

GAO

Testimony

Before the Subcommittee on Domestic
Policy, Committee on Oversight and
Government Reform, House of
Representatives

For Release on Delivery
Expected at 10:00 a.m. EST
Wednesday, December 16, 2009

TROUBLED ASSET RELIEF PROGRAM

The U.S. Government Role as Shareholder in AIG, Citigroup, Chrysler, and General Motors and Preliminary Views on its Investment Management Activities

Statement of

Orice Williams Brown, Director
Financial Markets and Community Investment

A. Nicole Clowers, Acting Director
Physical Infrastructure



GAO

Accountability * Integrity * Reliability



Highlights of [GAO-10-325T](#), a report to The Subcommittee on Domestic Policy, Oversight and Government Reform, House of Representatives

Why GAO Did This Study

The recent financial crisis resulted in a wide-ranging federal response that included infusing capital into several major corporations. The Troubled Asset Relief Program (TARP) has been the primary vehicle for most of these actions. As a result of actions and others, the government is a shareholder in the American International Group (AIG), Citigroup Inc. (Citi), Chrysler Group LLC (Chrysler), and General Motors Company (GM), among others. As market conditions have become less volatile, the government has been considering how best to manage these investments and ultimately divest them. This testimony discusses (1) the government's approach to past crisis and challenges unique to the current crisis; (2) the principles guiding the Department of the Treasury's implementation of its authorities and mechanisms for managing its investments; and (3) preliminary views from GAO's ongoing work with the Special Inspector General for TARP on the federal government's monitoring and management of its investments. This statement builds on GAO's work since the 1970s on providing government assistance to large corporations and more recent work on oversight of the assistance and investments provided under TARP.

In its November 2009 report, GAO recommended that Treasury ensure it has expertise needed to monitor its investment in Chrysler and GM and that it has a plan for evaluating the optimal method and timing for divesting this equity.

View [GAO-10-325T](#) for key components. For more information, contact Orice Williams Brown at (202) 512-8678 or williamso@gao.gov. A. Nicole Clowers at (202) 512-4010 clowersa@gao.gov.

TROUBLED ASSET RELIEF PROGRAM

The U.S. Government Role as Shareholder in AIG, Citigroup, Chrysler, and General Motors and Preliminary Views on its Investment Management Activities

What GAO Found

Looking at the government's role in providing assistance to large companies dating back to the 1970s, we have identified principles that serve as a framework for such assistance; including identifying and defining the problem, setting clear goals and objectives that reflect the national interests, and protecting the government's interests. These actions have been important in the past, but the current financial crisis has unique challenges, including the sheer size and scope of the crisis, that have affected the government's actions. As a result, the government's response has involved actions on the national and international levels and oversight and monitoring activities tailored to specific institutions and companies. We have also reported on considerations important for Treasury's approach to monitoring its investments in the companies that received assistance.

The administration developed several guiding principles for managing its ownership interest in AIG, Citigroup, Chrysler, and GM. It does not intend to own equity stakes in companies on a long-term basis and plans to exit from them as soon as possible. It reserves the right to set up-front conditions to protect taxpayers, promote financial stability, and encourage growth. It intends to manage its ownership stake in institutions and companies in a hands-off, commercial manner and to vote only on core governance issues, such as the selection of a company's board of directors. Treasury has also required companies and institutions that receive assistance to report on their use of funds and has imposed restrictions on dividends and repurchases, lobbying expenses, and executive compensation, among other things. As part of its oversight efforts, it also monitors a number of performance benchmarks. Chrysler and GM will submit detailed financial and operational reports to Treasury, while an asset management firm will monitor the data on Citi, including credit spreads, liquidity and capital adequacy. To monitor its investment in AIG, Treasury coordinates with the Federal Reserve Bank of New York in tracking liquidity and cash reports, among other indicators.

Treasury directly manages its investment in Citi, Chrysler, and GM, but the common equity investment in AIG, obtained with the assistance of the Federal Reserve, is managed through a trust arrangement. Each of these management strategies has advantages and disadvantages. Directly managing the investment affords the government the greatest amount of control but could create a conflict of interest if the government both regulates and has an ownership share in the institutions and could expose the government to external pressures. A trust structure, which places the government's interest with a third party, could mitigate any potential conflict-of-interest risk and reduce external pressures. But a trust structure would largely remove accountability from the government for managing the investment. GAO is reviewing Treasury's plans for managing and divesting itself of its investments, but the plans are still evolving, and, except for Citi, Treasury has yet to develop exit strategies for unwinding the investments.

Chairman Kucinich, Ranking Member Jordan, and Members of the Subcommittee:

We are pleased to be here to discuss the federal government's role as shareholder in American International Group (AIG), Citigroup Inc. (Citi), Chrysler Group LLC (Chrysler), and General Motors Company (GM). As you know, the recent financial crisis resulted in a wide-ranging federal response that included providing large infusions of capital into the financial system and automotive industry, sometimes in the form of common equity investments. The Troubled Asset Relief Program (TARP), which was created under the Emergency Economic Stabilization Act of 2008 (the act), has been the primary vehicle for making these equity investments.¹ As market conditions have become less volatile, Treasury is working to determine how best to manage these investments and ultimately divest itself of them.

The government has purchased equities in hundreds of financial institutions and other companies under TARP. As requested, our statement today focuses on four of them: AIG, Citi, Chrysler, and GM. Specifically, we will address three broad issues relating to the government's ownership interest:

- the historical context of large-scale federal financial assistance programs and the challenges specific to the current crisis;
- the U.S. Department of the Treasury's (Treasury) implementation of its authorities under the act and management of its investments in each company; and
- preliminary observations on the federal government's role as shareholder from our ongoing work with the Special Inspector General for TARP (SIGTARP).

