would give the FSOC sufficient time to consider the safety and soundness implications of rules.

The House passed H.R. 1315 on July 21, 2011. You can see how they voted here.

H.R. 1667, Bureau of Consumer Financial Protection Transfer Clarification Act: Introduced by Rep. Shelly Moore Capito (R-W.V.), it would ensure a Senate-confirmed director of the CFPB is in place before the transfer of regulatory authority to the new bureau takes place. If the CFPB does not have a Senate-confirmed Director by July 21, the Bureau may continue to operate under the Treasury Secretary's authority.

Chairman Bachus: "Despite the overheated rhetoric from opponents, none of these bills weakens consumer protection in any way, shape or form. In fact, these bills will help make sure the consumer protection rules issued by the CFPB are consistent, fair and do not endanger the safety and soundness of financial institutions. Endangering the safety and soundness of financial institutions is bad for our economy, and a bad economy is bad for consumers."

Still Too Big To Fail?

The Dodd-Frank law seeks to limit growth in the banking sector and remove risks that could destabilize the financial system. The size, scope and connections among large financial institutions contributed to the financial crisis, according to regulators.

The law aims to prevent banks from becoming too big to fail, so that the government is not forced to spend taxpayer money to bail out the shareholders of large banks and other financial companies in the event of crisis. The law establishes a concentration limit that prohibits mergers of the largest firms. It also institutes a new process for the liquidation of any financial company whose failure could threaten the economy.

However, Dodd-Frank does not prevent firms from becoming larger.

A recent Bloomberg Government Study found that the banking sector has become even more concentrated since the 2008 financial crisis. Individual banks continue to grow in asset size. If the growth rate of banks in the past is an indicator, the number of so-called too-big-to-fail banks could increase by almost 40 percent over the next 15 years, putting added strain on regulators.

The banking sector grew seven times faster than gross domestic product since the beginning of the financial crisis. This growth has been concentrated in the largest banks. As of December 2010, the top 10 banks in the U.S. held 77 percent of all U.S. bank assets, compared to 55 percent of the total assets at the end of 2002.

Growth in total assets of banks in the U.S. has outpaced inflation every decade since the 1930s, when total assets in the banking system were first recorded.

The study also found that the Dodd-Frank law included a provision that could allow the largest financial firms, even those subject to concentration limits, to grow even larger. That could occur during a future crisis, when those firms will have the most flexibility to take control of failed firms. As a result, large banks will continue to grow disproportionately to other banks. Further, we cannot know whether policymakers will cave in to the temptation to bail out "too big to fail" firms until another financial crisis happens.

What About Fannie and Freddie?

In their rush to push through Dodd-Frank, Democrats failed to address what many consider to be some of the root causes of the financial crisis. For example, a key reform missing in the Act was an exit strategy from Fannie Mae and Freddie Mac.

- **The bill does nothing to address Fannie Mae and Freddie Mac**
    - In a June 28, 2010, WebMemo, The Heritage Foundation wrote, "Despite much rhetoric about ending bailouts, the bill does nothing to address Fannie Mae and Freddie Mac, two of the largest recipients of federal bailout money. These two government-sponsored enterprises, now in federal receivership, helped fuel the housing bubble. When it popped, taxpayers found themselves on the hook for some $150 billion in bailout money.

"The failure to address their future is a serious error and shows just how hollow are claims that this agreement will prevent future crises."[55]

- **Government-controlled Fannie Mae and Freddie Mac, which together own or guarantee half of all U.S. mortgages, are largely untouched by the legislation, and it could take years before they are reformed**

    - In a June 25, 2010, article, *The Wall Street Journal* reported, "Government-controlled Fannie Mae and Freddie Mac remain a multibillion dollar drain on the U.S. Treasury, and largely untouched by this proposal. And the banking sector in parts of Europe remains fragile."[56]

    - In a June 25, 2010, article, Reuters reported, "Here is a look at some proposals that were left behind: Fixing Fannie and Freddie: the two giants of U.S. mortgage finance – Fannie Mae and Freddie Mac – need a major overhaul. That much both political parties in Congress can agree on. But the consensus ends there.

      "Fixing Fannie and Freddie, which together own or guarantee half of all U.S. mortgages, is such a contentious problem that Democrats set it aside for the time being.

      "The Obama administration has asked for public input on what to do about the housing finance system, a classic Washington tactic to buy more time.

