

**FOLLOWING THE MONEY: A QUARTERLY REPORT
BY THE SPECIAL INSPECTOR GENERAL
FOR THE TARP**

HEARING

BEFORE THE

**JOINT ECONOMIC COMMITTEE
CONGRESS OF THE UNITED STATES**

ONE HUNDRED ELEVENTH CONGRESS

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GENERAL FOR THE TARP**

THURSDAY, APRIL 23, 2009

CONGRESS OF THE UNITED STATES,
JOINT ECONOMIC COMMITTEE,
Washington, DC.

The committee met at 9:30 a.m., in Room 210, Cannon House Office Building, the Hon. Carolyn B. Maloney (Chair), presiding.

Senators present: Klobuchar and Casey.

Representatives present: Maloney, Hinchey, Sanchez, Cummings, Snyder, Brady, and Burgess.

Staff present: Gail Cohen, Nan Gibson, Colleen Healy, Hayley Matz, Andrew Wilson, Lydia Mashburn, Chris Frenze, and Robert O'Quinn.

Chair Maloney. The meeting will come to order, and I welcome the members of the panel and our special guest.

Good morning. I want to welcome Mr. Barofsky, the Special Inspector General for the Troubled Asset Relief Program, and thank him and his staff for his testimony today on the SIGTARP's new report to Congress, just released last Tuesday.

**OPENING STATEMENT OF HON. CAROLYN B. MALONEY, CHAIR,
A U.S. REPRESENTATIVE FROM NEW YORK**

Chair Maloney. The SIGTARP reports to Congress quarterly, and this is the second report. Like the first report, issued February 6th, this report takes a strong but clear position against the aspects of the TARP program that the SIGTARP believes risk promoting fraud, waste, and abuse. Mr. Barofsky is a former prosecutor who does not shrink from telling it like it is, so the interests of the SIGTARP's mission is to make the best use of our taxpayers' dollars.

The SIGTARP's reports distinguish themselves by thorough but very clear explanation of the TARP programs and the SIGTARP's audit and investigation strategy, as well as specific recommendations on steps Treasury should take to prevent waste, fraud, and abuse in the program.

Regrettably, some of the key recommendations in this report reiterate critical recommendations in the first report—recommendations that would promote transparency and accountability and reduce the potential for fraud and misappropriation, but which Treasury has yet to adopt.

The second report is even more critical to our understanding than the first, in part because the TARP has become such a complex series of programs and in part because the dialogue between the SIGTARP and Treasury on key issues is more advanced and is getting into some specific issues that are of great interest to policymakers and to this committee.

As a proponent of greater transparency of the program, I requested that the Federal Reserve release AIG counterparty information; and the disclosures were made last month. The SIGTARP is set to audit the payments to the AIG counterparties and investigate why it was deemed necessary to redeem these securities at full value. This is a key issue that lies at the heart of the AIG rescue: Why were the counterparties made whole at the expense of the taxpayer? Shouldn't they have had to share in the loss?

The report repeats the recommendation of the first report that Treasury must require TARP recipients to report the use to which they put the TARP money. This recommendation echoes the concerns of legislation I have introduced with many of the members of this committee that would require Treasury to track the TARP funds, even using presently reported or public information. Treasury has not adopted this very important recommendation, but the work of the SIGTARP, including a survey they conducted of some 364 TARP recipients, shows that additional information can be provided.

On a basic level, it is absolutely critical that we know where the money has gone and how it has been used. There are reports that some banks getting TARP money have used it to buy banks in China and highways in Spain or even to short the stock of their competitors. These emphasize the need for us to know where the money has gone. Beyond that, we should be able to assess, looking at available data and performance measurements, whether or not these funds have been used effectively.

However, these lessons are not always reflected in the new proposed programs. As this report notes, the PPIP has some inherent features that make it vulnerable to conflicts of interest. The government would be remiss in its duty if it were not to impose rigorous reporting and disclosure requirements on these managers and investors. I am concerned that Treasury Secretary Geithner, in his testimony Tuesday, headed in the opposite direction, saying that Treasury would exempt the PPIP participants from the executive compensation requirements of the TARP statute.

The goals of transparency and accountability that guide the SIGTARP inform this new report and its recommendations. It is crucial not only to the success of the TARP but to the recovery of our financial system and our economy that we pay very close attention.

[The prepared statement of Representative Maloney appears in the Submissions for the Record on page 40.]

Chair Maloney. I very much look forward to your testimony and recognize the ranking member, Mr. Brady.

**OPENING STATEMENT OF HON. KEVIN BRADY, A U.S.
REPRESENTATIVE FROM TEXAS**

Representative Brady. Thank you.

I am pleased to join with you in welcoming Inspector General Barofsky before the committee this morning. His office is one of the most important guardians of the trillions of dollars taxpayers have at risk in the massive bailouts of large financial institutions.

Unfortunately, as Kansas City Federal Reserve President Thomas Hoenig testified earlier this week, these bailouts “risk prolonging the crisis while increasing the cost.” In this context, I found the Inspector General’s most recent report quite disturbing.

Mr. Barofsky, your report contains very troubling information that has not been previously disclosed. This report identifies numerous key weaknesses in the design and implementation of the government bailouts that could greatly increase their cost.

For example, according to your report, the Treasury Department has indicated it will not adopt the special Inspector General’s recommendations that all TARP recipients “account for the use of TARP funds, set up internal controls to comply with such accounting, and report periodically to Treasury on the results with appropriate sworn certifications.” The complexity and lack of transparency in TARP programs are further reason for concern.

I think the key question before the committee this morning is why this Treasury continues to resist adopting many of the commonsense safeguards recommended in your report. The massive Public-Private Investment Program unveiled by Secretary Geithner is, to many, key to our Nation’s economic recovery.

Your report notes many aspects of the Public-Private Investment Program could make it inherently vulnerable to fraud, waste, and abuse. Vulnerabilities include the huge size of the program, along with conflicts of interest, collusion, and money laundering.

With regard to money laundering, which you identify as a potential risk, your report notes it would be unacceptable if TARP or related funds, “were used to leverage the profits of drug cartels or organized crime groups.” Unlike banks and retail brokers, the government’s proposed public-private partnerships are not currently subject to comparable disclosure rules to prevent money laundering and abuse. The question is, why not?

Furthermore, the report demonstrates how interactions between two different bailout programs could encourage excessive leverage and greatly magnify taxpayer losses. In other words, without adequate protections, the toxic loan program could be gamed for profit by the financial institutions it is trying to save, or used as a legal vehicle for those who cannot launder their money through existing financial institutions. The question is, why not address in advance the vulnerabilities your report has identified?

With regard to another component of the bailouts administered by the Fed, your report said Treasury should require additional anti-fraud and credit protection provisions specific to all mortgage-backed securities before participating in an expanded TALF, including minimum underwriting standards and other fraud prevention measures.

According to the latest estimates, the amount of losses from toxic assets in the U.S. alone may be as high as \$2.7 trillion. This clearly is a huge potential liability for American taxpayers. Unfortunately, Treasury’s financial rescue plan seems designed to marginalize Congress in this debate and avoid the appropriations process.

Nonetheless, Congress should not finalize the 2009 budget resolution without considering the tremendous costs of the ongoing bailouts.

Economic research shows that the national debt following this financial crisis may increase by as much as \$8.5 trillion in as few as 3 years. This grim fiscal prospect should be an overriding consideration as we consider budget priorities and proposals for yet more spending. Congress should not go on an irresponsible spending spree with trillions of dollars of bailouts already threatening the taxpayers.

Inspector General, you have raised serious and troubling questions in your report. Let's hope we can receive satisfactory answers to them from this administration.

I would yield back.

[The prepared statement of Representative Brady appears in the Submissions for the Record on page 40.]

Chair Maloney. I would now like to introduce our distinguished witness.

Neil Barofsky is the Special Inspector General for the Troubled Asset Relief Program. He was confirmed by the Senate on December 8, 2008, and was sworn into office on December 15, 2008.

Prior to assuming the position of Special IG, Mr. Barofsky was a Federal prosecutor in the U.S. Attorney's Office for the Southern District of New York for more than 8 years. In that office, Mr. Barofsky was a senior trial counsel who headed the mortgage fraud group which investigated and prosecuted all aspects of mortgage fraud, from retail mortgage fraud cases to investigations involving potential securities fraud with respect to collateralized debt obligations.

One of the matters that Mr. Barofsky supervised was the broad investigation into the \$55 trillion credit default swap market which was conducted in partnership with the New York State Attorney General's Office.

Mr. Barofsky is a magna cum laude graduate of the New York University School of Law.

I want to thank you very much for your work, for being with us today, and please proceed with your testimony. And I welcome all my colleagues and thank them for being here at this important hearing. Thank you.

**STATEMENT OF NEIL BAROFSKY, SPECIAL INSPECTOR
GENERAL, TROUBLED ASSET RELIEF PROGRAM**

Mr. Barofsky. Thank you, Madam Chair, and thank you for that kind introduction. It is a privilege to appear before you today and before this committee to discuss our quarterly report to Congress.

It was approximately a little bit more than 6 months ago, close to 7 months, that the Emergency Economic Stabilization Act was enacted and a little bit over 3 months, 4 months, since I took office. During that time period, the original concept of the bailout designed to be a \$700 billion program to buy up toxic assets from struggling financial institutions has changed significantly. We are now charged with overseeing 12 separate programs involving, by our calculation, up to \$3 trillion of predominantly government

money. TARP money, the \$700 billion, is the seed; and it was combined with guarantees by the FDIC and nonrecourse loans from the Federal Reserve.

This is a daunting and historic challenge for my office; and, as we report in our quarterly report, as I have been building my office I have addressed three primary areas in carrying out this task: enforcement, transparency, and coordinated oversight.

I would like to first discuss what we have been doing on the enforcement front. This is of particular importance to us because, of the four oversight bodies referenced in the bailout act, we stand alone as the one having a criminal law enforcement body. I recently have been described as the TARP cop, and we take that role very, very seriously.

Our hotline is up and running, available on the Internet at our Web site: www.SIGTARP.gov. We have a toll-free telephone number: 877-SIG-2009. We process more than 400 referrals from that hotline. We have had tremendous response to it. We have had—of our 21 ongoing criminal investigations, a third of them come from the hotline, tips from whistle-blowers, insiders, and victims of fraud.

Our approach as an investigations division as we build is to be extremely proactive. We are seeking to, in many ways, to redefine Federal criminal law enforcement in reaction to large government programs.

I think a best example of that is our assembling of the TALF task force, which we are about to expand to include not only the TALF program but also the Private-Public Investment Program. This task force will then be addressing up to \$2 trillion of coverage of the bailout programs. It includes us, of course, as well as seven other law enforcement agencies, including the FBI, the SEC, the IRS, FinCEN, the IG for the Federal Reserve, the Postal Inspection Service, basically a who's who of white collar criminal law enforcement.

The way that we are seeking to redefine the policing of these programs is to put enforcement up front. Way too often in the past there has been a launch for a Federal government program, then there is the fraud, then there is the law enforcement reaction.

What we are trying to do is move that reaction up the chain, not only just before the actual fraud but even in the formation of these programs. And what I mean by that is, as was referred in the introductions, in our quarterly report we make specific recommendations about some of these programs that have not yet been rolled out in their entirety. Those recommendations came not just from our own study and analysis but consulting with members of our task force. We are seeking to combine the collective resources, knowledge, and expertise of these fine Federal law enforcement officers to help protect the program before they go out.

And the second thing that we are doing through that is deterrence. By letting all those out there who may seek to criminally profit off of these programs to know that we are out there and we are not alone, that this is a combined Federal law enforcement. We are going to marshal our resources to bring those who may try to steal to justice.

And I think another great example of that is what happened yesterday. Yesterday, I was down in Tennessee announcing the first criminal charges being filed in connection with the SIGTARP investigation. Gordon Grigg was charged with eight counts of mail and wire fraud through his conducting of a scam that involved selling a fictional investment, TARP-backed securities, something that doesn't exist, cannot exist, was a pure creation of his criminal imagination.

What is significant about this case is not the numbers. It was a \$10 million securities fraud. But it shows you what coordinated law enforcement can do.

We first learned of this case back in January when the SEC called us up and told us what was going on. They asked us for our assistance; and we helped shut the scam down, helping them get a temporary restraining order. After that, we used our unique position to coordinate a criminal law enforcement response. The FBI, the Postal Inspection Service, and the U.S. Attorney for the Middle District of Tennessee, coordinated together to get the filing of those charges.

And I think that these charges indicate and should signal to those considering to commit fraud that we are out there. It doesn't matter what the size of the fraud is, whether it is large or small; it doesn't matter where the fraud is committed, whether it is on Wall Street or on Main Street; and it doesn't matter who the victim of the fraud is. Whether it is the United States, it is government itself, individual unsuspecting investors, such as in the Grigg case, or even struggling homeowners, the Federal government stands ready, willing, and able to enforce the laws and to make sure that these folks get brought to justice.

The second area that we are focusing on is, of course, transparency. On my eighth day in office, December 23rd, we made our first of our series of recommendations to Treasury, and these were largely based on our concerns about transparency. One of them, which has been adopted, was that Treasury post all of its agreements up on the Internet related to the TARP, although not a terribly complicated concept but one that hadn't been adopted at that point. And in the last administration they largely agreed to do so; and Secretary Geithner, shortly after he took office, fully adopted that recommendation.

We also made the recommendation, however, which was referenced in the opening comments, which has not been adopted; and that is that Treasury require all TARP recipients to account for their use of funds. This is a recommendation that we made back in late December. It is a recommendation we continue to make. It was referenced in our last report, and it is referenced in this report.

Our efforts to get this recommendation implemented met only with success with respect to two TARP recipients, Citigroup and Bank of America, but, otherwise, it hasn't come to pass. Even this week, when the final agreement was inked with AIG, provide AIG with another \$30 billion of taxpayer money, once again what we believe is a basic concept of oversight, making the recipient account for the use of funds, was left out.

What we did because of our commitment to transparency in late January, early February, was to take matters into our own hands. We launched our own audit by surveying each of the TARP recipients; and what we found after we got 100 percent response rate from the 364 institutions that we surveyed was that you can—it is possible and you can get good results from requiring or asking banks how they are using the money. Particularly for those financial institutions that established internal controls before they got the money, made the conscious effort to try to keep track of the funds.

This is a recommendation we made to Treasury that hasn't been adopted, but some financial institutions did it on their own. And those that did were able to give us some very specific answers, sometimes granular detail, about specific actions they were able to take that they wouldn't be able to take but for TARP funds. Sometimes even individual loans that were made out of TARP money.