This statement builds primarily on our work since the 1970s on providing government assistance to large corporations; our recent work on the oversight of the assistance and investments provided under TARP, including the government's investments in AIG, Citi, Chrysler, and GM; and our ongoing work on the role of the federal government as shareholder

¹Pub. L. No. 110-343, Div. A, 122 Stat. 3765 (Oct. 3, 2008), *codified in part, as amended*, at 12 U.S.C. §§ 5201-5261.

that we have undertaken with SIGTARP.² As part of our ongoing work, we have reviewed relevant laws, regulations, guidance, and documents and interviewed relevant federal and company officials. We conducted our ongoing work from August 2009 through December 2009 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Summary

Using our previous work on federal financial assistance to large firms and municipalities, we have identified three fundamental principles that provide a framework for considering and evaluating such assistance. First, the problems confronting the industry or institution need to be clearly defined and those that require an immediate financial response differentiated from those that are likely to require more time to resolve. Second, the government needs to determine whether the national interest will be best served through some type of government intervention or whether market forces and established legal procedures, such as bankruptcy reorganization, should be allowed to take their course. If the federal government decides that federal financial assistance is warranted, it must set clear objectives and goals for this assistance. Third, given the significant financial risk the federal government may assume on behalf of taxpayers, the structure created to administer any assistance must have appropriate mechanisms to protect them from excessive or unnecessary risk. These mechanisms may include concessions by all parties, controls over management, compensation for risk, and a strong independent board or other entity managing or overseeing the assistance. We also have

²See GAO, *Guidelines for Rescuing Large Failing Firms and Municipalities*, [GAO/GGD-84-34](#) (Washington, D.C.: Mar. 29, 1984); *Auto Industry: A Framework for Considering Federal Financial Assistance*, [GAO-09-242T](#) (Washington, D.C.: Dec. 4, 2008); *Auto Industry: A Framework for Considering Federal Financial Assistance*, [GAO-09-247T](#) (Washington, D.C.: Dec. 5, 2008); *Auto Industry: Summary of Government Efforts and Automakers' Restructuring to Date*, [GAO-09-553](#) (Washington, D.C.: Apr. 23, 2009); *Troubled Asset Relief Program: Status of Government Assistance Provided to AIG*, [GAO-09-975](#) (Washington, D.C.: Sept. 21, 2009); *Troubled Asset Relief Program: One Year Later, Actions Are Needed to Address Remaining Transparency and Accountability Challenges*, [GAO-10-16](#) (Washington, D.C.: Oct. 8, 2009); and *Troubled Asset Relief Program: Continued Stewardship Needed as Treasury Develops Strategies for Monitoring and Divesting Financial Interests in Chrysler and GM*, [GAO-10-151](#) (Washington, D.C.: Nov. 2, 2009).

previously identified considerations that are important for Treasury's approach to monitoring its investments in some of the companies that have received exceptional assistance. These considerations include retaining necessary expertise; monitoring and communicating company, industry, and economic indicators; determining the optimal time and method to divest; and managing the investments in a commercial manner. While Treasury adhered to certain aspects of these principles and considerations, it has been challenged in meeting others due to the widespread and evolving nature of the crisis.

Moreover, the government's role as a shareholder differed across the institutions that received federal assistance, largely because of differences in the types of institutions and the nature of the assistance they received. For example, the Federal Reserve Bank of New York (FRBNY) as a condition of secured loans it provided to AIG, created a trust to hold the convertible preferred shares it purchased.³ Conversely, Treasury later obtained common shares in Citi after Citi requested that Treasury's initial investment in preferred shares be converted to common shares to strengthen the bank's capital structure. Treasury obtained an ownership interest in Chrysler and GM during their bankruptcy and restructuring. To guide its oversight of these investments going forward, the administration developed several core principles. These include (1) acting as a reluctant shareholder or not owning equity stakes in companies any longer than necessary; (2) not interfering in the day-to-day management decisions of a company in which it is an investor; (3) ensuring a strong board of directors; and (4) exercising limited voting rights. Therefore, while Treasury has not been involved in the day-to-day operations of these companies as a result of its ownership stake, it has established conditions for receiving assistance and routinely monitored the companies' operations—for example, setting limits on executive compensation and voting on certain limited matters.

As part of our ongoing work with SIGTARP, we are reviewing the extent of government involvement in the corporate governance and operations of companies that have received exceptional assistance, the mechanisms used to ensure that companies are complying with key covenants, and its management of the investments and divestiture strategies. According to Treasury officials, direct investments are managed at three levels:

³Under TARP, Treasury also purchased preferred shares and acquired warrants as part of its investment in AIG.

individually at the institution and program levels and collectively at the portfolio level. While Treasury does not manage the day-to-day activities of the companies by virtue of its ownership interest, it does monitor their financial condition, with the goal of achieving financial viability. While the AIG convertible preferred shares acquired by FRBNY is held in trust, the Office of Financial Stability (OFS) manages common equity investments in Citi, Chrysler, and GM. Each of these strategies has advantages and disadvantages that must be weighed in deciding which to adopt. GAO is currently reviewing Treasury's plans for divesting itself of the investments in the four companies, but the plans are still evolving, and, except for Citi, Treasury has yet to develop exit strategies for unwinding the investments. Given the complexity and importance of this decision, we recommended in November that Treasury develop criteria for evaluating the optimal method and timing for divesting its equity stake. In response to this recommendation, Treasury said that it will continue to monitor and evaluate the performance of Chrysler and GM with a view toward determining the appropriate method and timing for divesting Treasury's interest in the auto companies.⁴