      "A more detailed proposal on housing finance is not expected until 2011, and it could take years before lawmakers agree on a new framework."[57]

- **"By far the most significant error of omission in the bill is the failure to reform Fannie Mae and Freddie Mac, the government sponsored enterprises that encouraged the origination of risky mortgages in the first place by purchasing them with the support of many in Congress"**

    - In a July 1, 2010, opinion, John Taylor, a professor of economics at Stanford and a senior fellow at the Hoover Institution, wrote in *The Wall Street Journal*, "By far the most significant error of omission in the bill is the failure to reform Fannie Mae and Freddie Mac, the government sponsored enterprises that encouraged the origination of risky mortgages in the first place by purchasing them with the support of many in Congress. Some excuse this omission by saying that it can be handled later. But the purpose of 'comprehensive reform' is to balance competing political interests and reach compromise; that will be much harder to do if the Frank-Dodd bill becomes law. For example, many of the same activists who supported proxy-access provisions are those that also favor the Fannie and Freddie subsidies."[58]

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55 David C. John and James Gattuso, "Financial Reform in Congress: A Disorderly Failure," The Heritage Foundation, June 28, 2010
56 Damian Paletta, "U.S. lawmakers reach accord on new finance rules," *The Wall Street Journal*, June 25, 2010
57 Kevin Drawbaugh and Corbett Daly, "Factbox: Some financial reforms missing from U.S. legislation," June 25, 2010
58 John B. Taylor opinion, "The Dodd-Frank financial fiasco," *The Wall Street Journal*, July 1, 2010

<u>What They Are Saying About Dodd-Frank</u>

- **"The legislation would redraw how money flows through the U.S. economy, from the way people borrow money to the way banks structure complicated products like derivatives. It could touch every person who has a bank account or uses a credit card."**
    - In a June 25, 2010, article, *The Wall Street Journal* reported, "The legislation would redraw how money flows through the U.S. economy, from the way people borrow money to the way banks structure complicated products like derivatives. It could touch every person who has a bank account or uses a credit card."[59]

- **"This legislation is the wrong approach to fixing the financial industry. Rather than end the 'too big to fail' mindset, it reinforces it. Rather than end bailouts, it ignores the ongoing bailout of Fannie Mae and Freddie Mac. Rather than make the financial system safer, it reduces firms' ability to handle risk. And rather than help consumers, it raises their costs, reduces their choices, and hinders the capital formation necessary to make them more prosperous."**
    - In a June 28, 2010, WebMemo, The Heritage Foundation wrote, "This legislation is the wrong approach to fixing the financial industry. Rather than end the 'too big to fail' mindset, it reinforces it. Rather than end bailouts, it ignores the ongoing bailout of Fannie Mae and Freddie Mac. Rather than make the financial system safer, it reduces firms' ability to handle risk. And rather than help consumers, it raises their costs, reduces their choices, and hinders the capital formation necessary to make them more prosperous. Congress should consider these problems carefully before rushing into final passage next week."[60]

- **The bill would not fundamentally alter the shape of Wall Street or break up the nation's largest firms, instead it would give government broad new powers and regulatory authority**
    - In a June 25, 2010, article, *The Washington Post* reported, "Despite myriad changes in recent days, Democrats appear poised to deliver a final bill that largely reflects the administration's original blueprint unveiled almost precisely a year ago. While it would not fundamentally alter the shape of Wall Street or break up the nation's largest firms, the legislation would establish broad new oversight of the financial system.

      "A new consumer protection bureau housed in the Federal Reserve would have independent funding, an independent leader and near-total autonomy to write and enforce rules. The government would have broad new powers to seize and wind down large, failing financial firms and to oversee the $600-trillion derivatives market. In addition, a council of regulators, headed by the Treasury secretary, would monitor the financial landscape for potential systemic risks."[61]

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[59] Damian Paletta, "U.S. lawmakers reach accord on new finance rules," *The Wall Street Journal*, June 25, 2010
[60] David C. John and James Gattuso, "Financial Reform in Congress: A Disorderly Failure," The Heritage Foundation, June 28, 2010
[61] Brady Dennis, "House, Senate leaders finalize details of sweeping financial overhaul," *The Washington Post*, June 25, 2010

- **The bill could signal the end of community banking, leading to less credit, fewer loans and higher costs for customers due to voluminous new regulation in the bill**

    - In a June 29, 2010, opinion, Sara Wallace, the chair of the board of directors of First Federal Savings and Loan Association in Newark, Ohio, wrote in *The Wall Street Journal*, "The comprehensive financial reform agreed upon by the House and Senate on Friday, along with all the new regulations of the past year, could signal the end of community banking. The new reforms will give more power to the Federal Reserve to regulate how my bank and others like it do business.