And I think that the results of the survey—and we are going to be putting a preliminary report out hopefully in June—will indicate that the prior complaints that are impractical or impossible or a waste of time are simply unfounded complaints; and we are going to continue to push the Treasury to adopt this recommendation.

Also part of our transparency efforts in our oversight is through our audit function. We currently have six audits pending, as was mentioned. Not only is it on use of funds but on executive compensation, AIG counterparties, the recent bonus and retention payments made by AIG, a case study into Bank of America and Merrill Lynch and how Bank of America was the beneficiary of, in four different transactions, three different TARP programs, \$45 billion in cash and more than \$100 billion of toxic asset guarantees, as well as several other issues that we are looking into.

And, of course, also part of our oversight function is making recommendations; and, as I noted before, we don't do these in a vacuum. For example, in our report, we consulted with the mortgage fraud experts at the FBI. We sat down with them before even any of the details of the mortgage modification program were rolled out because we thought it was so important.

In drawing on my own experience as a mortgage fraud prosecutor, we were concerned that some of those same concerns that I saw in prosecuting those cases would be funneled in and try to victimize this program. So not only the recommendations reflect my own experiences but also those of mortgage fraud experts at the FBI.

Similarly, our recommendations concerning the Private-Public Investment Program. And, as noted, we have some grave concerns about the structure of these programs if certain very serious steps are not taken to address the high potential for fraud, whether it is conflicts of interest, price collusion, price fixing, money laundering, and other dangers that are potentially present in these programs.

I was happy to see, though, that last night Treasury did announce adoption of one of our recommendations involving asset management. We have long been pushing for Treasury to take steps to value this vast portfolio of assets that they manage on behalf of the taxpayers, who, of course, are the investors in this pro-

gram; and yesterday they did adopt that recommendation by hiring three asset managers. We were encouraged to see that.

And, obviously, it is so important now that Treasury is going to be actually liquidating some of the assets, including the warrants that were required in the capital purchase program.

As I noted before, it is an honor and privilege to appear before you today to deliver my quarterly report to this committee; and I look forward to answering any questions that you may have. Thank you.

Chair Maloney. Thank you very much for your testimony.

[The statement of Neil Barofsky appears in the Submissions for the Record on page 42.]

Chair Maloney. In your report, you express concern that the new PPIP is, and I quote, “inherently vulnerable to fraud, waste, and abuse due to conflicts of interest among fund managers, the opportunities for collusion in the procedures, and money laundering opportunities.” The report proposes a series of conflict of interest rules and disclosures and investor screening comparable to “Know Your Customer” requirements to guard against these risks.

Can you explain the dangers you envision in more detail?

Mr. Barofsky. If I may, if I can give you an example, I think it might be the best way to provide some detail to this. For conflicts of interest, for example, basically—I am going to use the legacy securities program as an example. This is where—the program where \$1 of private investment is going to be raised by a fund manager, and it is going to be matched with a dollar from Treasury of equity and then \$2 of lending. So the \$1 is going to turn into \$4 of buying power. And of course it is not going to be \$1. It is going to be \$1 billion or \$2 billion. But it is going to be 75 percent taxpayer money at risk.

And the way the conflict of interest could work is that the funds that are going to qualify for this by their very definition, by the nature of the prerequisites, will likely either have for themselves or be managing vast portfolio of the same very toxic assets they are going to go out and be out and purchasing. And the design of the program is that the fund managers in essence set the new price for these securities.

The theory behind the PPIP is that these markets are broken and that the prices that currently exist in the market are depressed, are much lower than they would be if the market was functioning and normal. And the idea behind the PPIP is that putting government money to help restart the market and help price it at what would be more accurate. So a lot of discretion and, frankly, economic power is going to be given to this small number of fund managers.

Now, the conflict of interest comes into play. What if that fund manager has on its books or managing for other clients from which it derives fees the exact same mortgage-backed security that it is going to go out and buy at a higher price?

An example we use in the report, if—let’s say there is one that is currently at 20 because the market is depressed, and the fund manager thinks, well, it is probably worth about 30. Normally, without a conflict of interest, it would go out and buy that security from others up to the price of 30. But if the fund manager realizes

that it could set the price and set that price at what it feels or wants to do, it could set that price at 50 and start buying at 50. Obviously, the sellers would be more than willing to take 50 for an asset that is only worth 30.

Now, at the same time, the asset manager then can sell off what he or she has on their books and records that they value at 20, think it could be worth up to 30. They can unload it at 50, making a huge profit.

So what happens at the end of this scenario? The fund manager makes a huge profit, the seller of the toxic asset makes a huge profit, but eventually that price drops down to what its market level would be, to 30. And who is left holding the bag? The taxpayer.

So that is a really simplified example of how conflict of interest could come into play and hurt the taxpayer without the right types of protections.

Chair Maloney. Could you elaborate more on steps that we could take to prevent these type of risks to taxpayer dollars?

Mr. Barofsky. I think the two areas that are going to be essential is, one, we have to have very, very strict conflict-of-interest rules. Now, there is a wide array of possible solutions. One is that the entity not be able to enter into transactions for securities that it has on its own books and records. Now, this may be inherently very, very difficult, if not impossible, the way the program is currently structured, but that would be a way of limiting this conflict of interest.

Alternatively, there has to be very, very strict walls, we believe, so that whoever is making these decisions for the fund manager isn't providing information to other parts of the company and isn't receiving information from other parts of the company. So in a way to put that manager in a black box so that their decisions are independent of what impact those decisions may have for the benefit of the rest of the company.

Another key area is, obviously, transparency; and our recommendations continue to push for more and more transparency throughout the TARP. But in this area we think it is crucial. Again, not just for the point of transparency, for the sake that, obviously, this Congress and the American people need to know what is going on with their investments, but as a fraud protection. We need to know every detail of every transaction that is going on in these funds the taxpayers are a part of, and that should be publicly reported so all the investors can see. And by investors I mean taxpayers can see what is going on.

But we also need to access and be able to see what else is going on in the company. So my office and Treasury, as part of its compliance function, has to be provided all information about transactions managed or for that fund manager's books in the securities and similar securities so that we can track and see if that fund manager is making decisions not for the benefit of the taxpayer but the benefit of itself or other clients that it has.

Those are some of the types of recommendations we include in our report.

Chair Maloney. Thank you.

My time is expired. Mr. Brady for 5 minutes.

Representative Brady. Thank you.

I applaud your approach on being proactive on the fraud area and prevention and also on focus on transparency within the program. Both are clearly needed.

On page 147 of the report, you talk about the areas of vulnerability under the new Public-Private Investment Program; and you talk about, as the chairman said, conflicts of interest, collusion, and the potential for money laundering, which our U.S. leaders have rightly focused in the G-20 and in the OECD on trying to stop these activities around the world. So my question is: Has the Treasury adopted all of your recommendations to protect taxpayer interest related to the new Public-Private Investment Program?

Mr. Barofsky. They have not yet. We had a meeting with them earlier this week where we discussed in detail a lot of our recommendations. They have indicated that a lot of them are under consideration, but they have not yet adopted them.

Representative Brady. Have they given you a time line for adopting them or indicated that they will adopt some, many, most, all?

Mr. Barofsky. They have not. The people that we were speaking to were sort of the engineers and mechanics of the program, and they were extremely receptive of our recommendations. They thought that they made sense. They raised significant concerns. But, ultimately, those are decisions that are made by the policymakers. And they have not communicated to us, one, where they are leaning as far as our recommendations or, two, providing us with a time line.

Representative Brady. So Secretary Geithner has not announced publicly or privately whether he is going to adopt these recommendations.

Mr. Barofsky. No, he has not.

Representative Brady. You make the same, commonsense recommendations in dealing with the TARP, simply asking that the recipients account for the use of the money and set up internal controls so we can continue to track it. I think that is a desire of every Member of Congress and the public as well. Has Treasury adopted these recommendations? And, if not, why?

Representative Barofsky. They have not, other than in the last administration when the—in the targeted investment program investments of Citi and B of A. That is the only time it was adopted.

As to the why not, it is really for Treasury to answer. What I have been told on various times by Mr. Kashkari is that they believe that, because of the inherent fungibility of money, that it is not a positive use of resources, that it would be a waste of time possibly, that it is very difficult to track and other explanations.

I believe the results of our survey disprove those suggestions. But as I spoke to Mr. Kashkari I think last week or the week before, he told me that he has raised our concerns to the Secretary as well as to Chairman Bernanke and that they continue to agree that this requirement not be imposed.

Representative Brady. I just think stonewalling on this issue of transparency really undermines public support and confidence in

the program. One of the goals of it is to restore public investor confidence in the system.

Can I ask a final question? But in your report you raise issues about using the dollars that have been set aside for the Term Asset-Backed Securities Loan Facility, TALF, basically focused at consumer loans and using that to finance the Public-Private Investment Program. You suggest it really undermines TALF's stated purpose of trying to deal with creditworthy consumers and small business. Can you elaborate on that?

Mr. Barofsky. There are a number of concerns that we had in the expansion of the TALF. The program was designed for a certain purpose, as you noted; and that purpose was inherent in the fraud and credit loss protections of the program.

Applying that to legacy assets, these toxic mortgage-backed securities, those protections don't really work. That is why we previously made the recommendation to tread very carefully, and what we are encouraging Congress to do is really rethink those protections.

We have had discussions with the Federal Reserve as well as with Treasury; and they have indicated that they are going to be adopting our recommendations, at least to the extent that they are not going to at least be dropping the legacy mortgage-backed securities right into the program. They are going to do—in response to our recommendations, they have indicated that they are going to do security-by-security analysis and also indicated that they may adopt our recommendation that certain types of mortgage-backed securities are just off the table. And those would be things—these securities that we know have been just riddled with fraud, the liar loans, the stated loans with no underwriting whatsoever, those types of things.

So we are going to continue to push for those recommendations to be adopted.

Representative Brady. Well, I just hope that Treasury understands that if they don't adopt your recommendations this Congress may well direct them to do.

So, Madam Chairman, thank you.

Chair Maloney. Thank you so much.

The gentleman's time is expired.

Congresswoman Sanchez for 5 minutes.

Representative Sanchez. Thank you, Madam Chair; and thank you, Mr. Barofsky, for being before us.

I used to work in the securities industry. I used to be one of those people that put together financial deals. So my question goes to something that you were talking about earlier, that conflict of interest that is occurring.

Now, at least when I used to work in the investment banking industry, when we would sell securities, whatever type they were, we would make a syndicated group, spreading the risk over everybody on the street, including people who had desks like Bank of America and your typical commercial banks. So my question is, doesn't everybody have some part of these assets, and it would be very—for anybody to think that they don't have any of these funds within their portfolio?

Mr. Barofsky. That is one of the problems with the conflict of interest; and that is one of the problems ultimately in the design of the program unless very, very strict conflict of interest rules are put into place and the right types of walls. Because, unlike most times when a deal is being syndicated here, by design the fund manager who is going to be using the government assets is going to be setting a brand new price.

Representative Sanchez. He is setting a price on what he has got already in his portfolio. I mean, it would be highly unlikely, in particular with these large mortgage-backed loans which include so many different pieces of mortgages, that he wouldn't have something in his portfolio with respect to that.

Mr. Barofsky. That is a huge danger in the program. It is unlike anything we have seen.

I mean, if this program didn't exist with the government sanction and one party was—a private party in normal circumstances was setting the price for an asset that was on its books and records, one might suggest that that would be manipulation. Here, this is what the whole point of the program is to get these prices up. So it is why we really strongly believe these protections must be in place.

Representative Sanchez. I basically see the taxpayers paying going in and the taxpayers paying coming out, too. I mean, it is a very difficult thing to adjust to.

I have a question about what Secretary Geithner said yesterday in his testimony. He talked about there being an availability of about \$135 billion left in the TARP funds. It showed your figure of \$109.5 billion, but he also said that \$25 billion of that would be from the monies that the banks are paying back by the end of the year.

Now, when we did this TARP program—by the way, I didn't vote for it, because I saw a lot of these problems inherent in it—we said that we wanted the taxpayers to be paid back. So now we have Secretary Geithner saying, well, when these monies are paid back it is like a revolving fund, and we are going to be putting them back out again. Is that your interpretation of the program or do you think it was a one-time appropriation?

Mr. Barofsky. I think the legal analysis that I have seen—and I have seen it from Treasury as well as—from what has been described to me by Treasury as well as by GAO—is that for the principal amounts, if those come back, the Treasury has the ability to keep \$700 billion out up and through the end of this year. That is when, under the legislation, when that authority sunsets unless it is expanded. For any of the interest payments, the profits, any of those types of things, that doesn't go back into the kitty. That actually goes directly to pay down the debt.

But that is my understanding of the legal construct, that money that is paid back of principal can be reused by Treasury as part of the TARP, at least until the end of the year.

Representative Sanchez. Now, I have been reading in the paper about how some of these banks want to pay back the money; and the insinuation has been that they want to be able to pay their directors and their executives at compensation levels above the amounts that congress passed recently. Why do you think that some of these banks are so anxious to pay back those monies?

Mr. Barofsky. I have been reading the same articles as you have; and I think that is certainly one of the concerns, I think, for a lot of financial institutions, increased oversight. I think from what I read there is a fear that terms and conditions may change on them.

I don't want to presume to get inside the mind of the chief executives of these financial institutions, but I certainly think that executive compensation restrictions must weigh on their decision making.

Representative Sanchez. And, lastly, I have some people who have said that the next problem with respect to mortgages will come in the commercial mortgage industry and that one of the reasons the banks are holding onto these monies is that they want to be able to have the reserves in place for some of the losses that they expect in the commercial field. Do you have any comment on that?

Mr. Barofsky. Well, I think we have seen—and, again, our ultimate—or I should say our initial report on the use of funds survey that we had is going to come out now within the next 2 months. But I obviously have looked through about probably about 100 of the responses; and one of the things that we do see is that financial institutions are preserving the TARP money as a cushion for future losses. Whether it is commercial mortgage-backed security or the residential mortgage-backed security or just further deepening of the recession, that is something that we have seen.

Representative Sanchez. Thank you.

Thank you, Madam Chair.

Chair Maloney. The gentlelady's time has expired. Congress-
man Burgess for 5 minutes.

Representative Burgess. Thank you, Madam Chair; and thank you for being here today.

Madam Chair, I might ask unanimous consent that my opening statement be inserted into the record.

[The prepared statement of Representative Burgess appears in the Submissions for the Record on page 55.]