Background

The act's purposes are to provide Treasury with the authorities and facilities to restore liquidity and stability to the U.S. financial system while protecting taxpayers, including the value of their homes, college funds, retirement accounts, and life savings. The act also mandated that Treasury's efforts help preserve homeownership and promote jobs and economic growth, maximize overall returns to taxpayers, and provide public accountability for the exercise of its authority. The act created OFS within Treasury to administer TARP, which in turn created a number of programs designed to address various aspects of the unfolding financial crisis. Some of those programs resulted in the government having an ownership interest in several companies.

- The Capital Purchase Program (CPP) is the largest program, with several hundred participants, including Citi. Created in October 2008, it aimed to stabilize the financial system by providing capital to viable banks through the purchase of preferred shares and subordinated debentures. In addition to the value of the assets purchased, these transactions require that the fixed dividends be paid on the preferred shares, that the debentures accrue interest, and that all purchases are accompanied by a warrant to

⁴[GAO-10-151](#).

purchase either common stock or additional senior debt instruments. Citi is one of several hundred participants in this program.

- The Targeted Investment Program (TIP) was created in November 2008 to foster market stability and thus strengthen the economy by investing in institutions that Treasury deemed critical to the functioning of the financial system. In addition to the value of the assets purchased, transactions under this program also required that the fixed dividends be paid on the preferred shares, and that all purchases be accompanied by a warrant to purchase common stock or additional senior debt instruments. TIP provided assistance to two institutions, which Treasury selected on a case-by-case basis.⁵ Citi is the only remaining participant but has recently announced plans to repay the Treasury.
- The Asset Guarantee Program (AGP) was created in November 2008 to provide federal government assurances for assets held by financial institutions that were deemed critical to the functioning of the U.S. financial system. Citigroup is the only institution participating in AGP. As a condition of participation, Citigroup issued preferred shares to the Treasury and the Federal Deposit Insurance Corporation (FDIC) and warrants to Treasury in exchange for their participation, along with the Federal Reserve Bank of New York (FRBNY) \$301 billion of loss protection on a specified pool of Citigroup assets.
- The Systemically Significant Failing Institutions Program was created in November 2008 to help avoid disruptions to financial markets from an institutional failure that Treasury determined would have broad ramifications for other institutions and market activities. AIG has been the only participant in this program and was targeted because of its close ties to other institutions. Assistance provided under this program is in addition to the assistance provided by FRBNY. Under this program, Treasury owns preferred shares and warrants. Treasury now refers to this program as the AIG, Inc. Investment Program.
- The Automotive Industry Financing Program (AIFP) was created in December 2008 to prevent a significant disruption of the U.S. automotive industry. Treasury has determined that such a disruption would pose a systemic risk to financial market stability and have a negative effect on the U.S. economy. The program requires participating institutions to

⁵On December 9, 2009, Bank of America, the other participant in this program, repurchased its preferred shares held by Treasury. As of this date, Bank of America has not exercised its right to buy back the warrants held by Treasury.

implement plans to show how they intend to achieve long-term viability. Chrysler and GM participate in AIFP.

The Federal Response to the Current Financial Crisis Builds on Responses to Past Crises but Faces Unique Challenges

The government has a long history of intervening in markets during times of crisis. From the Great Depression to the Savings and Loan crisis of the 1980s, the government has shown a willingness to intervene in private markets when national interests are at stake. It has undertaken financial assistance efforts on a large scale, including to private companies and municipalities—for example, Congress created separate financial assistance programs totaling over \$12 billion to stabilize Conrail, Lockheed, Chrysler, and the New York City government during the 1970s. Most recently, in response to the most severe financial crisis since the Great Depression, Congress authorized Treasury to buy or guarantee up to \$700 billion of the “troubled assets” that were deemed to be at the heart of the crisis. The past and current administrations have used this funding to help stabilize the financial system and domestic automotive industry. While TARP was created to help address the crisis, the Treasury, Federal Reserve Board, FRBNY, and FDIC have also taken a number of steps to address the unfolding crisis.

Looking at the government’s role in providing assistance to large companies dating back to the 1970s, we have identified three fundamental principles that can serve as a framework for large-scale federal financial assistance efforts and that still apply today. These principles are identifying and defining the problem, determining the national interests and setting clear goals and objectives that reflect them, and protecting the government’s interests. The federal response to the current financial crisis generally builds on these principles.

Identifying and defining the problem includes separating out those issues that require an immediate response from structural challenges that will take more time to resolve. For example, in the case of AIFP, Treasury identified as a problem of national interest the financial condition of the domestic automakers and its potential to affect financial market stability and the economy at large. In determining what actions to take to address this problem, Treasury concluded that Chrysler’s and GM’s lack of liquidity needed immediate attention and provided short-term bridge loans in December 2008. Treasury also required Chrysler and GM to prepare restructuring plans that outlined how the automakers intended to achieve long-term financial viability and provided financial assistance to help them through the restructuring process.