      "What does all this mean for our customers? Less credit will be available, costs will increase, and we will be less able to make loans to regular people who were creditworthy in the past. This is the perfect storm for the small retail banking customer. We will start to see more small community bank failures and mergers because of voluminous regulation."[62]

- **Banks are already warning that consumers could see new account fees or balance premiums and that "free checking" may be a thing of the past**

    - In a June 26, 2010, article, *Politico* reported, "But banks have wasted no time warning that they if they get pinched on one side by the financial reform bill – say, by a loss in debit card fees – they've got to make it up somewhere else.

      "And already they're warning that could be consumers.

      "Banks are saying that could come in the form of new account fees or balance minimums. And some banks have already said the notion of 'free checking' – open an account for no monthly maintenance cost – may soon be a thing of the past for low-dollar savers."[63]

- **Commercial banks could essentially end up paying to bail out large hedge funds**

    - In a June 30, 2010, editorial, *The Wall Street Journal* wrote, "Democrats also voted to raise the fees banks pay for federal deposit insurance, which would be one more in a series of fee increases on banks struggling to rebuild capital and maintain lending. A $5.6 billion special levy early in the financial panic was followed by a December 2009 requirement that banks prepay $46 billion in assessments for future years. The fees will rise again in January under current rules, and a separate part of Dodd-Frank encourages future increases by permanently raising to $250,000 the insurance coverage for individual accounts.

      "This would also mean that commercial banks could essentially end up paying to bail out large hedge funds. The new Orderly Liquidation Authority was explicitly created for nonbanks, since the Federal Deposit Insurance Corporation already has a resolution process for commercial banks. Dodd-Frank would thus codify the mistakes of 2008, with bank deposit insurance supporting the rescue of all manner of uninsured adventures in the capital markets."[64]

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[62] Sarah Wallace opinion, "The end of community banking," *The Wall Street Journal*, June 29, 2010
[63] Carrie Budoff Brown and Ben White, "Wall St. reform winners and losers," *Politico*, June 26, 2010
[64] Editorial, "The bailout tax," *The Wall Street Journal*, June 30, 2010

- **The bill provides a new "orderly liquidation authority," which gives regulators the power to seize and wind down failing "systemically important" institutions, but the problem of "too big to fail" could linger on**

    - In a June 30, 2010, analysis, *Financial Times* wrote, "Central to the legislation is its attempt to deal with a chronic problem laid bare during the latest crisis: the existence of institutions such as Citigroup and AIG deemed "TBTF" – too big to fail.

      "The TBTF brigade, which includes most large financial groups in the US, benefits from a reduced cost of capital because of the assumption that in a crisis the government will not allow them to go under. In 2008, Washington proved the assumption correct when it bailed out AIG and its counterparties as well as Citi.

      "The weapon to be deployed is a new 'orderly liquidation authority', which gives regulators the power to seize a failing 'systemically important' institution, stabilise [sic] its viable parts, sack executives, impose losses on unsecured creditors and then use the assets to pay secured creditors. If the plan works, the implicit government guarantee should end. Creditors will no longer feel they can lend to a large or highly interconnected group in the knowledge that if it gets into trouble the government will step in. 'Yes ... I think it ends,' Mark Warner, the Democratic senator from Virginia who helped craft the mechanism, says of the guarantee. 'I think it is the best effort possible."[65]

    - The same analysis goes on to say, "The problem, largely overlooked by both Republican critics of the bill and its Democratic supporters, is that the impartial Congressional Budget Office estimates a $20.3bn cost to the economy over 10 years. This is the main budget hole that Democrats have struggled to fill in the final messy tinkering with the bill. Without total credibility in the new mechanisms, the problem will linger on."[66]

- **The bill may result in the markets believing that certain giant financial firms are guaranteed a government rescue in the future, which will make the largest Wall Street banks even more likely to be rescued in some future crisis**

    - In a June 25, 2010, column, *Newsweek's* political reporter Michael Hirsh wrote, "The bill leaves many other future decisions, for example on pay structure and incentives, to regulators as well. 'The bottom line: this doesn't fundamentally change the way the banking industry works,' says a former U.S. Treasury official who has followed the legislation closely but would give his judgment only on condition of anonymity. 'The ironic thing is that the biggest banks that took the most money end up with the most beneficial position, and the regulators that failed to stop them in first place get even more power and discretion.'

