

Exposing Corruption Exploring Solutions

Project On Government Oversight

Letter sent to the Chair and Ranking Member of:

Senate Committee on Banking, Housing, and Urban Affairs
Senate Committee on Finance
Senate Committee on Homeland Security and Governmental Affairs
House Committee on Financial Services
House Committee on Oversight and Government Reform

November 20, 2008

Dear Chair and Ranking Member:

The Project On Government Oversight (POGO) is a non-partisan, non-profit government watchdog that works to achieve a federal government that is effective, accountable, open, and honest. In line with our mission, we are worried about the continued lack of openness concerning the government's response to the current economic crisis.

We take no position on the merits of the various actions over recent months to address the crisis. However, Congress needs to act now to ensure that the ongoing expenditures of billions—even trillions—of the taxpayers' funds are subjected to extraordinary scrutiny.

Too few questions are being asked about the how, and even the why, behind these enormous undertakings. Even when questions do get raised, as at recent hearings, numerous important questions go unanswered. This issue is so critical we feel compelled to urge you to demand those answers, either directly from policymakers and recipients of these taxpayer funds, or through your own independent investigations.

At this writing, nearly half of the \$700 billion appropriated under the Troubled Assets Relief Program (TARP) has gone out the Treasury's door with little openness. The public needs to know how the beneficiaries of their tax funds are chosen, how conflicts of interest are guarded against, and whether the integrity of the process has been assured.

POGO strongly believes that the markets cannot be settled, public confidence cannot be restored, and credit cannot be unfrozen unless and until full explanations of the decision-making processes are provided.

We are pleased that a candidate for the crucial position of Special Inspector General for TARP (SIGTARP) has finally been chosen and may be in place soon, but we regret it took so long. As Senator Snowe noted at Monday's Finance Committee hearing, 45 days had elapsed since the passage of the Emergency Economic Stabilization Act of 2008 (EESA) without a nominee. Furthermore, it will

be months before the SIGTARP is effectively up and running. Additionally, only three of the five appointments on the Congressional Oversight Panel have been filled, even though it also needs to be fully functional as quickly as possible.

Even after these critical oversight functions have been filled, fundamental questions about the “bailout” remain.

Our overriding concern is the utter lack of information about who is making critical decisions involving untold billions of taxpayer dollars. It is not clear how banks or other institutions are chosen to be bailed out or allowed to fail. It is a mystery to us and to the public why one industry is favored and another is left to suffer. We are at a loss to understand how particular companies or institutions within particular industries are blessed and others are not. Irrespective of whether the decisions are made by political appointees, career employees, or Members of Congress, the decision-making process has been a nearly perfect black box.

Among the issues of continuing concern about TARP and the other bailout-related efforts are:

- Does the SIGTARP have sufficient power and authority, as well as resources, to accomplish his mission? POGO believes that the law needs to be amended to make clear that the SIGTARP has responsibility for oversight of any and every expenditure authorized under the legislation, and will have prompt access to all relevant information, whether it involves “troubled assets” or not.

Additionally, POGO would like to see the EESA amended to allow SIGTARP, as with the Special IG for Iraq Reconstruction, to be given emergency hiring authority so that he can waive civil service requirements to hire essential staff quickly.

- The newly created oversight board for TARP is simply a gathering of the top policymakers from the federal agencies running the bailout.¹ POGO is concerned that these officials will be monitoring themselves—this is hardly an example of true oversight.
- FDIC Chairwoman Sheila Bair is proposing expanding “mortgage mitigation,” under which the FDIC would back banks that rework defaulting mortgages by lowering the interest rate, extending loan terms, or deferring payment on some of the principal. Mortgage mitigation has not only been preliminarily successful at IndyMac in addressing the underlying issue of keeping people in their homes, but is also supported by the language of the EESA law. The purpose of the law includes using TARP funds in a manner that “preserves home ownership and promotes jobs and economic growth.”²

¹ Emergency Economic Stabilization Act (EESA), sec. 104.

² EESA, sec. 2(2)(B).