Determining national interests and setting clear goals and objectives that reflect them requires deciding whether a legislative solution or other government intervention best serves the national interest. For example, during the recent crisis Congress determined that government action was needed and Treasury determined that the benefits of intervening to support what were termed “systemically significant” institutions far exceeded the costs of letting these firms fail. As we have also seen during the current crisis, companies receiving assistance should not remain under federal protection indefinitely, and as we discuss later, Treasury has been clear that it wants to divest as soon as practicable.

Because large-scale financial assistance programs pose significant financial risk to the federal government, they necessarily must include mechanisms to protect taxpayers.⁶ Four actions have been used to alleviate these risks in financial assistance programs:⁷

- Concessions from others with a stake in the outcome—for example, from management, labor, and creditors—in order to ensure cooperation and flexibility in securing a successful outcome. For example, as a condition of receiving federal financial assistance, TARP recipients had to agree to limits on executive compensation and GM and Chrysler had to use their “best efforts” to reduce their workers’ compensation to what workers at foreign automakers receive.
- Controls over management, including the authority to approve financial and operating plans and new major contracts, so that any restructuring plans have realistic objectives and hold management accountable for achieving results. Under AIFP, Chrysler and GM were required to develop restructuring plans that outlined their path to financial viability. In February 2009, the administration rejected both companies’ restructuring plans, and required them to develop more aggressive ones. The administration subsequently approved Chrysler’s and GM’s revised plans, which included restructuring the companies through the bankruptcy code.

⁶GAO-01-1163T and GAO-09-975.

⁷GAO/GGD-84-34.

-
- Adequate collateral that, to the extent feasible, places the government in a first-lien position in order to recoup maximum amounts of taxpayer funds. While Treasury was not able to fully achieve this goal given the highly leveraged nature of Chrysler and GM, FRBNY was able to secure collateral on its loans to AIG.⁸
 - Compensation for risk through fees and/or equity participation, a mechanism that is particularly important when programs succeed in restoring recipients' financial and operational health. In return for the \$62 billion in restructuring loans to Chrysler and GM, Treasury received 9.85 percent equity in Chrysler, 60.8 percent equity and \$2.1 billion in preferred stock in GM, and \$13.8 billion in debt obligations between the two companies.

These actions have been important in previous financial crises, but the sheer size and scope of the current crisis has presented some unique challenges that affected the government's actions. For example, as discussed later, as Treasury attempted to identify program goals and determine, which ones would be in the national interest, its goals were broad and often conflicted. Likewise, while steps were taken to protect taxpayer interests, some actions resulted in increased taxpayer exposure. For example, preferred shares initially held in Citi offered more protection to taxpayers than the common shares into which they were converted. However, the conversion strengthened Citi's capital structure. In the next section, we discuss the federal government's actions in the current crisis that resulted in it having an ownership interest and provide information on how the government is managing its interests.

In addition to these principles, we have also reported on important considerations for Treasury in monitoring and selling its ownership interest in Chrysler and GM, which may also serve as useful guidelines for its investments in AIG and Citi as well. The considerations that we identified, based on interviews with financial experts and others, include the following:

- **Retain necessary expertise.** Experts stressed that it is critical for Treasury to employ or contract with individuals with experience managing and selling equity in private companies. Individuals with investment, equity, and capital market backgrounds should be available to provide advice and expertise on the oversight and sale of Treasury's equity.

⁸FRBNY provided secured loans to AIG as part of its revolving credit facility.

-
- **Monitor and communicate company, industry, and economic indicators.** All of the experts we spoke with emphasized the importance of monitoring company-specific indicators and broader economic indicators such as interest rates and consumer spending. Monitoring these indicators allows investors, including Treasury, to determine how well the companies, and in turn the investment, are performing in relation to the rest of the industry. It also allows an investor to determine how receptive the market would be to an equity sale, something that contributes to the price at which the investor can sell.
 - **To the extent possible, determine the optimal time and method to divest.** One of the key components of an exit strategy is determining how and when to sell the investment. Given the many different ways to dispose of equity—through public sales, private negotiated sales, all at once, or in batches—experts noted that the seller’s needs should inform decisions on which approach is most appropriate. Experts noted that a convergence of factors related both to financial markets and to the company itself create an ideal window for an IPO; this window can quickly open and close and cannot easily be predicted. This requires constant monitoring of up-to-date company, industry, and economic indicators when an investor is considering when and how to sell.
 - **Manage investments in a commercial manner.** Experts emphasized the importance of Treasury resisting external pressures to focus on public policy goals over focusing on its role as a commercial investor. For example, some experts said that Treasury should not let public policy goals such as job retention interfere with its goals of maximizing its return on investment. Nevertheless, one expert suggested that Treasury should consider public policy goals and include the value of jobs saved and other economic benefits from its investment when calculating its return, since these goals, though not important to a private investor, are critical to the economy.

Treasury Has Developed Core Principles to Guide the Management of Its Varied Ownership Interests

Treasury ownership interests differ across the institutions that have received federal assistance, largely because of differences in the types of institutions and the nature of the assistance they received. Initially, Treasury had proposed purchasing assets from financial institutions as a way of providing liquidity to the financial system. Ultimately, however, Treasury determined that providing capital infusions would be the fastest and most effective way to address the initial phase of the crisis. As the downturn deepened, Treasury provided exceptional assistance to a number of institutions including AIG, Citi, Chrysler, and GM.⁹ In each case, it had to decide on the type of assistance to provide and the conditions that would be attached. In several cases, the assistance resulted in the government obtaining an ownership interest that must be effectively managed.¹⁰