Representative Burgess. Now, the report that we have, almost 20 criminal investigations under way in connection with the TARP facility for the financial sector; and the report said these investigations involve possible public corruption, corporate stock and tax fraud, insider trading and mortgage fraud. To the extent that you can do so in front of the committee today, can you provide us more background information in some specific detail surrounding those criminal investigations and what we might expect to see going forward?

Mr. Barofsky. Well, as I noted before, one of them was Gordon Grigg, who was formally charged in an information in the Middle District of Tennessee yesterday on eight counts of mail fraud and wire fraud involving defrauding individual investors by lying and saying that he had connections with the TARP program, was selling TARP-backed securities. That is an example of one of the smaller investigations we have ongoing.

We have previously discussed that we have an ongoing inquiry into Bank of America and Merrill Lynch and the circumstances that surrounded its end-of-the-year bonus payments.

Although I can't comment on any detail of our other pending investigations, they do include the categories of cases that you have.

And just by way of an example of a type of potential investigation, in the securities fraud let's say a financial institution applied for TARP funds but was cooking its books. In other words, its financial statements were off. They were manipulated or its ratios were distorted, and they did so to get TARP money or to get more TARP money. That would be a very good example of the type of investigation that we are going to be conducting.

Representative Burgess. Let me—and as a consequence of your quarterly report to this committee, we will be informed of those investigations as they come to conclusions and the results of those?

Mr. Barofsky. Absolutely.

Representative Burgess. Let me ask you—and I hate it when people do this to me—but you gave an example, so can I walk through a hypothetical example with you of the public-private investment partnership that we are hearing so much about? And I think you stated in your testimony that part of the oversight function is making recommendations. So I will offer this as something you might consider for a recommendation.

You also made the point that collusion and money laundering, and it was important to know your customer. So perhaps we ought to choose our customers more wisely. And much of this debt we are passing off to our children and grandchildren, so actually not original with me.

American solutions, the American Enterprise Institute have suggested that perhaps we make a TARP fund for students, if you will. So that the FDIC providing the debt-to-equity funding at a ratio 6 to 1, Treasury providing 50 percent of the equity financing, and the investor is left with 7 percent of the initial cost.

An example has been given if two students near graduation have \$70,000 in loans to pay off that they sell their loans to each other. And each could then put down a down payment of \$10,000, which will be borne half by the student and half by the TARP funding, and the remaining \$60,000 will be guaranteed by the Federal Deposit Insurance Corporation. The result would be that they would have their student loans reduced significantly to a liability of \$5,000; and in the end they could walk away from the \$70,000 debt with that \$5,000, leaving the government, or the taxpayer, on the hook for covering it.

I will admit that is a novel approach. What would you think of such a scenario?

Mr. Barofsky. I think I may have a conflict of interest since I am still carrying law school debt, and I would like to participate in that program, so it might be unfair for me to comment on that.

Representative Burgess. And this is tongue in cheek, but this is what our constituents are telling us. This is what they are feeling. This program, it almost defies gravity the way it is being approached. You have people back home asking where is my bailout or where is my Treasury-backed security or where is my funding or where is my bailout on my student loan? It just underscores the enormity of the task that is in front of us and certainly in front of you.

I think we are very fortunate to have someone of your caliber who is on top of this and certainly am grateful for the time that you have given us this morning. I wish you every success in bringing these cases forward and bringing them to light and then successful prosecutions where those are necessary.

I thank you, Madam Chair. I yield back the balance of my time.

Chair Maloney. I thank the gentleman.

And in order of appearance to the committee the Chair now yields 5 minutes to Representative Snyder.

Representative Snyder. Thank you, Madam Chair.

Good morning. I wanted to ask, in terms of your approach, should there be a different approach in terms of some of the requirements you have talked about—I don't remember the details of some of your suggestions—between those institutions that clearly at the beginning of this 6, 8, 10 months ago were institutions in trouble versus those banks—90 percent or so of banks or other financial institutions that are not in trouble, that are still making a living, versus those that are clearly somewhat of a criminal enterprise, should your approach, should the approach of the Treasury Department be different as we approach those three different entities?

Mr. Barofsky. Well, I think it depends on the program. I think within any particular program all institutions should be treated fairly and equally. Obviously, anything that approaches a criminal enterprise should be treated very differently. We will seek to have those individuals responsible for that put in jail, which will be a much different approach. But I think that—

Representative Snyder. How about with regard to your requirement of how—the specific transparency with regard to the use of TARP funds? Should it be the same whether an institution has been in trouble, or it is one that we are actually encouraging to take money in order to improve the credit market?

Mr. Barofsky. Our recommendation is across the board on that. We think that any TARP recipient should be required to report on its use of funds.

Representative Snyder. I interrupted you. So, basically, it will take out the criminal enterprise there. In fact, those institutions that were not in trouble at the beginning of this program and still aren't, ones that we have been somewhat encouraged to take funds and participate because we want these funds to get out to the American public as part of the credit market, you are saying in another program they should be treated differently than those institutions that were in trouble.

Mr. Barofsky. I think that, with respect to use of funds, certainly any institution, regardless of its health, if they are taking 10, 15, 20, \$25 billion of taxpayer funds and getting the benefit of those funds, they should be required to let us know how they are using it.

I think as far as other conditions or more stringent conditions that are put on the terms of the funds, I think the Treasury has adopted different approaches for those financial institutions. The terms and conditions for Citi and Bank of America are more stringent than that on Goldman Sachs; and I think that that is reflec-

tive of the different types of investment, the higher risks of those investments.

Representative Snyder. You mentioned specific dollar amounts. Is your recommendation that beyond a certain level—you said \$10 billion, \$20 billion. I thought your recommendation was any level of TARP funds should be declared, the use of the funds should be declared. Am I wrong on that?

Mr. Barofsky. No, no. Absolutely, that is the case.

I was just using that as an example, that whether they are healthy or not healthy, because of the volume of money, and some of the banks that received the most have been most public about their intention to pay back the funds. That is why I was using those numbers. But I think in those cases it is all the more important. We believe that every financial institution—it should just be a basic condition of taking government assistance.

Representative Snyder. We use the phrase “bailout funds” a lot, and then you just used the phrase “government assistance”. I am trying to put myself in the position of the community bankers out there—we all have some of these in our district—that they are actually doing well. At least they are in Arkansas. They are trying to weather this thing reasonably well. They are not in trouble.

I think their view is that they thought they were—initially, early on—kind of helping things out. It was a chance for them to make some money. It was a chance for them to make some more loans, at the same time expand the credit market. And yet we kind of come back to them. I think they feel like they are being treated as something different than what they initially thought.

So—I don’t know—is it fair to call it assistance? They probably would look on it as a chance to try to help to get the American economy moving again.

I want to ask, you were dismissing, though, the fungibility argument. If I was somebody who was going to declare how I was going to use these funds and money is fungible, I would take that money in. And you have given some examples. I think you think most folks can say exactly how they use that money, but if I am a banker that has got 10 projects and I think if I bring in this sum of money that will enable me to do 8 or 9 of those projects versus 6 or 7, wouldn’t I just cherry-pick and pick the nicest looking one to declare that is how I am using my TARP funds? How do you get around that?

Mr. Barofsky. Well, to be clear, there is no question that money is fungible. We are not suggesting otherwise. I think when—we heard this in similar arguments when we were first announcing our survey. When we did our survey, we asked the banks not just the blanket question of how did you use the money. We asked them to make specific reference to issues like how do you plan to use the money. Our belief is that most financial institutions, responsible financial institutions, have budgets and plans; and when they are acquiring a large and significant amount of capital they make a plan.

So in your example you may say, okay, we have these nine projects on the shelf. We are going to do these six. And then there is going to be some internal planning—e-mails internal memoranda, formal budgets—that it is going to say, well, if we get this

money, we are going to also be able to do these other three that have been sitting on the shelf.

If they then, in fact, do those other three, notwithstanding the unarguable fungibility of money, you can track that use of funds because those are three projects that wouldn't have gotten done other than the infusion of government capital.

And I do agree with your comment before. Assistance is another word. It is one of the words that is used in the statute, which is probably why I use it, but for a lot of these it is just an investment from the government. So I don't in any way argue with your other characterization.

Representative Snyder. One final comment, please. Of eight or nine projects there and you are going to have them declare the one that you say this is the TARP funds. Now that we are an investor in that bank, the taxpayer investment, we want all six, eight, nine, ten of those projects to work well, do we not?

Mr. Barofsky. We certainly are hopeful that the banks perform well so they can repay the money.

Representative Snyder. Thank you.

Chair Maloney. Thank you.

Senator Casey for 5 minutes.

Senator Casey. Thank you very much, Madam Chair; and I want to thank you for inviting the Senators to come over to this side of the Capitol. We are grateful to be here. We don't get over here enough.

Sir, thank you for your service to the country and for your prior service as a prosecutor. I think it is important to reiterate the real cornerstone or foundation of your work in this capacity.

I was an elected state auditor, and in that capacity the foundation of the work that I was charged with doing—and I think it is very similar to what you are doing and what you have worked hard at doing—is that you have to be independent. No matter who the President is, no matter who is in Congress, no matter who is in the administration, you have to maintain that independence; and I appreciate and commend the work that you have done already. You need to have that kind of independence and objectivity as you pursue these difficult issues.

Our job here is not just to talk about or react to your reports. Our job is to make sure that you have all the resources that you need. Whether it is money or personnel, whatever it takes, we have to make sure that you have those resources.

So the first question I have is in terms of personnel. I know in the midst of a tough economy, people don't like to talk about hiring more people but I am a great believer that the human resources you have is commensurate with the result you get, especially as a prosecutor or an investor or an auditor. So the first question I have is, do you have the resources you need in terms of personnel, in terms of technology and other resources to do the job you have to do?

Mr. Barofsky. We currently have 37 people on staff. We are building to 150 is what our target is for us to be efficient, not too big, not too small, to be able to do this task that is assigned to us.

This Congress unanimously passed, both Houses, a bill that is going to give us some enhanced hiring flexibility. I look forward to

that hopefully being signed this week, and that is going to help us as we build towards that goal.

We have a pending request to OPM, the Office of Personnel Management at the White House, to give us some other flexibilities, some direct hire flexibilities; and I am confident if we get those flexibilities we are going to be able to build and get the right people to make sure that we can carry out this task.

As far as resources is concerned, the original bill provided us with \$50 million. We think that is certainly going to get us through this year and through a good chunk of next year. We are, obviously, since we are going to be around for more than 2 years—I think that is inevitable—we are going to need additional resources. I know that there is a pending amendment in the Senate on a bill that I think Senator Boxer is going to introduce this morning which would give us some additional funding which I think would certainly take us through fiscal year 2010; and when we run short we will be back and let you know for sure.

Senator Casey. Great. One last question. When I look at what was set forth in the Emergency Economic Stabilization Act—an act that I voted for, because I thought it was the right thing to do, but we have to make sure that act works—the underlying purpose, as set forth there, talks about protecting home values and college funds and retirement accounts and life savings. That is number one. Number two is preserving homeownership and promoting jobs. Number three, promoting overall returns to the taxpayers. Finally, provides public accountability.

We all understand from our States and districts across the country, when people call in, they are frustrated on two levels. First, they see layer upon layer of legislation and public initiative, and they don't see the results. They don't think that credit is flowing, and they don't see any significant positive effect on their lives. That is one area of frustration.

The other area is lack of accountability. I know that you talked at length before and I don't want to reiterate it, but I want to get your sense of why this is happening. When you said to Treasury that you thought there should be some—with regard to the 364 institutions—that there should be some accountability as to how they are spending the dollars, which you continue to reassert or reiterate that recommendation to Treasury, that they should require all TARP recipients to report on the use of the funds. Please tell us again and articulate for us, what argument does Treasury use pursuant to your recommendation or in response to your recommendation as to why they should not do that?

Mr. Barofsky. Although I am reluctant to speak for Treasury, what I have heard is arguments because of the fungibility of money, that it is impractical or impossible to require banks to report on the use of funds. It could be a waste of time or resources, and just a fundamental disagreement with why it would be important for us to do so.

Senator Casey. That makes no sense to me and I know it makes no sense to you. So I am glad you pursued this information on your own and got the information on your own initiative.

I am over my time. Thank you very much.

Chair Maloney. Thank you. Congressman Hinchey has yielded his time to Senator Klobuchar due to her time constraints. The Chair recognizes the good Senator for 5 minutes.

Senator Klobuchar. Thank you very much. Thank you, Congressman Hinchey. Who says that the House and Senate can't work together?

It is good to see you again, Mr. Barofsky. We had a hearing in front of the Judiciary and I thought that I learned everything that I needed to know about you. Now I know you still have student loans. I will tell you, when I met my husband, he had \$50,000 in student loans but I married him anyway. Hopefully you are doing fine.

I have to get back to the Senate on the Fraud Enforcement Recovery Act which I know you support. It is very important to add some funds to help you out. You talked to Senator Casey about your goal of reaching that 150 employees. When do you think you will reach that goal?

Mr. Barofsky. A lot of that depends on once we have all of our hiring authority and we get this direct hire authority from OPM. We are building to that. I would love to have it by the end of this year. That is our goal.

Senator Klobuchar. Because you and I discussed the kind of perfect storm that the Justice Department is facing, and you are facing. With more money going out there, it means more potential for fraud and corruption. We also have the issue of more white collar crime that is either starting up, or actually has been going on, as in the case of Bernie Madoff for years, that it is being discovered because of the tough economic times.

Along the line of Bernie Madoff, which I know we talked about in the Judiciary Committee, how that tip had come in and was disregarded from a whistle-blower. And I know that you and the Justice Department are very focused on doing a better job of handling these whistle-blower tips. I will give you a little pitch here, 877-SIG-2009; is that correct?

Mr. Barofsky. Thank you. That is correct.

Senator Klobuchar. I have read since the Judiciary Committee hearing, you have had hundreds of tips come in. The argument before was it is just too hard. There are too many tips; we can't figure them out. What triage process are you going through, and how is that working?

Mr. Barofsky. From day one—and I have to credit my chief of investigations—from the day I hired him, he was pushing the importance of a hotline. He always thought it was going to be one of the most important functions of his investigative division.

One of the things we did is we hired a very capable attorney from another IG's office, attorney investigator, and someone fairly senior. We put her in charge of the hotline. So we put one of our best people that we have, and we gave this important responsibility to her. And we are supplying her with the right support.

We are not a large office yet. We are not even close to our capacity, but we made sure that we have the necessary resources and support so that she can follow up and the people working under her can follow up on every single inquiry. We take everyone seriously.

As I noted before, a third of our current criminal investigations are resulting from that hotline.

Senator Klobuchar. Unbelievable.