However, the Treasury Department has continued to balk at supporting Bair's proposal of expanding the program,³ an idea which has also been commended by *The New York Times*' editorial page.⁴ Just this Wednesday, Chairman Dodd of the Senate Banking Committee described the administration's reluctance to take up her plan as "deeply troubling."

- We are concerned that derivatives and credit-default swaps remain unregulated, despite the crisis.⁵ We urge Congress to address the inadequate regulatory system, in light of the nation's newfound understanding of the risks of such instruments.
- In the UK, the British government required more stringent restrictions on financial institutions receiving bailout money. Dividends are not to be paid to shareholders until the government recoups its stake, and cash bonuses for executives are forbidden. The banks also "pledged to boost lending to homeowners and small businesses."⁶ Congress should demand to know why such requirements were not imposed in this country.
- The Federal Reserve Board reportedly is lending trillions of dollars, above and beyond the funds provided by the Congress through TARP, without revealing which banks are the recipients.⁷ Congress should immediately require more transparency from both the Fed and the loans' recipients. POGO believes that with the Fed accepting lesser forms of collateral and operating outside its traditional role, there is ample justification for more than traditional transparency.

In addition to the above systemic issues, POGO is concerned about a number of red flags that may be signals of even more problems to come. Among them are:

- Why did Secretary Paulson authorize the purchase of \$10 billion of preferred stock from Goldman Sachs at a price significantly higher than that paid by Warren Buffett a week

³ Karey Wutkowski and Patrick Rucker, "FDIC, U.S. Treasury clash on anti-foreclosure plan," *Reuters*, November 14, 2008. <http://www.reuters.com/article/vcCandidateFeed2/idUSN1443340520081114> (Downloaded November 19, 2008); Glenn Somerville, "Lawmakers, Treasury lock horns on foreclosures," *Reuters*, November 18, 2008.

<http://www.reuters.com/article/wtMostRead/idUSN1825605820081118> (Downloaded November 19, 2008)

⁴ "It's About the Mortgages," *The New York Times*, November 10, 2008.

<http://www.nytimes.com/2008/11/11/opinion/11tue1.html?partner=permalink&exprod=permalink> (Downloaded November 17, 2008)

⁵ Heather Landy, "Credit Default Swaps Oversight Near," *The Washington Post*, November 15, 2008.

<http://www.washingtonpost.com/wp-dyn/content/article/2008/11/14/AR2008111403441.html> (Downloaded November 17, 2008)

⁶ Adam Smith, "Britain Sets Details of Huge Bank-Bailout Plan," *Time*, October 13, 2008.

<http://www.time.com/time/business/article/0,8599,1849612,00.html?xid=feed-cnn-topics> (Downloaded November 19,

2008); "Government statement on financial support," *BBC*, October 8, 2008.

<http://news.bbc.co.uk/2/hi/business/7658307.stm> (Downloaded November 19, 2008)

⁷ Steve Matthews and Craig Torres, "Bernanke Says Federal Reserve Won't Reveal Details on Loans," *Bloomberg*, November 18, 2008. <http://www.bloomberg.com/apps/news?pid=20601087&sid=aS1eWoJ0sKc&refer=home> (Downloaded November 19, 2008)

earlier?⁸ This gives the appearance of preferential treatment because a number of senior Treasury officials—including Secretary Paulson and Neel Kashkari, the Treasury point man on the bailout—previously worked for Goldman Sachs.

- Why and how did the Treasury Department, without Congressional approval or its knowledge, provide tax breaks for banks that will, by some estimates, give them up to a \$140 billion windfall?⁹ According to Senator Grassley, this move again raises the appearance of preferential treatment. The tax change enabled Wells Fargo to take over Wachovia, whose CEO had been a vice chairman at Goldman Sachs and until this summer was Treasury's Undersecretary of Domestic Finance.¹⁰
- Why are bond rating agencies still allowed to be paid by the banks whose products they are rating, given that they either failed spectacularly at measuring risk or they succumbed to pressure to rate favorably?¹¹ As Chairman Waxman pointed out, these agencies broke the bond of trust of millions of investors, resulting in a "colossal failure."¹²
- Treasury has added approximately \$65 billion in funds to the original \$85 billion for AIG¹³; the new infusion of funds is apparently not from TARP. Where did that money come from? On whose authority, and again, where is the transparency?