First, Treasury has committed almost \$70 billion of TARP funds for the purchase of AIG preferred stock, \$43.2 billion of which had been invested as of September 30, 2009. The remainder may be invested at AIG's request. As noted earlier, FRBNY has also provided secured loans to AIG. In consideration of the loans, AIG deposited into a trust convertible preferred shares representing approximately 77.9 percent of the current voting power of the AIG common shares after receiving a nominal fee (\$500,000) paid by FRBNY. The trust is managed by three independent trustees. The U.S. Treasury (i.e., the general fund), not the Department of the Treasury, is the sole beneficiary of the trust proceeds.¹¹

Second, Treasury purchased \$25 billion in preferred stock from Citi under CPP and an additional \$20 billion under TIP. Each of these preferred stock acquisitions was also accompanied by a warrant to purchase Citi common stock. Treasury has also received \$4.03 billion in Citi preferred stock

⁹The Targeted Investment Program, the Systemically Significant Failing Institutions Program, and the Automotive Industry Financing Program are considered exceptional assistance programs. Companies that have received exceptional assistance included AIG, Bank of America, Citi, Chrysler, GM, and GMAC.

¹⁰While the Office of Financial Stability's (OFS) financial statements reflect activities involved in implementing TARP, including providing resources to various entities to help stabilize the financial markets, the statements do not include the assets, liabilities, or results of operations of commercial entities in which OFS has a significant equity interest. According to OFS officials, OFS's investments were not made to engage in the business activities of the respective entities.

¹¹Under TARP, Treasury also holds AIG preferred shares and warrants. For the purposes of this statement, we will focus on the shares held in trust.

through AGP as a premium for Treasury's participation in a guarantee against losses on a defined pool of \$301 billion of assets owned by Citi and its affiliates.¹² As part of a series of transactions designed to strengthen Citi's capital, Treasury exchanged all its preferred shares in Citi for a combination of common shares and trust-preferred securities.¹³ This exchange, which was completed in July 2009, gave Treasury an almost 34 percent common equity interest in the bank holding company.

Finally, under AIFP Treasury owns 9.85 percent of the common equity in the restructured Chrysler and 60.8 percent of the common equity, plus \$2.1 billion in preferred stock in the restructured GM. Treasury's ownership interest in the automakers was provided in exchange for the assistance Treasury provided before and during their restructurings. The restructured Chrysler is to repay Treasury \$7.1 billion of the assistance as a term loan, and the restructured GM is to repay \$7.1 billion of the assistance as a term loan.

Four Core Principles Guide Treasury's Management of Its Ownership Interest

Recognizing the challenges associated with the federal government having an ownership interest in the private market, the administration developed several guiding principles for managing its TARP investments. According to Treasury, it has developed core principles that will guide its equity investments going forward, which are discussed in detail in OFS's financial report.¹⁴

- **Acting as a reluctant shareholder.** The government has no desire to own equity stakes in companies any longer than necessary and will seek to

¹²Treasury's exposure under the guarantee is limited to \$5 billion. The Federal Deposit Insurance Corporation (FDIC) and the Federal Reserve Bank of New York are also participating in this guarantee. FDIC also received preferred shares. As part of an exchange offering, both Treasury's and FDIC's shares were converted to trust preferred shares.

¹³Initially, Citigroup requested that Treasury exchange its preferred shares for common shares to strength its capital structure and increase its tangible common equity. Following the Federal Reserve Board stress test conducted as part of OFS's Financial Stability Plan, Citi expanded its planned exchange of preferred securities and trust preferred securities for common stock from \$27.5 billion to \$33 billion. The stress test found that Citigroup would need an additional \$5.5 billion in tier 1 common capital, for a total of \$58.1 billion, to ensure adequate capital for the more adverse economic scenario.

¹⁴*Office of Financial Stability: Agency Financial Report Fiscal Year 2009*, Department of the Treasury.

dispose of its ownership interests as soon as it is practical to do so—that is, when the companies are viable and profitable and can contribute to the economy without government involvement.

- **Not interfering in the day-to-day management decisions of a company in which it is an investor.** In exceptional cases, the government may determine that ongoing assistance is necessary but will reserve the right to set upfront conditions to protect taxpayers, promote financial stability, and encourage growth. When necessary, these conditions may include restructurings similar to that now under way at GM and changes to help ensure a strong board of directors.
- **Ensuring a strong board of directors.** After any up-front conditions are in place, the government will protect the taxpayers' investment by managing its ownership stake in a hands-off, commercial manner. Any changes to boards of directors will be designed to help ensure that they select management with a sound long-term vision for restoring their companies to profitability and ending the need for government support as quickly as possible. The government will not interfere with or exert control over day-to-day company operations, and no government employees will serve on the boards or be employed by these companies.
- **Exercising limited voting rights.** As a common shareholder, the government will vote on only core governance issues, including the selection of a company's board of directors and major corporate events or transactions. While protecting taxpayer resources, the government has said that it intends to be extremely disciplined as to how it uses even these limited rights.

Treasury's investments have generally been in the form of nonvoting securities. For example, the preferred shares that Treasury holds in financial institutions under CPP do not have voting rights except in certain limited circumstances, such as amendments to the charter of the company or in the event that dividends are not paid for several quarters (in which case Treasury has the right to elect two directors to the board). However, the agreements that govern Treasury's common ownership interest expressly state that Treasury does not have the right to take part in the management or operation of the company other than voting on certain issues, which are summarized in the following table (table 1).