Mr. Barofsky. It is a wonderful source.

I also think for victims as well as whistle-blowers, as sort of another benefit, it gives people an opportunity to vent sometimes.

Senator Klobuchar. I wouldn't advertise it that way. We know what it is like when people call to vent. It is a way for people to talk to you and get their ideas known.

Mr. Barofsky. Sometimes we get good ideas. For example, the hotline number was my office number. I would just pick it up.

Senator Klobuchar. I like that hands-on approach.

Mr. Barofsky. But one of the calls that I received was from a gentleman who was very upset who lived up in Massachusetts. It was the time Citi had announced that they were going to be paying \$50 million for a new plane. One of the things he said was, I am so tired, how come these banks are saying that they can't account for how they are using the money, but they can say with 100 percent certainty that \$50 million did not come from TARP funds?

It is a good argument. It helped inspire us to move towards our use of funds survey.

Senator Klobuchar. To end with that, the use of the funds, and you talked about how it is on the Web site now and people can trace it. And for people who don't have the time to go on, what is your Web site?

Mr. Barofsky. www.SIGTARP.gov.

Senator Klobuchar. That is for the tips.

And then www.financialstability.gov.

Mr. Barofsky. That is not ours. That is Treasury's Web site.

Senator Klobuchar. So for people who don't have the time to wade through all of that, what is your summary of where this money is being spent, so the American people know it is not all of these bonuses and the scandals. Where is the money being spent?

Mr. Barofsky. It is a little early for us to be able to report on our survey results. We expect to have something out there in hopefully early to middle June, which will give that information.

The Treasury Web site, as you noted, does track what the banks are reporting on their lending activities, as their lending goes up and down, sort of the impact of the TARP funds.

And, of course, if anyone wants to learn more about our problems, going to our Web site and pulling down the reports page brings up a copy of our reports. One of the things we try to do with these reports, the taxpayers, who are the investors in all these programs, we try to write them in Main Street terms so they can understand and see what is going on with their money.

Senator Klobuchar. Will it show a specific project that the money is being lent to and things like that?

Mr. Barofsky. Not on our Web site, no.

Senator Klobuchar. Where will they be able to find that out? Is that on the Treasury Web site? Or does it just show that it is going to lending?

Mr. Barofsky. The only monitoring that Treasury is doing is requiring them to report on what their lending levels are at certain categories and whether they go up or down from month to month.

But it doesn't have anything to do with tracking the use of TARP funds.

Senator Klobuchar. But it shows lending versus, say, bonuses?

Mr. Barofsky. It just says lending.

Senator Klobuchar. Thank you.

Chair Maloney. Congressman Hinchey is recognized for 5 minutes.

Representative Hinchey. Thank you, Madam Chairman, for doing this hearing.

Mr. Barofsky, I want to express to you my deep appreciation. I think it was a very wise move to bring you into this area of responsibility. I think you are doing a very good job, and I think all of us who focus on this really appreciate what you are doing.

At the same time that we appreciate what you are doing, we recognize the complexity of the job that you have and how complex and how difficult it can be, particularly when you are not getting the cooperation of people that you really have to work with in order to come up with the recommendations and the facts that you have the responsibility to deliver.

Your use of the word "fraud" in the context of your presentation this morning I think was very, very appropriate. Fraud is just so relevant in this particular set of circumstances from the very beginning. The situation we are dealing with is fraudulent investments that were put together by a number of operations, like AIG, for example, and a whole host of others. There were fraudulent investments that drew money out of the people who invested so they could make money for themselves. They knew what they were doing, and they did it purposely and intentionally. There is no question about it.

So what you are doing now to look into this situation with regard to the TARP funding—which was a bailout bill for some of the institutions that were engaged in that fraudulent practice from the beginning, and which was presented to us by former Secretary of the Treasury Paulson in a way that was guaranteed not to give any real analysis of the situation, any real facts—and, unfortunately, it was ultimately passed by this Congress without those kinds of contexts as well.

Subsequently, the House of Representatives passed legislation which would require the Treasury Department to get these kinds of facts and put the information out there. But, unfortunately, that bill was not passed by the Senate. I think that is just another example of the very effective political influence that is going on by a lot of these banking institutions and others, and also the political influence that is going on by people involved in the political process here in our government.

So what you are doing is very, very critical and important. The problem is how are we going to deal with it more effectively? What are we supposed to be doing? What can we do to help you? What can we do to strengthen your ability to get the facts that you want to get and which we need so badly?

Mr. Barofsky. I think right now, particularly with the recent Special Inspector General Act of 2009, it really gives us a lot of arrows in our quiver. I think we have the necessary tools to do our job. Ultimately, of course, our recommendations are just that; they

are recommendations, and Treasury is not compelled to adopt them.

Representative Hinchey. But that is the problem, isn't it? You are making recommendations. The recommendations that you are making are solid, secure, and very, very positive. They should be followed through. But the problem that we are seeing is that these recommendations are not being adhered to.

Mr. Barofsky. In some circumstances, that is true. Some are being followed, which is the good news. But ultimately, recommendations are just that—recommendations.

I mean, I think in the new act there is a requirement that the Secretary certify to Congress where he fails to adopt a recommendation that addresses a deficiency. To that extent once that act becomes law, there will be some very direct accountability for those circumstances.

Representative Hinchey. That is right, if that does become law. That is what has to happen. But in the meantime, we are struggling to get this situation to be dealt with in a more effective way, and there is obvious opposition to that.

Can you tell us at this point, what are the positive aspects that you have seen? What are the things that you have seen that give you some hope that this is going to develop in a more positive way?

Mr. Barofsky. First of all, I would say that one of the things that we are seeing from our initial returns of the use of funds survey is that this injection of capital for a lot of banks, particularly the smaller community banks, at least as they are reporting to us, did go out to increase lending. They were able to leverage the money and use it to increase lending, especially the smaller community bank levels.

I think a lot of these programs, although we have some very large concern about the potential for fraud in them, a lot of these potentials can be addressed. And if Treasury does adopt these recommendations, these could very well be very good and viable and positive programs.

On some of these issues, Treasury has been very receptive to our recommendations. They have not been implemented yet, but early indications are strong. I think there is hope. I certainly don't want to sound an alarm that all is lost. I think there is opportunity here to protect the taxpayer with these programs.

Representative Hinchey. We are going to have to be directly involved with you to make sure that the positive circumstances that you are talking about actually come into play, actually become facts. I thank you very much.

Mr. Barofsky. Thank you.

Chair Maloney. Congressman Cummings for 5 minutes.

Representative Cummings. Thank you, Madam Chairlady.

I want to thank you, Mr. Barofsky, for your very quick response to my letter, along with 20 or so other Members of Congress, about the counterparties. I really appreciate you jumping on that so quickly.

I just want to ask you what, if any, requirements has Treasury imposed upon the TARP recipients with regard to their need to increase lending to perform other acts in the public interest?

Mr. Barofsky. None. The requirements in the capital purchase program—I assume that you are talking about the capital purchase program.

Representative Cummings. That is right.

Mr. Barofsky. There is no such requirement. The only requirements or restrictions on the use of funds have to do with what will be the statutorily enforced restrictions on executive compensation, as well as some redistributions on dividends and buying back of shares.

Representative Cummings. Does that make your job more difficult?

Mr. Barofsky. What makes my job more difficult is the failure to adopt the recommendations to have the financial institutions report on their use of funds. As additional conditions are imposed, it is obviously a lot easier to see how money is not being used if you are also requiring the institutions under the pain of a certification for which it would be a crime to lie on the report to us how they are using the funds. That would obviously make oversight easier.

Representative Cummings. One of the problems that we face in this bailout is establishing metrics to measure the success of the various programs. I would like to ask about President Obama's Making Homes Affordable program. How much assistance has flowed to homeowners and servicers to facilitate mortgage modifications?

Mr. Barofsky. It is just getting underway: \$50 billion of TARP funds has been set aside; an additional \$25 billion from HERA has been set aside. I think they have signed contracts now with servicers that would be up to about \$13 billion. Money has not flown out yet under the mortgage modification program, but steps are in place.

I should say, if I can go back to my other answer, our requirements in the Citi and Bank of America agreements is that they do implement mortgage modification plans. So that is an example outside of the capital purchase program where Treasury is compelling those institutions to do something for public good.

Representative Cummings. I don't know if you are the appropriate person to ask this question of. How soon do you see that happening? One of the things that is happening in my district, we have a person who actually deals with foreclosures. That is all she does, trying to prevent foreclosures. It seems like the President's plan is out there, but the mortgage companies haven't caught up with it. Do you follow what I am saying? So in the meantime, people are falling through the floor. That is, they are being foreclosed upon. Do you have any idea of when you see that being in full operation?

Mr. Barofsky. It should be going on now. Part of the mortgage modification plan under this agreement with the servicers is that before Federal money starts flowing in, they need to put the struggling homeowner on a 90-day trial period. During that trial period, the servicer is supposed to not foreclose on the property. During that trial period, the individual homeowner should be making payments only at the level of what the reduced mortgage would be once it is modified. So that type of relief should be happening now.

One of the things that we are doing as part of our investigations is to make sure that that is what is happening; that the servicers are abiding by their rules, that they are not foreclosing. And we are working, obviously, with Treasury and their agents to make sure that happens.

Representative Cummings. So if I have folks dealing with my constituents who are not doing what you just said, how should I address that? Send that information to you?

Mr. Barofsky. Yes. The first thing they should do is contact their servicers. If they qualify, the servicers should be putting them into the modification plan. If they don't qualify, they should be directed to other forms of Federal assistance. If they are inside of a servicer, a program servicer agrees to modify the mortgage pursuant to President Obama's plan and they are still getting foreclosed upon or they are being charged a fee in a no-fee program, then they are the victims of fraud and they should contact our office.

Representative Cummings. Finally, some have argued that even though the mortgage modifications may reduce interest rates for homeowners, the outstanding principal remains unchanged and homeowners tend to remain underwater. Without a change in refinancing criteria, the interest rate reductions may only be forestalling rather than preventing default. Do you think a change in the refinancing criteria is required?

Mr. Barofsky. That is sort of a policy-level opinion. I would be reluctant to offer an opinion without doing a more comprehensive study.

Representative Cummings. Thank you, Madam Chair.

Chair Maloney. Thank you for your insightful questions.

Mr. Barofsky, there have been suggestions that a significant number of CDOs were grounded in fraud or misrepresentations by the entities that were the sponsors of these transactions. As a consequence, the investors in the CDOs and in related credit default swaps have suffered substantial losses. Now taxpayer money is being used in essence to bail out the originators, investors, and counterparties to these transactions.

What programs are being considered by your Department to recover taxpayer dollars from those persons and entities that engaged in fraud, misrepresentation, or other wrongdoing which induced investors and others to participate in fraudulent transactions for which the taxpayers are now footing the bill?

Mr. Barofsky. We are going to be working closely with the Department of Justice. They of course have their civil enforcement as well as asset forfeiture abilities using the court system. We are forging a close relationship with the Department of Justice here in Washington, D.C., as well as in individual U.S. attorney's offices.

When we find the type of contact that you are describing, we are going to work with the Department of Justice as our partner to try to reclaim that money.

Chair Maloney. Have you found any of these cases? Have you initiated any cases such as this now in your Department as described?

Mr. Barofsky. I don't want to comment on that too detailed because I am reluctant to discuss too much of the details of pending investigations.

Chair Maloney. I think one of the problems is that there is a statute of limitations running. By the time you get around to it, the statute of limitations may have expired. Your comment on that?

Mr. Barofsky. Our focus is going to be on reclaiming taxpayer funds on these transactions. On those we have 5 years from the date of investment at least. If there is any ongoing fraud that is occurring, that would extend that statute of limitations. So from a TARP perspective and recovering taxpayer funds, we do have some time to put these investigations together and to get the Department of Justice on board.

Chair Maloney. I would like to share with you that we have come forward with legislation that would require the tracking of where the TARP moneys are going, giving you and government, the public, and others more information so that we can make better policy decisions in the future. I would like to give this legislation to you for your consideration and response back to the committee, if you have any further programs or ideas of how we could better track this money so we could have better policies going forward.

Mr. Barofsky. I look forward to receiving it.

Chair Maloney. My time has expired, and I will call on Mr. Brady.

Representative Brady. Thank you, Madam Chairman.

On page 148 of the report you focus on the potential for collusion within the Public-Private Investment Program. The scenario you lay out is two banks, both of which have a toxic loan of \$100 million value in the marketplace, much less \$60 million. So basically they buy each other's toxic loan at a higher price net, put up a small amount of money, and Treasury matches that in equity. FDIC gives them a loan for \$60 million, or really the value of itself. In that case, both banks book a profit on the sales and they have now transferred 92 percent of the risk to the taxpayer. Yet the toxic loans still stay within the system, which is great if you are at the bank or a shareholder, bad if you are the taxpayer who eventually ends up with the cost.

What changes should be made in this bad loan program to prevent this type of thing? In your scenario you talk about kickbacks and more complicated collusion, and I am just using the simple example you used in your report. What changes need to be made to prevent things like that from occurring?

Mr. Barofsky. The list is probably a lot longer than I will go through. Transparency, I keep coming back to that. It is vital for us to be able to mine the data for these institutions, to be able to keep track and look not just at the transactions that apply to that particular transaction, but to look at other transactions and similar transactions to see what is going on.

Our ability to seek through some of these, look through some of the corporate shells to know who the players are so we can run through them through databases and see if there are bad players out there, players who have had prior regulatory problems. Try to identify the bad players, that is very important.

Making sure that the funds are under strict KYC, and giving Treasury the ability to look through and run its own tests.

Those are just some of the examples of where we can help deter as well as detect. And that is really an important part of it. If you

increase transparency, not only does it make it easier to detect, but if the players know bright sunlight is shining down on them, it is a lot harder to do this type of collusion.

And of course we are going to keep pushing our hotline. Insiders who know about this, who can tip us off, will also help us being able to detect those committing frauds.

Representative Brady. Having now dug into the use of these dollars, the complex programs that have been morphed and welded together, and then your background prosecuting with credit-debit swaps and complicated financial instruments, given the complexities, and how deep and wide this financial crisis was interwoven, do you think lawmakers up here really understand all of the intricate issues that created the point of our financial collapse?—I know that Mr. Burgess has introduced sort of a 9/11 Commission on the financial crisis so that we can sort of move away from the narrative and the spin and really go through and identify all of the complex decisions and financial models and everything that led to a global financial collapse.

From your background, do you think it would be helpful to have that type of detail as we move forward on trying to prevent, as you are trying to from the bailout funds, to prevent this in the future?