      "Indeed, the bill may make these banks even more critical to the economy and therefore even more likely to be rescued in some future crisis, this former official says. Obama declared, 'No longer will we have companies that are, quote unquote, too big to fail.' But by imposing new capital charges that will create barriers to entry for new firms, especially in

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[65] Francesco Guerrera, Tom Braithwaite and Justin Baer, "Financial regulation: a line is drawn," *Financial Times*, June 30, 2010
[66] Francesco Guerrera, Tom Braithwaite and Justin Baer, "Financial regulation: a line is drawn," *Financial Times*, June 30, 2010

swaps and other derivatives, while at the same time permitting giant bank holding companies to continue controlling most of what they were before, 'we've consolidated the position of the five banks that were most central to the crisis,' the former Treasury official says—in other words: J.P. Morgan, Goldman Sachs, Bank of America, Morgan Stanley, Citigroup, along with, currently, Wells Fargo. 'In my mind,' he says, 'they've created six new GSEs,' or government-sponsored entities like Fannie Mae and Freddie Mac.

"A former senior-career Federal Reserve official agrees. 'It makes it way tougher now to kiss somebody off when they get in trouble,' says this official, who also would speak only if his name were not used. The one hope, he adds, is if tough-enough capital and leverage restrictions are imposed to prevent the giant banks from getting themselves into too much trouble. But many of those standards are yet to be set by future generations of regulators, who may prove as vulnerable to Wall Street lobbying as their predecessors did.

"The result could be that the markets come to believe that certain giant firms will be vouchsafed a government rescue in the future, no matter what the bill's intentions are."[67]

- **Under this bill, "taxpayers will pay for bailouts like they always do, when they happen, and this bill makes them more likely"**

    - In a June 30, 2010, editorial, *The Wall Street Journal* wrote, "Most absurd is the claim that any of this money, however it is raised, will somehow be reserved for bank failures. Congress will spend it immediately. Taxpayers will pay for bailouts like they always do, when they happen, and this bill makes them more likely."[68]

- **The bill "vastly increases the power of government in ways that are unrelated to the recent crisis and may even encourage futures crises."**

    - In a July 1, 2010, opinion, John Taylor, a professor of economics at Stanford and a senior fellow at the Hoover Institution, wrote in *The Wall Street Journal*, "But instead of trying to make implementation of existing government regulations more effective, the bill vastly increases the power of government in ways that are unrelated to the recent crisis and may even encourage future crises."[69]

- **"The bill effectively institutionalizes the harmful bailout process by giving the government more discretionary power to intervene," "The problem of 'too big to fail' remains, and any cozy relationship between certain large financial institutions and the government that existed before the crisis will continue."**

    - In a July 1, 2010, opinion, John Taylor, a professor of economics at Stanford and a senior fellow at the Hoover Institution, wrote in *The Wall Street Journal*, "The bill creates a new resolution, or 'orderly liquidation,' authority in which the Federal Deposit Insurance Corporation (FDIC) can intervene between any complex financial institution and its creditors in any way it wants to. Effectively the bill institutionalizes the harmful bailout

[67] Michael Hirsh column, "Financial reform makes biggest banks stronger," *Newsweek*, June 25, 2010
[68] Editorial, "The bailout tax," *The Wall Street Journal*, June 30, 2010
[69] John B. Taylor opinion, "The Dodd-Frank financial fiasco," *The Wall Street Journal*, July 1, 2010

process by giving the government more discretionary power to intervene. The FDIC does not have the capability to take over large, complex financial institutions without causing disruption, so such firms and their creditors are likely to be bailed out again. The problem of 'too big to fail' remains, and any cozy relationship between certain large financial institutions and the government that existed before the crisis will continue."[70]

- **The bill does not prevent future financial crises and instead makes them more likely while impeding economic growth**

  - In a July 1, 2010, opinion, John Taylor, a professor of economics at Stanford and a senior fellow at the Hoover Institution, wrote in *The Wall Street Journal*, "The continuing debate over the Dodd-Frank bill in the days since it emerged from conference is good news. People may be waking up to the fact that the bill does not do what its supporters claim. It does not prevent future financial crises. Rather, it makes them more likely and in the meantime impedes economic growth."[71]