Table 1: Treasury’s Governance Principles for Exercising Its Voting Power

Potential Voting Matter	Citi	Chrysler	GM ^a
Election or removal of directors	x	x	x ^b
Certain major corporate transactions such as mergers, sales of substantially all assets, and dissolution	x	x	x
Issuances of equity securities that entitle shareholders to vote	x	x	x
Amendments to the charter or bylaws	x	x	x
Matters in which Treasury’s vote is necessary for the stockholders to take action, in which case the shares will be voted in the same proportion (for, against, or abstain) as all other shares of the company’s stock are voted.	x	x	x
All other matters requiring a vote	x ^c		

Source: GAO summary of Monthly Section 105(a) Report, OFS, Treasury. December 2009.

^aBefore GM’s expected initial public offering (IPO), Treasury will vote its shares as it determines, provided that it votes in favor of directors nominated by the GM Voluntary Employee Benefit Association (VEBA) or the government of Canada, the other shareholders.

^bThe election of directors, provided that Treasury votes in favor of individuals nominated through a certain predesignated process, and individuals nominated by the Voluntary Employee Benefit Association (VEBA).

^cOn all other matters, Treasury will vote its shares in the same proportion (for, against or abstain) as all other shareholders.

The AIG trust created by FRBNY owns shares that carry 77.9 percent of the voting rights of the common stock. FRBNY has appointed three independent trustees who have the power to vote and dispose of the stock with prior FRBNY approval and after consultation with Treasury. The trust agreement provides that the trustees cannot be employees of Treasury or FRBNY, and Treasury does not control the trust or direct the actions of the trustees. Treasury also owns AIG preferred stock, which does not have voting rights except in certain limited circumstances (such as amendments to the charter) or in the event dividends are not paid for four quarters, in which case Treasury has the right to elect additional directors to the board.¹⁵

¹⁵AIG has not made any dividend payments since receiving assistance. After four missed dividend payments OFS may appoint to the AIG board of directors the greater of two members or 20 percent of the total number of directors of the company.

Treasury Imposed a Number of Conditions That These Companies Must Meet

As a condition of receiving exceptional assistance, Treasury placed certain conditions on these companies. Specifically, the agreements with the companies impose certain reporting requirements and include provisions such as restrictions on dividends and repurchases, lobbying expenses, and executive compensation. The companies were also required to establish internal controls with respect to compliance with applicable restrictions and provide reports certifying their compliance.

While all four institutions were subject to internal control requirements, as set forth in the credit and other agreements that outline Treasury's and the companies' roles and responsibilities, Chrysler and GM have agreed to (1) produce a portion of their vehicles in the United States; (2) report to Treasury on events related to their pension plans; and (3) report to Treasury monthly and quarterly financial, managerial, and operating information. More specifically, Chrysler must either manufacture 40 percent of its U.S. sales volume in the United States, or its U.S. production volume must be at least 90 percent of its 2008 U.S. production volume. In addition, Chrysler's shareholders, including Treasury, have agreed that Fiat's equity stake in Chrysler will increase if Chrysler meets benchmarks such as producing a vehicle that achieves a fuel economy of 40 miles per gallon or producing a new engine in the United States.¹⁶ GM must use its commercially reasonable best efforts to ensure that the volume of manufacturing conducted in the U.S. is consistent with at least 90 percent of the level envisioned in GM's business plan. Treasury has stated that it plans to manage its equity interests in Chrysler and GM in a hands-off manner and does not plan to manage its interests to achieve social policy goals. But Treasury officials also noted that some requirements reflect the administration's views on responsibly utilizing taxpayer resources for these companies as well as efforts to protect Treasury's financial interests as a creditor and equity owner.

As a condition of receiving exceptional assistance, all four institutions must also adhere to the executive compensation and corporate governance rules established under the act, as amended by the American Recovery and Reinvestment Act of 2009 (ARRA), which limited

¹⁶Current equity ownership in New Chrysler is as follows: the Chrysler Voluntary Employee Benefit Association (67.7 percent), Fiat (20 percent), Treasury (9.85 percent) and the Government of Canada (2.5 percent).

compensation to the highest paid executives.¹⁷ Treasury also created the Office of the Special Master (Special Master) to carry out this requirement.

The Special Master generally rejected the companies' initial proposals for compensating the top 25 executives and approved a modified set of compensation structures with the following features:

- generally limited salaries to no greater than \$500,000, with the remainder of compensation in equity;
- most compensation paid as vested "stock salary," which executives must hold until 2011, after which it can be transferred by executives in three equal annual installments (subject to acceleration of the company's repayment of TARP funds);
- annual incentive compensation payable in "long-term restricted stock," which requires three years of service, in amounts determined based on objective performance criteria;
- actual payment of the restricted stock is subject to the company's repayment of TARP funds (in 25 percent installments);
- \$25,000 limit on perquisites and "other" compensation, absent special justification; and
- no further accruals or company contributions to executive pension plans.

The Special Master also made determinations about the compensation structures (but not individual salaries) of these companies' next 75 most highly compensated employees. He rejected the proposed compensation structures for the companies subject to review, so the companies must

¹⁷Section 111 of EESA, as amended by the American Recovery and Reinvestment Act of 2009, Pub. L. No. 111-5, Div. B, Title VII, 123 Stat. 115, 516-520 (2009), codified at 12 U.S.C § 5221, prescribes certain standards for executive compensation and corporate governance for recipients of financial assistance under TARP. Treasury published an interim final rule setting forth the applicable compensation and corporate governance standards (74 Fed. Reg. 28,394, June 15, 2009, codified at 31 C.F.R. Part 30).

make additional changes to their compensation structures and resubmit them for approval.¹⁸

Treasury Monitors a Number of Performance Benchmarks as Part of Its Oversight Effort

One of the principles guiding the government's management of its investments in the companies includes monitoring and communicating information from company, industry, and economic indicators. According to OFS, the asset management approach is designed to implement these guiding principles. It attempts to protect taxpayer investments and promote stability by evaluating systemic and individual risk through standardized reporting and proactive monitoring and ensuring adherence to the act and compliance with contractual agreements.