Mr. Barofsky. I think it is vital for us to understand how we got here. It is absolutely vital; otherwise we will repeat our prior mistakes. It is inevitable.

One of the things that we try to do in the reports, as I mentioned before, is to at least unlock the riddle of what is currently happening with these 12 different programs and try to explain them in ways that the Members of Congress as well as the American public and the media can really understand what is going on now.

But I think looking back and seeing how we got there, it would be vitally important for policymakers and lawmakers and the administration to get a good, comprehensive understanding of why we are here.

Representative Brady. I do, too. I think it is important that we move away from the spin zone and get into the intricacies, and I think it would provide an independent view of how we go here and independent recommendations on how we stop it from occurring again.

Thank you for the work that you are doing. Please let this committee and lawmakers know what other resources you need and how we can help. I think you are on the right track.

Chair Maloney. Thank you. Mr. Hinchey.

Representative Hinchey. There is a very interesting story in the Wall Street Journal today about how Bank of America bought Merrill Lynch and how that purchase of Merrill Lynch triggered the situation where they needed a big bailout and they needed substantial amounts of money from TARP.

In the context of the examination of that situation recently, it was revealed that Secretary Paulson and Ben Bernanke, the head of the Federal Reserve, had pressured the Bank of America not to reveal what they were doing with regard to the purchase of Merrill Lynch, why they were doing it and how they were doing it. Didn't they realize that was going to cause them some problems and get them into a situation where they needed a TARP bailout? But they

were told not to say anything, as I have just said, by those two very powerful individuals.

Have you looked into this situation yet? Have you had an opportunity to look into it yet? And if so, can you tell us what you believe the circumstances are?

Mr. Barofsky. Yes, we are looking into that situation. The article that you are talking about was testimony taken up in New York of Chairman Ken Lewis. I was actually there during that testimony. We have our own investigation as well as an audit into these circumstances.

I would say we are going to be putting out an audit product that details all of the circumstances. But I would caution anyone from leaping to too many conclusions about what Secretary Paulson or Chairman Bernanke said until we have looked at all of the facts and reported on them.

I think that the conclusion that one may draw that it is black and white, that there was an order from the United States Government not to disclose this information, I don't think it is as crystal clear as may be suggested in that article. But that is something we are going to do. We are going to present all of the sides of those conversations in our audit report. It is a part of an ongoing investigation that we have. We are aware of the circumstances and the situation that you described.

Representative Hinchey. I am happy that you are looking into this, and I hope that you are going to do it in a very effective and thorough way. I know there are going to be some restrictions on you and some lack of cooperation with you with regard to this particular set of circumstances, as there are in the whole array of circumstances, a lack of providing the information that you need. Is that going to be a problem for you as this moves forward?

Mr. Barofsky. I don't think so. We have not encountered any restrictions. I know that there are certain things that it is reported in that article that the State attorney general accessed, certain things that he couldn't get. We can get access to that because of our situation as the Federal oversight body overseeing the bailout.

And to date, everyone has been very cooperative in providing us information and giving us access to necessary interviews. I assume that is going to continue. As required by statute, I will certainly let Congress know if there is any resistance or push back.

Representative Hinchey. I hope you are right. We look forward to the results of your investigation. We know from the basis of our own experience here with regard to hearings that we have had with the Treasury Department and with the Federal Reserve, how they have been reluctant to be candid about the economic circumstances that we were facing back in 2008 in the context of a recession which began, clearly, as early as December of 2007. Nevertheless, they continued over and over to say that there were no economic problems that we were facing, there was nothing big to worry about. And all of that continued until all of a sudden the TARP bill showed up here in the Congress with Secretary Paulson saying this was something absolutely essential that needed to be passed.

There was no preliminary, actual honest analysis of the economic circumstances that we were facing then. I can't help but see that

some of this is still continuing. We are still not getting all of the truth about this situation. We are not getting a clear analysis of it. As a result of that, this Congress has not been as effective as it should be in moving forward and dealing with the legislation that is needed to move us forward on behalf of the people of this country so that their money is not being wasted the way that as it has been. Hundreds of billions of dollars wasted in the context of this set of circumstances. And even now, as you were saying, as much as \$3 trillion, money that has come of the Federal Deposit Insurance Corporation, the Federal Reserve, and a whole host of other places, much of that is still on the back of the taxpayers of America.

All of this information needs to come forward. So if there is something that you can say about that now and what you think is going to happen soon, it would be appreciated.

Mr. Barofsky. We are going to continue, through our audit function and our investigative function, to push and push for more and more transparency. Our audit reports will be available to every Member of Congress and eventually to every taxpayer. We will push for that transparency to bring forward those answers.

Representative Hinchey. Thank you.

Chair Maloney. Congressman Burgess for 5 minutes.

Representative Burgess. And that transparency, the Federal Reserve, the FDIC, to some degree Treasury, when you stop and think how much money—it probably equals all of the discretionary money that we will appropriate this year—that those appointed individuals have under their control, it is absolutely critical that that transparency and that accountability and that oversight be there. Because I think Mr. Hinchey is correct; the credibility of the United States Government has suffered as a consequence of mis-handling of this situation. There is plenty of blame to go around for all branches of the government and both parties, certainly.

In your report, you point out that many aspects of the public-private investment partnership could make it inherently vulnerable to fraud, waste and abuse, and you identified three major areas.

Let me ask you specifically on the conflict of interest, first on the conflict of interest, do we need to be a little concerned, moderately concerned, greatly concerned on the conflict-of-interest issue?

Mr. Barofsky. If unaddressed, extremely concerned. Too much power is being granted to these private players, and if the right protections are not in place, we basically would be asking I think potentially for catastrophic taxpayer loss without the right protections.

Representative Burgess. On the issue of collusion, government leverage presenting a great incentive for collusion, can you explain how that can expose taxpayers to further loss?

Mr. Barofsky. As a simple example, buyer and seller agree on a price that is above the price that it should be. The price should be 50. They agree to pay 80; the buyer agrees to give 80. Therefore, a criminal profit of 30. The reason they can do that is because the buyer is only on the hook, because of leverage, 7 percent of that initial investment.

So if the spread on the price fix is greater than the exposure because of the tremendous amount of government leverage, it is a

simple economic mathematical calculation. Both sides can make a lot more money. The only downside is, of course, detection and prosecution.

Representative Burgess. On the money laundering, the fact that both the public/private invested partnerships and the term asset-backed securities loan facility present an opportunity for money laundering, organized crime, narcotics, and large-scale fraud operations, do you think that we are doing enough to forestall those activities, the activities of the money laundering?

Mr. Barofsky. Not yet; but I am hopeful as these programs are rolled out they will be.

I think the Federal Reserve has a pretty good anti-money laundering program on the TALF as it currently exists. For these other programs which will be run by Treasury and the FDIC, we are going to have to see. They are still in their formation stages.

My prior background being a prosecutor of narcotics traffickers, my chief of staff who is here, headed up the Southern District's international narcotics trafficking unit and did massive money laundering cases. We are pretty familiar with the complexities and the ways that drug trafficking organizations launder their funds. There needs to be very, very tight restrictions, and we are going to push for them.

Representative Burgess. And you are making recommendations to Treasury to protect the taxpayers' interests?

Mr. Barofsky. Absolutely.

Representative Burgess. Have any been adopted by Treasury?

Mr. Barofsky. They are still in the formation stages. They have indicated early that they have registered our concerns and they are taking them seriously. But they have not formally adopted these restrictions yet.

They have required certain know-your-customer standards be applied in the legacy securities program, and that is certainly a very, very good first step.

Representative Burgess. Is there anything that we can do to help?

Mr. Barofsky. I think conducting hearings like this, making sure that the Members of Congress and members of the public know what is going on with their money is a tremendous help. If there is anything specific, I will be sure to let you know.

Representative Burgess. We look forward to that.

Your report documents a potential increase in leverage from the interaction of the public-private investment partnership and the term asset-backed security loans facility. You note the unfairness and the additional risk imposed to the taxpayer. Can you also explain how this can magnify the dangerous incentives already in place?

Mr. Barofsky. This really concerns us. When this was rolled out, it was not part of the initial announcement. It was in one of the term sheets. When I saw it, it raised my concern.

One of the basic things that was explained to us, because we made a series of recommendations with respect to the TALF back in February, and one of the things that the Federal Reserve kept impressing on us, the Federal Reserve and the Treasury, is that based on the complicated economic models that the Federal Re-

serve conducts, is that this haircut, this skin in the game, the amount of money that the private investor is responsible for putting up personally before getting these nonrecourse loans was crucial from credit loss as well as a fraud risk.

When you have these programs interact, particularly what you have in the PPIF program, Treasury lending money to the fund manager and then taking that already leveraged lent money and bringing it to the TALF window, you are diluting that interest, that skin in the game, by at least 50 percent, thereby undercutting one of the fundamental protections to the taxpayer. That caused us grave concern.

As you also noted, that leverage on leverage. So that fund manager has that tremendous ability and power to set the price. When you are pricing up a security which, in an illiquid market, you are magnifying that ability by two, three, four, or five times; thus, increasing the dangers, making it all the more important that we have the right fraud protection measures in the original program as well.

So that is why we recommend not to do it, particularly if there is Treasury leverage, that there shouldn't be this interaction between the two programs unless they come up with a way to almost significantly redo and recalculate the way that they do the TALF.

Representative Burgess. I hope they are listening to you. I yield back.

Chair Maloney. Congressman Cummings for 5 minutes.

Representative Cummings. Thank you, Madam Chairlady.

You said something that struck my interest, and I hope it doesn't go by our committee. You said that one of your greatest concerns is the conflict-of-interest issue; is that right?

Mr. Barofsky. It is a very grave concern of ours.

Representative Cummings. Why is that, Mr. Barofsky? What do you mean by that?

Let me tell you where I am going with this. A lot of my constituents when they see who the players are, they feel as if everybody came off Wall Street. And as they say to me in the grocery store, these folks may be playing golf together, social events and those kinds of things. And what is to say that things are not being done which are not necessarily—and I am not accusing anybody of anything, I am just telling you what my constituents feel—in the public interest. That is one type of conflict.

I think it is very important if the President and the leadership, this Congress, is going to turn this economic situation around that the public has a certain level of confidence that everybody is playing fairly. You just gave some scenarios that should concern all of us.

I am just wondering with regard to conflict, what kind of recommendations have you made? And when we spoke to Mr. Devaney, by the way, with regard to the stimulus package, who is the watchdog trying to help folks, he said one of his basic concerns was that he prevent people from doing stuff wrong. I am wondering, is there any of that here? Are you following me?

Mr. Barofsky. Sure. So much of our recommendations are geared towards deterrence. The bottom line is that with \$3 trillion, we could have a staff of thousands, and if the right protections are

not in place beforehand, we will never catch up. That is why we pushed so hard with these recommendations, our law enforcement, and our task force to deter fraud from occurring beforehand.

That is where transparency becomes so important, as I noted before. It is hard to execute a conflict of interest if you know everyone is looking very carefully at what you are doing. But conflict of interest really, in the terms I am using, is anytime someone puts their own private interest above that and to the detriment of the taxpayer. In these programs there is a real danger of that.

I think what you are referring to are the relationships between Wall Street and those who may be making policy decisions. The importance is for the policymakers to have a sense of detached skepticism of Wall Street. That is what we bring. It is not that we think that all of Wall Street is geared and going to do things wrong, but we have to recognize where the economic incentives are and at times have to assume the worst in order to build the right protections.

Representative Cummings. One of the arguments we heard on Tuesday from Dr. Simon Johnson and Dr. Joseph Stiglitz was that corporate separation of ownership and control have produced perverse incentives for the officers and directors of these financial firms such that the interests of the officers were not necessarily aligned with the interests of the shareholders.

Do you agree with this assessment and, if so, how can taxpayers' ownership rights be exercised, especially in light of the recent discussion of a potential plan to convert preferred stock to common equity shares? Do you have any concerns there?

Say, for example, with AIG, we own 79 percent, and decisions are being made every day of something that we own. I guess you end up investigating us. But the question is, do we have sufficient control there to actually carry out the wishes of the public? The things that are in the best interests of the public?

Mr. Barofsky. I think of the benefits of the audits of AIG, the one that obviously we have initiated at your request, as well as the audit of the executive compensation issues at AIG, will bring attention to this issue. Right now, AIG—basically the Federal interest is being run by a number of trustees who have been assigned to look out for the government's interest.

Under the conversion that you are describing, under the capital assistance program, again the concept is there is going to be a private trust that is independently going to manage the government's voting interests. So, in a way, separating the voting and control from the actual policymakers, and the goal there is to separate from political influences decisions to run the corporations.

One of the things that we are going to see in the AIG audit is how much of that is actually happening. What is the impact and influence on a day-to-day basis of the Federal Reserve and of the Treasury in decision-making?

But these are very complex and very real concerns, and we are hoping that this audit will help shed some light on it.

Representative Cummings. Thank you very much.

Chair Maloney. Thank you.

I would like to go back to your comments, Mr. Barofsky, on the use of TALF to buy toxic assets with taxpayer funds, to better understand it.

The SIGTARP expresses in your report serious concerns that Treasury's proposed expansion of TALF to allow the use of legacy residential mortgaged-backed securities as collateral poses a significant risk of fraud. And to mitigate these, the report recommends that Treasury require individual review of the securities involved and reject those that do not meet sound underwriting standards. Has Treasury agreed to do that, to do an individual review?

Mr. Barofsky. They have to a certain extent. Always when dealing with Treasury and our interactions with them, until something is formally announced, we are going to keep pushing and pushing. They have indicated in their response to our recommendations, basically the way it works before we put these recommendations in the report, we share them with Treasury and give them an opportunity to respond.

In response to this particular recommendation, they did note that they are going to be considering, in their language, CUSIP by CUSIP, and that is the individual number that is assigned to each type of bond review, and that they are going to consider individual underwriting standards. We think this is vitally important.

Under the original version of the TALF, there is a reliance on credit rating agencies. And with these toxic—particularly these residential mortgaged-backed securities, those are useless. They shouldn't be paid any attention. We need to protect the taxpayer, to look behind those ratings at the actual loans that backed these securities in order to protect the taxpayer.

Chair Maloney. And the so-called liar loans, you also recommended that Treasury impose significant higher haircuts on all MBSs, and especially the legacy RMBs. Are they going to do that? Have they indicated their reaction to that?

Mr. Barofsky. They are going to impose higher haircuts for those. We will have to see what the percentage is. Just to be clear, on the liar loans, our recommendation for that is we don't touch them, that they be thrown out of the program. We can't have any degree of certainty that these loans with virtually no underwriting, the very worst of what got us into the current crisis, and there can really be no taxpayer protection.