⁸ Letter to Henry M. Paulson, Secretary of the Treasury, from Leo W. Gerard, President of the United Steelworkers Union, October 28, 2008. <http://assets.usw.org/News/GeneralNews/paulson-letter-final.pdf> (Downloaded November 17, 2008)

⁹ Amit R. Paley, "Grassley Calls for Probe into Tax Decision Favoring Banks," *The Washington Post*, November 15, 2008, p. D03. <http://www.washingtonpost.com/wp-dyn/content/article/2008/11/14/AR2008111403442.html?tid=informbox> (Downloaded November 19, 2008)

¹⁰ Letter to Eric M. Thorson, Inspector General - U.S. Department of Treasury, from Senator Chuck Grassley, November 14, 2008. http://grassley.senate.gov/news/Article.cfm?customel_dataPageID_1502=18109# (Downloaded November 17, 2008)

¹¹ Daniel Covitz and Paul Harrison, *Testing Conflicts of Interest at Bond Ratings Agencies with Market Anticipation: Evidence that Reputation Incentives Dominate*, Federal Reserve, December 2003, p. 2.

<http://www.federalreserve.gov/Pubs/feds/2003/200368/200368pap.pdf> (Downloaded November 17, 2008); Pallavi Gogoi, "Lawmakers blast credit rating agencies," *USA Today*, October 23, 2008.

http://www.usatoday.com/money/industries/banking/2008-10-22-credit_N.htm (Downloaded November 19, 2008)

¹² Opening Statement of Rep. Henry A. Waxman, Chairman, Committee on Oversight and Government Reform, "Credit Rating Agencies and the Financial Crisis," October 22, 2008.

¹³ Andrew Ross Sorkin and Mary Williams Walsh, "U.S. Provides More Aid to Big Insurer," *The New York Times*, November 10, 2008.

<http://www.nytimes.com/2008/11/11/business/economy/11aig.html?partner=permalink&exprod=permalink> (Downloaded November 17, 2008)

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- Why are large non-banks (possibly including foreign companies such as Aegon) being allowed to buy tiny banks and qualifying as banks under the bailout program?¹⁴
- Are the media reports correct that Fannie Mae and Freddie Mac have been instructed to buy sub-prime mortgage securities, thereby doing without close supervision what TARP was initially supposed to do? This move was apparently ordered by the Federal Housing Finance Agency, but POGO is concerned that it could produce increased losses for Fannie and Freddie while bringing windfall profits to the banks.¹⁵
- Are there adequate safeguards for the taxpayer with respect to the Treasury decision to back up the liquidity of bonds issued by Fannie Mae and Freddie Mac?

Whether it is the multi-billion dollar bailout of Wall Street giants; the newly created (and ever-evolving) TARP; the Federal Reserve's additional lending of \$2 trillion; calls for both a new economic stimulus package; or an additional \$25 billion to the auto industry—not one of these steps has been adequately explained, justified, or documented.

Congress must not only hold the relevant policymakers accountable but also demand the answers that Treasury and the Fed have apparently failed to require from the recipients of these funds. If you have any questions or need further information, please contact us at (202) 347-1122.

Sincerely,



Danielle Brian
Executive Director

¹⁴ Vidya Ram, "Aegon Hopes to Tap Into Tarp," *Forbes*, November 18, 2008.

http://www.forbes.com/markets/2008/11/18/aegon-bailout-buy-markets-equity-cx_vr_1118markets18.html (Downloaded November 19, 2008); Leslie Schism, Michael Crittenden, Matthew Karnitschnig, and Matthias Rieker, "Insurers Buy Banks In Effort to Get Aid," *Wall Street Journal*, November 17, 2008.

http://online.wsj.com/article/SB122696868966435573.html?mod=googlenews_wsj (Downloaded November 19, 2008)

¹⁵ Dawn Kopecki, "Fannie, Freddie to Step Up Mortgage Bond Purchases," *Bloomberg*, October 13, 2008.

<http://www.bloomberg.com/apps/news?pid=20601109&sid=avRPqkHu4YHE&refer=home> (Downloaded November 19, 2008)