Treasury has developed a number of performance benchmarks that it routinely monitors. For example, as we reported in November, Treasury will monitor financial and operational data such as cash flow, market share, and market conditions and use this information to determine the optimal time and method of sale.¹⁹ Similarly, for AIG and Citi, Treasury has been monitoring liquidity, capital, profits/losses, loss reserves, and credit ratings. Treasury has hired an outside asset management firm to monitor its investment in Citigroup. The valuation process includes tracking market conditions on a daily basis and collecting data on indicators such as credit spreads, bond and equity prices, liquidity, and capital adequacy. To monitor its investment in AIG, Treasury also coordinates with FRBNY in tracking liquidity, weekly cash forecasts and daily cash reports, among other indicators.

¹⁸The determinations cover four companies: AIG, Citigroup, GM, and GMAC. Chrysler and Chrysler Financial were exempt from the Special Master's review during this round because total pay for their executives did not exceed the \$500,000 "safe harbor" limitation in Treasury's compensation regulations. Because Bank of America repaid its TARP obligations on December 9, 2009, its 26 - 100 most highly compensated employees plus additional executive officers are not subject to the Special Master's review.

¹⁹[GAO-10-151](#).

Our Ongoing Work Suggests That Different Management Strategies for Investments Have Advantages and Disadvantages and That Divestment Strategies Are Evolving

As part of our ongoing work with SIGTARP, we are reviewing the extent of government involvement in the corporate governance and operations of companies that have received exceptional assistance, Treasury's mechanisms for ensuring that companies are complying with key covenants, and the government's management of the investment and its divestiture strategies.²⁰ Today, we will highlight some of our preliminary observations from this review including observations about the advantages and disadvantages of managing these investments directly or through a trust arrangement.

According to OFS, investments are managed on the individual (institutional and program) and portfolio levels. As previously discussed, the government generally does not manage the day-to-day activities of the companies. Rather, Treasury monitors the financial condition of the companies with the goal of achieving financial viability. In conducting the portfolio management activities, OFS employs a mix of professional staff and external asset managers. According to OFS, these external asset managers provide periodic market-specific information such as market prices and valuations, as well as detailed credit analysis using public information. A portfolio management leadership team oversees the work of asset management employees organized by program basis, so that investment and asset managers may follow individual investments. OFS uses this strategy to manage its investment in Citi, Chrysler, and GM, and the independent trustees of the AIG trust manage the government's common equity interest in AIG.²¹ According to officials we interviewed, each structure—managing the investment directly or through a trust—has advantages and disadvantages.

Directly managing the investments offers two significant advantages. First, it affords the government the greatest amount of control over the investment. Second, having direct control over investments better enables the government to manage them as a single portfolio. However, such a structure also has disadvantages. For example, having the government both regulate and hold an ownership interest in an institution or company could create a conflict of interest and potentially expose the government to external pressures. Treasury officials have noted that they have been

²⁰Companies that have received exceptional assistance include AIG, Bank of America, Citi, Chrysler, GM, and GMAC. We also include Fannie Mae and Freddie Mac in our review.

²¹OFS also manages its preferred investments and warrants in AIG but for purposes of this statement, we focus on the government's interest in AIG common shares.

contacted by members of Congress expressing concern about dealership closings, and as long as Treasury maintains ownership interests in Chrysler and GM, it will likely be pressured to influence the companies' business decisions.²² Further, a direct investment requires that the government have staff with the requisite skills. For instance, as long as Treasury maintains direct control of its ownership interest in Citi, Chrysler, and GM, among others, it must have staff or hire contractors with the necessary expertise in these specific types of companies. In our previous work, we questioned whether Treasury would be able to retain the needed expertise to assess the financial condition of the auto companies and develop strategies to divest the government's interests given the substantial decline in the number of staff and lack of dedicated staff providing oversight of its investments in the automakers. We recommended that Treasury take action to address this concern.²³

In contrast, a trust structure puts the government's interest in the hands of an independent third party. While the Treasury has interpreted the act as currently prohibiting placing TARP assets in a trust structure, FRBNY was able to create a trust to manage the government's ownership interest in AIG.²⁴ One potential advantage of a trust structure is that it helps to avoid any potential conflicts of interest that could stem from the government's having both regulatory functions and its ownership interests in a company. It also mitigates any perception that actions taken with respect to TARP recipients were politically motivated or that any actions taken by Treasury were based on any "inside information" received from the regulators. Conversely, a trust structure largely removes control of the investment from the government. Finally, the trustees would also require specialized staff or contractors, would need to develop their own mechanisms to monitor the investments and analyze the data needed to assess the financial condition of the institutions or companies and decide when to divest.

²²GAO, [GAO-10-151](#).

²³GAO, [GAO-10-151](#).

²⁴EESA § 101(c) (4) authorizes the secretary to take all necessary actions to carry out its authorities under ESSA, including, without limitation, "establishing vehicles that are authorized, subject to the supervision of the Secretary, to purchase, hold and sell troubled assets and issue obligations." Under a traditional trust structure, however, the assets of the trust would be under the supervision of trustees, not Treasury.