Chair Maloney. In your first report, you recommended against the expansion of TALF to this category, correct?

Mr. Barofsky. Yes.

Chair Maloney. And obviously Treasury has not responded or reacted to that.

Can you explain your reasoning and comments? Why does Treasury believe that it should be expanded to TALF? Have you had any conversations? Can you shed some light on that reasoning?

Mr. Barofsky. Our recommendation was that it not be expanded unless it significantly reworked the program. And the type of recommendations that we are making are a significant reworking of the program. So if these recommendations are adopted, we think that the taxpayer can be protected.

Chair Maloney. Can you elaborate just to clarify for our colleagues and the public, TALF was not designated for this purpose. Is this going to weaken the ability of TALF to fulfill the purpose that it was put in place for? If this program needs more subsidy, maybe it is better to give the subsidy instead of endangering another program? Can you elaborate on that.

Mr. Barofsky. TALF, as originally envisioned, was a \$200 billion facility to deal with certain classes of asset-backed securities, including student loans. That hasn't changed. That \$200 billion as far as we have been informed by the Federal Reserve and Treasury, this is in addition to. So it is not pushing out the original intent of TALF. It is adding to it.

Chair Maloney. Will it hinder its ability to meet its original purpose?

Mr. Barofsky. It shouldn't. As described, if that money is still in place, it should exist alongside the expansion of the program.

Chair Maloney. Do you believe the measures that you have suggested to mitigate the risk will make this expansion an effective and sound use of taxpayer money? Or do you think the risk is too high and the benefit does not correspond to the risk?

Mr. Barofsky. Whenever we make our recommendations, we recognize the reality. The only way to ensure there is no fraud in a government program is to not have a government program. We deal with the hand that we are dealt. We try to make our recommendations to protect these programs from fraud, waste and abuse to the greatest degree we can, given what the programs are.

It would be a very rare circumstance where we would come out and say, "You cannot do this program, it is too vulnerable to fraud." I think with the right protections, we can be okay.

Chair Maloney. Thank you, and I yield 5 minutes to Mr. Burgess.

Representative Burgess. Thank you. I appreciate the recognition. Let me ask you a question, Mr. Barofsky. The Secretary of the Treasury, Henry Paulson, and Federal Reserve Chairman Ben Bernanke pressed some major banks to accept the TARP funds in October, 2008, even though these large banks, neither wanted the TARP funds. Now some of the banks, notably Goldman Sachs and J.P. Morgan Chase, want to return the funds immediately, but the administration has talked about imposing a national interest test to block well-capitalized banks from returning TARP funds. In a fiscal year where Federal deficits will exceed \$1.8 trillion or 13 percent of the GDP, does blocking well-capitalized banks from repaying the taxpayer serve the public interest?

Mr. Barofsky. That is a policy based question that is better asked to the Secretary of Treasury.

I will note that in the stimulus act, which changed the rules regarding the ability of banks to repay or redeem their preferred shares, it is in consultation with the regulators. Ultimately, it is the regulators' decision as to whether to approve or not approve, or at least it should be the regulators' decision to approve or not approve the repayment of funds.

But your more fundamental question is one that I am not really qualified to answer.

Representative Burgess. I appreciate that, and I appreciate your honesty.

Just intellectually, it seems as if the banks no longer need the money, it would make sense to give it back or it would make sense to allow them to do so. Can you speculate as to what would be the moral hazard for not allowing them to repay the money that they felt they no longer needed or didn't need in the first place?

Mr. Barofsky. I think a lot of this gets—to use a phrase that was used earlier during this hearing—a lot of spin. From our perspective, we don't like to get into speculation and addressing the motives without a full-fledged audit. We are doing an audit. Part of our audit into Bank of America includes looking at that fateful day in October when the nine financial institutions were called to the Treasury and, as you say, that they were basically told that they were going to be accepting these infusions of capital. We will be able to provide more detail through that audit.

Representative Burgess. Very well. Can we talk AIG for just a minute?

Mr. Barofsky. Sure.

Representative Burgess. What can you share with us about your findings so far through the audit as you have been through it concerning potential overpayments made by AIG to its counterparties?

Mr. Barofsky. Generally, I can share with you very little. One of the tenets of an ongoing audit is that we, as a matter of policy, we don't share information until the audit is complete.

There are a number of reasons for this. One of the most significant is we want to encourage an atmosphere of free flowing of information with AIG and with the Federal Reserve and with Treasury. If we start disclosing information as we go, it can impact the actual audit itself. It is a long-standing audit principle.

The one exception I have drawn on that is in the use of funds, where we will be doing preliminary results even before our audit is concluded. I have given some anecdotal answers because it is such a vital and important issue to get that information out because of its impact on our other recommendations. But I have to ask for your indulgence to allow us to finish that audit before we start giving results and observations.

Representative Burgess. When can we expect to see the completed results?

Mr. Barofsky. My current plan is that all of audits, our six pending audits, will be completed by the summer. I am hoping that it will be earlier in the summer than later. But that is our goal for each of the audits, including the two AIG audits.

Representative Burgess. So late June or early July when we have this quarterly visit again?

Mr. Barofsky. I would say within the next 3 months. I am hopeful to have some of these audits completed, if not all of them.

Representative Burgess. Very well.

On the issue that the Senator from Minnesota brought up about having the hotline and how critical that was. Last fall, when we did not have any sort of infrastructure at all and we would get those venting calls—I mean a lot of venting calls, thousands of venting calls—it would have been great to have a 1-800-go-ask-

Neil number to triage those. With your permission, I may link to your Web site or put your number up on our Web site as well, because I think you bring up a point that is so critical.

A lot of that information is out there, and I was astounded by the amount of information that came to me last October. And not feeling I was the correct one for that information or qualified to act on it, it was sometimes difficult for me to find where that information should go. So I am very grateful that you are on the job and doing what you are doing. Thank you.

I yield back the balance of my time.

Chair Maloney. Mr. Hinchey is recognized for 5 minutes.

Representative Hinchey. I once again want to express my appreciation to you. What you are doing is critically important for the economic circumstances that this country is confronting. We are very grateful for the competent way in which you are doing this.

One of the things that you have done is to highlight the lack of financial disclosure, the lack of information coming out of this whole financial situation. As I was reading your SIGTARP report that came out just recently, one of the things that you talked about was the fact that you had checked in with I think it was 364 recipients of the TARP funding and that you had contact with them and you were asking questions and trying to get information from them. And you were pressing for the facts: How much money did you get? What did you do with it? What were the effects of what you were doing?

I mean, this is public money, money owned by the people of this country. And so that should be known. What you were doing obviously is so important and you were doing it in such a significant way.

But the Treasury comes back and says, no, it is not going to be possible. We can't do that. That information cannot be delivered.

But then, in the context of those 364 operations that you looked into, you made a very interesting statement which is that some banks were able to provide detailed, at times even granular descriptions of how they used taxpayer money.

So if some banks can do it, why can't all of the banks do it? I know that they all can, but I know also that they don't want to for their own particular reasons, whatever they may be. We can speculate what those reasons might be, and it would be interesting to do so. But that is the situation that we are confronting.

What do you think is going to happen as this moves forward? Do you think you will be more successful to get that information out through the Treasury and through the banks? Or what is it that we should be doing to make sure that actually happens?

Mr. Barofsky. We are going to keep trying and pressing. I believe that logic for our arguments ultimately should win the day.

Obviously, Congress has the ability and power to statutorily requirement of this kind of information. You have required me through the Special Inspector General Act, once it is signed, required me to do this report. We got out in front of it back in January, but part of that requires us to report to you by September 1 on how the financial institutions have used those funds. A similar type of requirement could be imposed on Treasury.

Representative Hinchey. Good. I hope there is more success as time moves on and there is much more openness.

Your report notes that since the SIGTARP's office has only preliminary information, the recommendations are not necessarily at a very high level. A few of the recommendations you put forward are interesting and very important. I would just like to mention them.

Here is what you are recommending: Treasury should place strict conflict of interest rules upon the Public-Private Investment Program and the managers of that program so that investors in this program would not have the potential to artificially inflate prices of the assets; Treasury should mandate transparency which would ensure that taxpayers know how their funds are being used and that such transparency would identify conflicts of interest; stringent investor screening procedures should be in place to prevent money laundering. All of these things are so solid that you are recommending and so critically important and so obvious that they should be done.

So you've noted that this program is particularly vulnerable to fraud at many levels. Given the Treasury's track record on instituting accountability provisions in its contracts, what do you think the strategy should be to encourage the Treasury to employ the recommendations listed in the report in this program?

Mr. Barofsky. I am going to remain optimistic. I am an optimist by nature, and I am going to remain optimistic.

Putting aside even my optimism, I think the consequences of failing to adopt these recommendations are so great. I communicated this to Treasury earlier this week.

We want these programs to work. As Special Inspector General, it is vital to us that these programs work. The dangers here are so bad, in our view, that if they are not addressed it is not just a question of a little bit of fraud here or there but it is putting into question the American people's confidence in their government and the ability to get us out of this financial situation. It puts into danger the very recovery.

We think it is so fundamentally important that we are optimistic that Treasury is going to recognize these dangers and the potential consequences of failure to protect the taxpayer money. We are hopeful that they will be implemented and implemented in full.

Representative Hinchey. Mr. Barofsky, I thank you very much for everything you are doing and for everything that you have said and for the answers you have given to the questions here today. Thank you.

Chair Maloney. Mr. Cummings for 5 minutes.

Representative Cummings. What do you see as the consequences that you just talked about?

Mr. Barofsky. In the first place, we could be looking at literally hundreds of billions of dollars lost to fraud of taxpayer money. To me, as part of my mandate, that is front and foremost.

But the danger of loss of confidence—if the American people lose all confidence in their government and the ability of the Treasury to engineer this bailout, so much of economic recovery is based on confidence. When people start feeling good about spending money, going out, and purchasing—it is a very psychological concept, of

course, a recession. If there is a perception out there that all this program is picking winners and losers and rewarding at taxpayer expense and loss of hundreds of billions of dollars to fraud, it is going to have an impact beyond just the money that is lost. I think it could damage the psyche of the American people. I think it is critical that we make sure that the American people know that we are protecting their investment, and that ultimately that is going to lead to recovery.

Representative Cummings. First of all, I agree with every syllable that you just said. Without going into the AIG situation, you said everybody is cooperating with you, and I assume that includes AIG?

Mr. Barofsky. Yes. I would say initially there was a little bit of back and forth. But, as of this week, information is flowing.

Representative Cummings. How long have you been looking into them?

Mr. Barofsky. It has been a couple of weeks.

Representative Cummings. Okay. We have heard a lot of discussion about the stress test for certain TARP recipients. These tests are nearly completed. Do you think the results should be made public and do you think the tests are considering the right scenarios and asking the right questions?

Mr. Barofsky. I don't feel qualified to answer that question because I haven't seen the results of the stress test. We have many areas of expertise, but that type of regulatory detail is not something that we have looked at. I think it is something that we are going to look at. I think that is the subject of a future audit once we have the right staff and personnel in place to answer that question. But, at this time, I think it is too early for us to be able to do so.

Representative Cummings. Quite a few institutions are trying to pay money back, small and a few large. I know that a lot of it, according to reports in the paper, it had to do with compensation issues, but do you think any of it has to do with you and your office? I'm just curious. I mean, looking into things?

Mr. Barofsky. I think if there are financial institutions that are out there that are afraid of us and worried about the oversight that we are providing, I think that is a positive development.

Any financial institution that is playing by the rules and doing what they are supposed to do has absolutely nothing to fear from our office. We are not on a witch hunt or looking to make anybody look bad. But if they are not playing by the rules, if they are stealing and committing fraud, and we are inspiring them to get out of the program or not to get into the program in the first place, I think that is why you created me, to provide that level of deterrence.

Representative Cummings. Mr. Barofsky, you have the American people looking in on this right now, and the people in my district, many of them have lost their savings which they are never going to get back. Never. They have lost their homes. They have lost their jobs. They have lost all kinds of opportunities, and I think that they are just looking for somebody, just trying to make sure that somebody is watching over all of this. Like you said, this public confidence thing is major. I mean, what can you tell them

with regard to your office and how do you plan to deal with all of this?

It seems like you have a lot on your plate, a lot. They are just looking for—as all of the polling shows, they trust the President and they trust that he is going in the right direction. But they also realize that trying to straighten out this mess is like pushing a heavy boulder up a hill. And when these kinds of things happen, that is some of the things you most fear. It is like putting ice on that hill. So what can you tell them now? And I only have 3 seconds left.

Mr. Barofsky. I hope I have more than 3 seconds.

Congressman I have spent the last 8 or 9 years of my life as a Federal prosecutor before I came on board. Some of the most heart-breaking work I ever did was when I was heading up the mortgage fraud unit and seeing some of the pain that you are describing of your constituents and what happens when people are taken advantage of and they lose their homes, their life savings.

I bring all those experiences to this job; and I have assembled a staff that is just remarkably talented individuals. From my chief of staff here, who was a former prosecutor, my investigations division, my audit division, we have some of the best and brightest and most talented people you can imagine. So many of them making personal sacrifices, financial and otherwise, just to join my office, the amount of money that people have walked away from because they believe in this mission of our office.

And what I can say to your constituents is that we are here. The staff that I have together, my office, myself, we take this role, we view it in an historical context. \$3 trillion, never has so much money been pushed out in such a short period of time.

And you, the Congress, have given us an enormous responsibility; and it is one that we bear every single day. And we are going to be looking out for the taxpayers without regard to any political concern, economic concern for ourselves. We have an important role, and we are going to fulfill that role.

Representative Cummings. Thank you.

Chair Maloney. I want to thank my colleagues and particularly want to thank you, Mr. Barofsky, for your public service and for your testimony today. We certainly do appreciate your very hard work in tracking the TARP program and identifying waste, fraud, and abuse.

Clearly, we have a tremendous obligation to protect taxpayers' funds. I appreciate your efforts in this area, and I hope you will come back and speak to us again when your next report comes out.

Thank you very much, and this meeting is adjourned.

[Whereupon, at 11:35 a.m., the committee was adjourned.]

Submissions for the Record

PREPARED STATEMENT OF REPRESENTATIVE CAROLYN B. MALONEY, CHAIR

Good morning. I want to welcome Mr. Barofsky, the Special Inspector General for the Troubled Asset Relief Program, and to thank him and his staff for his testimony today on the SIGTARP's new report to Congress, just released Tuesday.