- **"In other words, our Washington rulers have taken 2,000 or so pages to double and triple down on the old system that failed"**

  - In a June 28, 2010, editorial, *The Wall Street Journal* wrote, "In other words, our Washington rulers have taken 2,000 or so pages to double and triple down on the old system that failed"[72]

- **"In the name of responding to a crisis, the bill greatly increases the power of politicians and regulators without addressing the real causes of that crisis"**

  - In a June 28, 2010, editorial, *The Wall Street Journal* wrote, "We could go on, but perhaps the best summary is to hail Dodd-Frank as the crowning achievement of the Obama "reform" method. In the name of responding to a crisis, the bill greatly increases the power of politicians and regulators without addressing the real causes of that crisis. It makes credit more expensive and punishes business without reducing the chances of a future panic or bailouts.

    "The only certain result is that when the next mania and panic arrive, and they will, Congress and the regulators will claim they were all someone else's fault."[73]

- **The bill leaves us with "the same systemic problem we had when the meltdown started in June 2007: too many institutions that are too big to fail, and a perilously opaque financial system that will freeze if problems recur"**

  - In a June 29, 2010, opinion, Allan Sloan, *Fortune* magazine's senior editor at large, wrote in the *Washington Post*, "Sure, there are some useful things other than consumer protection in Dodd-Frank. But assuming the bill becomes law in its current form, we'll have the same

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[70] John B. Taylor opinion, "The Dodd-Frank financial fiasco," *The Wall Street Journal*, July 1, 2010
[71] John B. Taylor opinion, "The Dodd-Frank financial fiasco," *The Wall Street Journal*, July 1, 2010
[72] Editorial, "Triumph of the regulators," *The Wall Street Journal*, June 28, 2010
[73] Editorial, "Triumph of the regulators," *The Wall Street Journal*, June 28, 2010

systemic problem we had when the meltdown started in June 2007: too many institutions that are too big to fail, and a perilously opaque financial system that will freeze if problems recur."[74]

[74] Allan Sloan opinion, "Congress fulfills narrow ambitions with financial overhaul bill," *The Washington Post*, June 29, 2010

OCCUPY WALL STREET PROTESTS

The Occupy Wall Street (OWS) demonstrations and protests that began in September 2011 at Zuccotti Park in New York City, N.Y. have not put forward any single set of grievances or demands. The protests reflect many points of views and widely different agendas. To the extent that a common concern may be identified, it is probably the gap between "the 1%" – wealthy traders and bankers at the top of the financial services sector – and "the 99%" – everyone else, including the demonstrators…hence, their "official" slogan, "We are the 99%." According to the protestors, the one percent are thought to have too much wealth and power and to have interests in conflict with the economic well-being of the rest of the country.

OWS was actually initiated by two Canadian citizens who classify themselves as "anti-consumerist" – Kalle Lasn and Micah White. The OWS protests have been riddled with instances of violence against police, theft, widespread arrest for assaulting law enforcement and breaking the law by setting up encampments where they cannot be set up. Many Democrats, including President Obama and House Democratic Leader Nancy Pelosi, have expressed support for the OWS movement. Most Republicans have responded to the protests by saying that while there have been bad apples in the bunch, these protests aimed at just one industry are not fair and the protests themselves are actually dangerous and are simply inciting "class warfare" rather than truly making a statement or putting forth any solutions to their complaints.

FINANCIAL CRISIS, BAILOUTS AND FINANCIAL REFORMS TALKING POINTS

- The culture of bailouts and government intervention in the private sector must come to an end.

- Unsustainable deficits, runaway spending, increased government regulation and uncertainty about the future of our tax system have created reluctance among business owners to grow and hire new workers.

- The expanding size and the scope of the federal government has stalled the economy, slowed innovation and destroyed jobs.

ADDITIONAL INFORMATION AND RESOURCES

- Bailout Recipients, ProPublica.org website - http://projects.propublica.org/bailout/list/index
- Federal Reserve - http://www.federalreserve.gov/
- House Financial Services Committee - http://financialservices.house.gov/
- Special Inspector General for the Troubled Asset Relief Program (SIGTARP) - http://www.sigtarp.gov/Pages/home.aspx
- U.S. Treasury Department - http://www.treasury.gov/Pages/default.aspx