The SIGTARP reports to Congress quarterly, and this is its second report. Like the first report, issued February 6, this report takes a strong but clear position against the aspects of the TARP program that the SIGTARP believes risk promoting fraud, waste and abuse. Mr. Barofsky is a former prosecutor who does not shrink from telling it like it is, so the interests of the SIGTARP's mission is to make the best use possible of the taxpayers' money.

The SIGTARP's reports distinguish themselves by thorough but very clear explanation of the TARP programs and the SIGTARP's audit and investigations strategy, as well as specific recommendations on steps Treasury should take to prevent waste, fraud and abuse in the program.

Regrettably, some of the key recommendations in this report reiterate critical recommendations in the first report—recommendations that would promote transparency and accountability and reduce the potential for fraud and misappropriation, but which Treasury has yet to adopt.

This second report is even more critical to our understanding than the first, in part because the TARP has become such a complex series of programs and in part because the dialogue between the SIGTARP and Treasury on key issues is more advanced and is getting into some specific issues that are of great interest to policy makers and to this Committee.

As a proponent of greater transparency of the program, I requested that the Federal Reserve release AIG counterparty information and the disclosures were made last month. The SIGTARP is set to audit the payments to the AIG counterparties and investigate why it was deemed necessary to redeem those securities at full value. This is a key issue that lies at the heart of the AIG rescue: why were the counterparties made whole at the expense of the taxpayer? Shouldn't they have had to share in the loss?

Similarly, the report repeats the recommendation of the first report that Treasury must require TARP recipients to report the use to which they put the TARP funds. This recommendation echoes the concerns of legislation I have introduced that would require Treasury to track the TARP funds, even using presently reported or public information. Treasury has not adopted this very important recommendation, but the work of the SIGTARP, including a survey they conducted of some 364 TARP recipients, shows that additional information can be provided.

On a basic level, it's absolutely critical that we know where the money has gone and how it's been used. Reports that banks getting TARP money have used it to buy banks in China, highways in Spain, or even to short the stock of their competitors to bring them down and gobble them up—these emphasize the need for us to know where the money has gone. Beyond that, we should be able to assess—looking at available data and performance measurements—whether or not these funds have been used effectively.

However, these lessons are not always reflected in the new proposed programs. As this report notes, the PPIP has some inherent features that make it vulnerable to conflicts of interest. The government would be remiss in its duty if it were not to impose rigorous reporting and disclosure requirements on those managers and investors. I am concerned that Secretary Geithner, in testimony Tuesday, headed in the opposite direction, saying that Treasury would exempt the PPIP participants from the executive compensation requirements of the TARP statute.

The goals of transparency and accountability that guide the SIGTARP inform this new report and its recommendations. It is crucial not only to the success of the TARP but to the recovery of our financial system and our economy that we pay close attention.

I look forward to the testimony.

 PREPARED STATEMENT OF KEVIN BRADY, SENIOR HOUSE REPUBLICAN

I am pleased to join in welcoming Inspector General Barofsky before the committee this morning. His office is one of the most important and effective guardians of the trillions of dollars taxpayers have at risk in the massive bailouts of large financial institutions.

Unfortunately, as Kansas City Federal Reserve President Thomas Hoenig testified earlier this week, these bailouts “risk prolonging the crisis, while increasing the cost.” In this context, I found Inspector General Barofsky's most recent report quite

disturbing. Mr. Barofsky, your report contains very troubling information that has not been previously disclosed.

This report identifies many key weaknesses in the design and implementation of the government bailouts that could greatly increase their cost. For example, according to the report, the Treasury Department has “indicated that it will not adopt SIGTARP’s recommendations that all TARP recipients account for the use of TARP funds; set up internal controls to comply with such accounting; and report periodically to Treasury on the results, with appropriate sworn certifications.” The complexity and lack of transparency in TARP programs is further reason for concern. The key question before the committee this morning is why the Treasury Department continues to resist adopting many of the safeguards recommended in your report.

Regarding the Public-Private Investment Program (PPIP) unveiled by Secretary Geithner, your report notes, “Many aspects of PPIP could make it inherently vulnerable to fraud, waste, and abuse.” Vulnerabilities include the huge size of the program along with conflicts of interest, collusion, and money laundering. With regard to money laundering, your report notes that it would be unacceptable if TARP or related funds “were used to leverage the profits of drug cartels or organized crime groups.” Unlike banks and retail brokers, these partnerships are not currently subject to comparable disclosure rules to prevent money-laundering and abuse. Furthermore, the report demonstrates how interactions between two different bailout programs could encourage excessive leverage and greatly magnify taxpayer losses.

With regard to another component of the bailouts administered by the Fed, the report said, “Treasury should require additional anti-fraud and credit protection provisions specific to all MBS, before participating in an expanded TALF, including minimum underwriting standards and other fraud prevention measures.”

According to the latest estimates, the amount of losses from toxic assets in the U.S. alone may be as high as \$2.7 trillion. This clearly is a huge potential liability for American taxpayers. Unfortunately, the Treasury’s financial rescue plan seems designed to marginalize Congress and avoid the appropriations process. Nonetheless, Congress should not finalize the 2009 budget resolution without considering the tremendous costs of the ongoing bailouts.

Economic research shows that the national debt following this financial crisis may increase by as much as \$8.5 trillion in as little as 3 years. This grim fiscal prospect should be an overriding consideration as we consider budget priorities and proposals for yet more spending. Congress should not go on an irresponsible spending spree with trillions of dollars of bailouts already threatening the taxpayers.



SIGTARP

OFFICE OF THE SPECIAL INSPECTOR GENERAL
FOR THE TROUBLED ASSET RELIEF PROGRAM

ADVANCING ECONOMIC STABILITY THROUGH TRANSPARENCY, COORDINATED OVERSIGHT AND ROBUST ENFORCEMENT

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STATEMENT OF NEIL BAROFSKY
SPECIAL INSPECTOR GENERAL
TROUBLED ASSET RELIEF PROGRAM

BEFORE THE
UNITED STATES SENATE AND HOUSE
JOINT ECONOMIC COMMITTEE

April 23, 2009

Chairman Maloney, Vice Chair Schumer, Ranking Member Brownback and Members of the Committee, I am honored to appear before you today to deliver to this Committee my quarterly report to Congress.

The Troubled Asset Relief Program (“TARP”) now includes 12 separate, but often interrelated, programs involving Government and private funds of up to almost \$3 trillion—roughly the equivalent of last year’s entire Federal budget. From programs involving large capital infusions into hundreds of banks and other financial institutions, to a mortgage modification program designed to modify millions of mortgages, to public private partnerships purchasing “toxic” assets from banks using tremendous leverage provided by Government loans or guarantees, TARP has evolved into a program of unprecedented scope, scale, and complexity. Before the American people and their representatives in Congress can meaningfully evaluate the effectiveness of this historic program, that scope and scale must be placed into proper context, and the complexity must be made understandable. That is what this report attempts to do.

In this report, the Office of the Special Inspector General for the Troubled Asset Relief Program (“SIGTARP”) endeavors to (i) explain the various TARP programs and how the Department of the Treasury (“Treasury”) has used those programs through March 31, 2009, (ii) describe what SIGTARP has done since its Initial Report to Congress, dated February 6, 2009 (the “Initial Report”), to oversee this historic program with respect to both audits and investigations, and (iii) set forth a series of recommendations for the operation of TARP.

TREMENDOUS EXPANSION IN THE SCOPE, SCALE, AND COMPLEXITY OF TARP

TARP, as originally envisioned in the fall of 2008, would have involved the purchase, management, and sale of up to \$700 billion of “toxic” assets, primarily troubled mortgages and mortgage-backed securities (“MBS”). That framework was soon abandoned, however, and the program’s scope, size, and complexity have dramatically increased. As of the writing of this report, TARP funds are being used, or have been announced to be used, in connection with 12 separate programs that, as set forth in Table 1.1, involve a total (including TARP funds, Federal Reserve loans, Federal Deposit Insurance Corporation (“FDIC”) guarantees, and private money) that could reach nearly \$3 trillion.

Treasury has announced, as of March 31, 2009, the parameters of how \$590.4 billion of the \$700 billion in TARP funding authorized by the Emergency Economic Stabilization Act of 2008 (“EESA”) would be spent through the 12 programs. Of the \$590.4 billion that Treasury has committed, \$328.6 billion has actually been spent as of March 31, 2009. This report provides an update on those TARP programs that had been announced as of SIGTARP’s Initial Report, as well as descriptions of programs that have subsequently been announced.

TABLE 1.1

TOTAL FUNDS SUBJECT TO SIGTARP OVERSIGHT, AS OF MARCH 31, 2009 (S BILLIONS)

Program	Brief Description or Participant	Total Projected Funding	Projected TARP Funding
Capital Purchase Program ("CPP")	Investments in 532 banks to date; 8 institutions total \$125 billion	\$218.0	\$218.0
Automotive Industry Financing Program ("AIFP")	GM, Chrysler, GMAC, Chrysler Financial	\$25.0	\$25.0
Auto Supplier Support Program ("ASSP")	Government-backed protection for auto parts suppliers	\$5.0	\$5.0
Unlocking Credit for Small Businesses ("UCSB")	Purchase of securities backed by SBA loans	\$15.0	\$15.0
Systemically Significant Failing Institutions ("SSFI")	AIG Investment	\$70.0	\$70.0
Targeted Investment Program ("TIP")	Citigroup, Bank of America Investments	\$40.0	\$40.0
Asset Guarantee Program ("AGP")	Citigroup, Bank of America, Ring-Fence Asset Guarantee	\$419.0	\$12.5
Term Asset-Backed Securities Loan Facility ("TALF")	FRBNY non-recourse loans for purchase of asset-backed securities	\$1,000.0	\$80.0
Making Home Affordable ("MHA") Program	Modification of mortgage loans	\$75.0	\$50.0
Public-Private Investment Program ("PPIP")	Disposition of legacy assets; Legacy Loans Program, Legacy Securities Program (expansion of TALF)	\$500.0 - \$1,000.0	\$75.0
Capital Assistance Program ("CAP")	Capital to qualified financial institutions; includes stress test	TBD	TBD
New Programs, or Funds Remaining for Existing Programs	Potential additional funding related to CAP; AIFP; Auto Warranty Commitment Program; other	\$109.5	\$109.5
Total		\$2,476.5 - \$2,976.5	\$700.0

Note: See Table 2.1 in Section 2 for notes and sources related to the information contained in this table.

OVERSIGHT ACTIVITIES OF SIGTARP

Since the Initial Report, SIGTARP has been actively engaged in fulfilling its vital investigative and audit functions as well as in building its staff and organization.

On the investigations side, SIGTARP's Hotline (877-SIG-2009 or accessible at www.SIGTARP.gov) is staffed, operational, and providing an interface with the American public to facilitate the reporting of concerns, allegations, information, and evidence of violations of criminal and civil laws in connection with TARP. As of the drafting of this report, the SIGTARP Hotline has received and analyzed nearly 200 tips, running the gamut from expressions of concern over the economy to serious allegations of fraud. Both from the Hotline and from other leads, SIGTARP has initiated, to date, almost 20 preliminary and full criminal investigations. Although the details of those investigations generally will not be discussed unless and until public action is taken, the cases vary widely in subject matter and include large corporate and securities fraud matters affecting TARP investments, tax matters, insider trading, public corruption, and mortgage-modification fraud.

SIGTARP has been proactive in dealing with potential fraud in TARP. For example, to get out in front of any efforts to profit criminally from the Term Asset-Backed Securities Loan Facility ("TALF"), which, as announced, involves up to \$1 trillion of lending by the Federal Reserve backed by up to \$80 billion in TARP funds, SIGTARP has organized and leads a multi-agency task force to deter, detect, and investigate any instances of fraud or abuse in the program. In addition to SIGTARP, the TALF Task Force consists of the Office of the Inspector General of the Board of Governors of the Federal Reserve Board, the Federal Bureau of Investigation, Treasury's Financial Crimes Enforcement Network, U.S. Immigration and Customs Enforcement, the Internal Revenue Service Criminal Investigation division, the Securities and

Exchange Commission, and the U.S. Postal Inspection Service. Representatives from each member organization participate in regular briefings about TALF, collectively identify areas of fraud vulnerability, engage in the training of agents and analysts with respect to the complex issues surrounding the program, and will serve as points of contact for leads relating to TALF and any resulting cases that are generated. The TALF Task Force represents a historic law enforcement effort with an ambitious goal: to redefine the policing of complex Federal Government programs by proactively arranging a coordinated law enforcement response before fraud occurs.

On the audit side, SIGTARP has initiated and is in the process of conducting six audits:

- **Use of Funds:** SIGTARP's first audit examines the use of TARP funds by TARP recipients, and is based upon a survey that SIGTARP sent to 364 TARP recipients that had received funds as of January 31, 2009.
- **Executive Compensation Compliance:** SIGTARP's second audit, also based on SIGTARP's survey, examines how TARP recipients are implementing controls with respect to applicable executive compensation restrictions.
- **Bank of America:** The third audit examines the review and approval processes associated with TARP assistance to Bank of America under three different TARP programs and examines Treasury's decision making related to additional TARP assistance provided in connection with Bank of America's acquisition of Merrill Lynch. Since its commencement, the audit's scope has expanded to examine broadly Treasury's decision making regarding the first nine institutions to be considered for funding under TARP.
- **External Influences:** The fourth audit examines whether, or to what extent, external parties may have sought to influence decision making by Treasury or bank regulators in considering and deciding on applications for funding from individual banks seeking TARP funds. This audit seeks to determine what procedures are in place to avoid undue outside influence on the process, whether there are any indications of any undue influence, and what actions might be needed to strengthen existing processes to avoid such undue influences in the future.
- **AIG Bonuses:** The next audit examines Federal oversight of executive compensation requirements, with a particular focus on recent payouts of large bonus payments to American International Group, Inc. ("AIG") employees. SIGTARP has undertaken an audit to determine: (i) the extent to which the recent bonus payments were made in accordance with conditions imposed in return for TARP assistance, and (ii) Treasury's monitoring of AIG's executive compensation agreements and whether it was aware of the full range of executive compensation, bonus, and retention payments throughout AIG's corporate structure.
- **AIG Counterparty Payments:** AIG, which has received the largest amount of financial assistance from the Government during the current financial crisis, reportedly made counterparty payments to other financial institutions, including foreign institutions and other TARP recipients, at 100% of face value. SIGTARP will examine the basis for the counterparty payments and seek to determine whether any efforts were made to negotiate a reduction in those payments.

SIGTARP'S RECOMMENDATIONS ON THE OPERATION OF TARP

One of SIGTARP's oversight responsibilities is to provide recommendations to Treasury so that

TARP programs can be designed or modified to facilitate effective oversight and transparency and to prevent fraud, waste, and abuse. In Section 4 of the report, SIGTARP details instances in which Treasury has addressed recommendations made in and since the Initial Report, and makes a series of new recommendations, including:

- **Use of Funds:** SIGTARP continues to recommend that Treasury require all TARP recipients to report on their actual use of TARP funds. This recommendation is particularly important with respect to the potential application of the Capital Purchase Program (“CPP”) to large insurance companies that may have purchased banks eligible for CPP in order to access TARP funds, and to Treasury’s recent announcement of an additional \$30 billion investment in AIG. Simply put, the American people have a right to know how their tax dollars are being used. This recommendation applies not only to capital investment and lending programs involving banks and other financial institutions, but also to programs in which TARP funds are used to purchase troubled assets, including transactions in the Public-Private Investment Program (“PPIP”) and surrenders of collateral in TALF.
- **Expansion of TALF:** The announced expansion of TALF to permit the posting of MBS as collateral poses significant fraud risks, particularly with respect to legacy residential MBS (“RMBS”). SIGTARP has made a series of recommendations to mitigate these risks, including, among others, that Treasury should require a security-by-security screening for legacy RMBS; that any RMBS should be rejected as collateral if the loans backing particular RMBS do not meet certain baseline underwriting criteria or are in categories that have been proven to be riddled with fraud, including certain undocumented subprime residential mortgages (*i.e.*, “liar loans”); and that Treasury should require significantly higher haircuts for all MBS, with particularly high haircuts for legacy RMBS.
- **PPIP Fraud Vulnerabilities:** Aspects of PPIP make it inherently vulnerable to fraud, waste, and abuse, including significant issues relating to conflicts of interest facing fund managers, collusion between participants, and vulnerabilities to money laundering. SIGTARP has made a series of recommendations to address these concerns, including, among others, that Treasury should (i) impose strict conflict-of-interest rules upon Public-Private Investment Fund (“PPIF”) fund managers, (ii) mandate transparency with respect to the participation and management of PPIFs, including disclosure of the beneficial owners of the private equity stakes in the PPIFs and of all transactions undertaken in them, and (iii) that all PPIF fund managers have stringent investor-screening procedures, including comprehensive “Know Your Customer” requirements at least as rigorous as that of a commercial bank or retail brokerage operation.
- **Interaction Between PPIP and TALF:** In announcing the details of PPIP, Treasury has indicated that PPIFs under the Legacy Securities Program could, in turn, use the leveraged PPIF funds (two-thirds of which will likely be taxpayer money) to purchase legacy MBS through TALF, greatly increasing taxpayer exposure to losses with no corresponding increase of potential profits. Such an expansion could cause great harm to one of the fundamental taxpayer protections in the original design of TALF by significantly diluting the private party’s personal stake, the “skin in the game,” and therefore reduce their incentive to conduct appropriate due diligence. Treasury should not allow Legacy Securities PPIFs to invest in TALF unless significant mitigating measures are included to address the dilution of this incentive, which could include prohibiting the use of leverage for PPIFs investing through TALF or proportionately increasing haircuts for PPIFs that do so.

- **Mortgage Modification Program:** To prevent fraud in the mortgage modification program, SIGTARP has recommended that Treasury build certain fraud protections into the mechanics of the program, including requiring third-party verification of residence and income, conducting a closing-like procedure in which identities of participants are confirmed, and delaying modification incentive payments to servicers. SIGTARP has also recommended that Treasury proactively educate homeowners about the nature of the program, publicize that no fee is necessary to participate in the program, and collect and maintain a database of the names and identifying information for each participant in each mortgage modification transaction.

Chairman Maloney, Vice Chair Schumer, Ranking Member Brownback and Members of the Committee, I want to thank you again for this opportunity to appear before you, and I would be pleased to respond to any questions that you may have.

SIGTARP Hotline

If you are aware of fraud, waste, abuse, mismanagement or misrepresentations affiliated with the Troubled Asset Relief Program, please contact the SIGTARP Hotline.

By Online Form: www.SIGTARP.gov *By Phone:* Call toll free: (877) SIG-2009

By Fax: (202) 622-4559

By Mail: **Hotline: Office of the Special Inspector General
For The Troubled Asset Relief Program**
1500 Pennsylvania Ave., NW, Suite 1064
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Press Inquiries

Please contact our Press Office if you have any inquiries: Kris Belisle,
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**Congress of the United States
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MAURICE D. HINCHEY
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AGRICULTURE, RURAL DEVELOPMENT,
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AND RELATED AGENCIES
INTERIOR
FINANCIAL SERVICES
AND GENERAL GOVERNMENT
JOINT ECONOMIC COMMITTEE

April 28, 2009

The Honorable Carolyn B. Maloney
Chair
Joint Economic Committee
G-01 Dirksen Senate Office Building
Washington, DC 20510

Dear Chair Maloney:

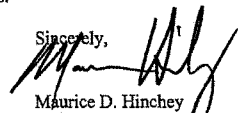
The following are questions for the record for the hearing titled "Following the Money: A Quarterly Report by the Special Inspector General for the TARP" held by the Joint Economic Committee on Thursday, April 23, 2009.

1: I am very worried about the so-called "lemons problems" that banks will only make the most toxic assets available for sale through the PPIP since it still remains difficult for investors to verify the long-term performance of these assets. Have you made any suggestions or recommendations to Treasury to try to prevent this since the worst performing assets are the ones that they would want to get rid while being most risky to the taxpayer?

2: You mentioned that Treasury – specifically Neel Kashkari – was reluctant to implement your recommendations regarding tracking funds. Mr. Kashkari, a holdover from the Paulson Treasury, has recently announced his departure date and I hope you will get more cooperation from his successor. Did you get any sense that Mr. Kashkari's sentiments were widespread among the new Treasury staff? Is there Congressional action needed?

3: Can you give me any details about the fraud prevention measures you intend to implement with regard to mortgage modifications? I am especially interested in any fraud deterrence efforts since so many of the borrowers were already victims of predatory loans. For example, can you prevent prepayment penalties on those modifications?

I would like for these answers to be included as part of the record and would appreciate receiving a copy of the responses.

Sincerely,

Maurice D. Hinchey
Member of Congress

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May 29, 2009

Honorable Maurice Hinchey
 United States House of Representatives
 2431 Rayburn House Office Building
 Washington, DC 20515-3222

Dear Congressman Hinchey:

I respectfully write in response to your letter asking several additional questions following my testimony on the April 23, 2009, before the Joint Economic Committee. We appreciate this opportunity to provide additional information about our efforts and are thankful for your continued support and interest in our mission.

I am very worried about the so-called "lemons problems" that banks will only make the most toxic assets available for sale through the PPIP since it still remains difficult for investors to verify the long-term performance of these assets. Have you made any suggestions or recommendations to Treasury to try to prevent this since the worst performing assets are the ones that they would want to get rid of while being the most risky to the taxpayer?

In Section 4 of the April 21, 2009, Quarterly Report to Congress, SIGTARP made a series of specific recommendations to Treasury concerning the Public Private Investment Program ("PPIP"). I have included the quarterly report as an attachment to this response. SIGTARP's recommendations focus on conflicts of interest, collusion, and the potential for money laundering and are geared towards protecting taxpayers from the problems that surround the PPIP. These recommendations, which are set forth at pages 146-151 of the quarterly report, discuss measures that are intended to ensure that PPIP fund managers act in the best interests of its investors (including the taxpayer). If effective rules are adopted and enforced, we believe that this will best address the serious potential that fund managers use taxpayer money to overpay for toxic assets. We also have addressed your concern by recommending that Treasury require minimum underwriting standards in the TALF program so as to keep the most toxic of the assets out of that program entirely. Unfortunately such a solution would not work for the PPIP program, which, by design, seeks to relieve banks of these most troubled assets.

You mentioned that Treasury – specifically Neel Kashkari – was reluctant to implement your recommendations regarding tracking funds. Mr. Kashkari, a holdover from the Paulson Treasury, has recently announced his departure date and I hope you will get more cooperation

Treasury, has recently announced his departure date and I hope you will get more cooperation from his successor. Did you get any sense that Mr. Kashkari's sentiments were widespread among the new Treasury staff? Is there Congressional action needed?

With limited exceptions (Citigroup, Bank of America and the most recent AIG agreement), Treasury has refused to adopt SIGTARP's recommendation with respect to requiring an accounting of recipients' use of TARP funds. Prior to his departure, Mr. Kashkari stated that this refusal was not simply his position, but also reflected the views of Secretary Geithner, and these views do appear to be widespread within Treasury. SIGTARP has now begun regular meetings with Herbert Allison, who has been nominated to replace Mr. Kashkari, and has begun a dialogue with Mr. Allison about this issue. Treasury has not indicated that it will be accepting our recommendation. As to Congressional action, as a matter of policy, we defer to all policy makers, including Congress, as to what steps, if any, they take to implement our recommendations.

Can you give me any details about the fraud prevention measures you intend to implement with regard to mortgage modifications? I am especially interested in any fraud deterrence efforts since so many of the borrowers were already victims of predatory loans. For example, can you prevent prepayment penalties on those modifications?

Potential fraud vulnerabilities with respect to the mortgage modification program are a particular personal concern of mine. I saw, first hand, heartbreaking examples of families suffering financial ruin as the result of so-called foreclosure rescue scams when I headed the mortgage fraud group as a federal prosecutor in the United States Attorney's Office for the Southern District of New York. In light of my background in mortgage fraud law enforcement, and in consultation with mortgage fraud experts at the FBI and other law enforcement agencies, SIGTARP made a series of specific recommendations to Treasury that speak to the potential for fraud in the mortgage modification program. SIGTARP's recommendations are set forth at pages 153--159 of the attached quarterly report and include a recommendation that Treasury undertake outreach efforts to educate homeowners so that they do not fall prey to scams. Moreover, SIGTARP is not relying entirely on its recommendations with respect to potential fraud connected to this important program: we are working closely with other agencies, including the FBI, HUD, FinCEN, FHFA and the FTC, on various initiatives and investigations designed to detect, investigate and shut down instances of this type of fraud. We will continue to make recommendations and direct our enforcement efforts to protect struggling homeowners who are victimized by those seeking to criminally profit off of their suffering. As to specific contract provisions in individual mortgage agreements, we will continue to work with Treasury to ensure that the Servicers who participate in MHA abide by the terms of the modification agreements, and will vigorously investigate those break the law.

I hope that we have addressed the concerns raised in your letter. If my office can be of any further assistance please do not hesitate to contact me.

Sincerely,

A handwritten signature in black ink, appearing to read 'Neil M. Barofsky', written in a cursive style.

Neil M. Barofsky
Special Inspector General

cc: Carolyn Maloney, Chairwoman of the Joint Economic Committee



OFFICE OF THE SPECIAL INSPECTOR GENERAL
FOR THE TROUBLED ASSET RELIEF PROGRAM
1500 PENNSYLVANIA AVE., NW, SUITE 1308
WASHINGTON, D.C. 20220

May 20, 2009

Congresswoman Carolyn Maloney
Chair, Joint Economic Committee
G-01 Dirksen Senate Office Building
Washington, DC 20510

Dear Chairman Maloney,

Thank you again for inviting me to testify before your Committee on April 23, 2009. During the hearing, I related my understanding that Treasury's April 17, 2009, \$30 billion Securities Purchase Agreement ("SPA") with American International Group, Inc. ("AIG"), did not require AIG to report on its use of Troubled Asset Relief Program ("TARP") funds. Information has come to my attention that requires me to correct my testimony, and I respectfully offer this letter for admission into the record of the hearing.

From the beginning of my tenure as Special Inspector General in December, I have advocated that Treasury require TARP recipients to report upon their use of TARP funds as a condition of receiving such funds. Treasury has, unfortunately, largely disregarded this recommendation. With respect to AIG in particular, I reiterated my recommendation that Treasury require it to detail its use of the additional \$30 billion that was to be made available to it pursuant to the SPA. Two days before my testimony (and before my office had access to the SPA), I asked a senior Treasury official in the Office of Financial Stability ("OFS"), by email, whether Treasury had adopted my recommendation in the SPA. In response, I was advised, via e-mail, that no such "use of funds" provision had been included. I testified accordingly at the hearing.

Recently, however, my office has had the opportunity to review the SPA and to consult with AIG. We were pleased to see that section 3.10(b) of the SPA requires AIG, among other things, to report quarterly on its use of TARP funds. Obviously, we applaud Treasury's adoption of our recommendation with respect to AIG, even if its adoption was not known by all senior OFS officials. Further, we remain hopeful that Treasury will finally adopt our recommendation with respect to all TARP recipients.

Please excuse my inadvertent conveyance of inaccurate information to the Committee, and thank you for the opportunity to offer this letter to correct the record. As always, do not hesitate to contact me if you have any questions or comments.

Very truly yours,

A handwritten signature in black ink, appearing to read 'Neil M. Barofsky', written in a cursive style.

NEIL M. BAROFSKY
Special Inspector General

cc: Members of the Committee
Anastasia D. Kelly, AIG

PREPARED STATEMENT OF REPRESENTATIVE MICHAEL BURGESS

Thank you Madam Chairwoman,

I would like to thank Mr. Barofsky for his testimony here today and for his important work as the Special Inspector General for the Troubled Asset Relief Program. The role of oversight and investigation may not be as glamorous as program implementation or funds management but to the people I represent, it is probably more important than any other aspect of the TARP. Your work is worth every penny that you recover through your criminal investigations or deter through the presence of your office. Not to mention, the prosecution of the individuals or group who seek to corrupt the public trust.

The report your team compiled is a compelling argument to provide you with more resources. Your recommendations to Treasury to require all TARP recipients to report on their actual use of every dollar, and auditing for verification, is an important first step in keeping the TARP out of trouble.

There is no doubt that the economic downturn we are experiencing makes government assistance programs like TARP susceptible to criminal elements, but, based upon my reading of this report, the TARP program has design flaws that make it an especially prime target. In your report you say "the character of the program makes it inherently vulnerable to fraud, waste and abuse," including collusion and money laundering. Taking advantage of any government program is despicable but TARP abuse has the potential to send Americans reeling from a lack of confidence in basic governmental protections.

Some of the weaknesses you expose in this report are certainly shocking. It makes me wonder if the "Troubled" part of the Troubled Asset Relief Program refers to the "Program" itself instead of the "Assets."

I look forward to hearing your testimony and your recommendations for Congress. With that I yield back.