We are reviewing Treasury's plans for divesting its investments and so far, have found that the strategy is evolving. Although Treasury has stated that it intends to sell the federal government's ownership interest as soon as doing so is practical, it has yet to develop exit strategies for unwinding most of these investments. For Citi, Chrysler, and GM, Treasury will decide when and how to divest its common shares.²⁵ With the exception of the TARP investments, the AIG trustees, with FRBNY approval, generally are responsible for developing a divestiture plan for the shares in the trust.

For Chrysler and GM, Treasury officials said that they planned to consider all options for selling the government's ownership stakes in each company. However, they noted that the most likely scenario for GM would be to dispose of Treasury's equity in the company through a series of public offerings. While Treasury has publicly discussed the possibility of selling part of its equity in the company through an initial public offering (IPO) that would occur sometime in 2010, some experts we spoke with had doubts about this strategy. Two said that GM might not be ready for a successful IPO by 2010, because the company might not have demonstrated sufficient progress to attract investor interest, and two other experts noted that 2010 would be the earliest possible time for an IPO. Treasury officials noted that a private sale for Chrysler would be more likely because the equity stake is smaller. Several of the experts we interviewed agreed that non-IPO options could be possible for Chrysler, given the relatively smaller stake Treasury has in the company (9.85 percent, versus its 60.8 percent stake in GM) and the relative affordability of the company. Determining when and how to divest the government's equity stake will be one of the most important decisions Treasury will have to make regarding the federal assistance provided to the domestic automakers, as this decision will affect the overall return on investment that taxpayers will realize from aiding these companies. Given the complexity and importance of this decision, we recently recommended that Treasury develop criteria for evaluating the optimal method and timing for divesting its equity stake.²⁶

²⁵ Citi announced its intention to repay the government's assistance and Treasury announced that it intends to sell up to \$5 billion of its common equity position in Citigroup. Treasury said it expects to sell the remainder of its shares in an orderly fashion within six-12 months.

²⁶ [GAO-10-151](#).

In closing, we would like to highlight three issues. First, as we have noted, having clear, nonconflicting goals is a critical part of providing federal financial assistance. Treasury, however, faces a number of competing and at times conflicting goals. For example, the goal of protecting the taxpayers' interests must be balanced against its goal of divesting ownership interests as soon as it is feasible. Consequently, Treasury must temper any desire to exit as quickly as possible with the need to maintain its equity interest long enough for the companies to demonstrate sufficient financial progress. Second, an important part of Treasury's management of these investments is establishing and monitoring benchmarks that will inform the ultimate decision on when and how to sell each investment. To ensure that taxpayer interests are maximized, it will be important for Treasury to monitor these benchmarks regularly. And finally, while many agree that TARP funding has contributed to the stabilization of the economy, the significant sums of taxpayer dollars that are invested in a range of private companies warrant continued oversight and development of a prudent divestiture plan.

Mr. Chairman, Ranking Member Jordan, and Members of the Subcommittee, we appreciate the opportunity to discuss these critically important issues and would be happy to answer any questions that you may have. Thank you.

Contacts

For further information on this testimony, please contact Orice Williams Brown on (202) 512-8678 or williamso@gao.gov or A. Nicole Clowers on (202) 512-4010 or clowersa@gao.gov. Contact points for our Congressional Relations and Public Affairs offices may be found on the last page of this statement. Individuals making key contributions to this testimony were Emily Chalmers, Rachel DeMarcus, Francis A. Dymond, Nancy M. Eibeck, Sarah A. Farkas, Heather J. Halliwell, Cheryl M. Harris, Debra R. Johnson, Christopher Ross, and Raymond Sendajas.

This is a work of the U.S. government and is not subject to copyright protection in the United States. The published product may be reproduced and distributed in its entirety without further permission from GAO. However, because this work may contain copyrighted images or other material, permission from the copyright holder may be necessary if you wish to reproduce this material separately.

GAO's Mission

The Government Accountability Office, the audit, evaluation, and investigative arm of Congress, exists to support Congress in meeting its constitutional responsibilities and to help improve the performance and accountability of the federal government for the American people. GAO examines the use of public funds; evaluates federal programs and policies; and provides analyses, recommendations, and other assistance to help Congress make informed oversight, policy, and funding decisions. GAO's commitment to good government is reflected in its core values of accountability, integrity, and reliability.

Obtaining Copies of GAO Reports and Testimony

The fastest and easiest way to obtain copies of GAO documents at no cost is through GAO's Web site (www.gao.gov). Each weekday afternoon, GAO posts on its Web site newly released reports, testimony, and correspondence. To have GAO e-mail you a list of newly posted products, go to www.gao.gov and select "E-mail Updates."

Order by Phone

The price of each GAO publication reflects GAO's actual cost of production and distribution and depends on the number of pages in the publication and whether the publication is printed in color or black and white. Pricing and ordering information is posted on GAO's Web site, <http://www.gao.gov/ordering.htm>.

Place orders by calling (202) 512-6000, toll free (866) 801-7077, or TDD (202) 512-2537.

Orders may be paid for using American Express, Discover Card, MasterCard, Visa, check, or money order. Call for additional information.

To Report Fraud, Waste, and Abuse in Federal Programs

Contact:

Web site: www.gao.gov/fraudnet/fraudnet.htm

E-mail: fraudnet@gao.gov

Automated answering system: (800) 424-5454 or (202) 512-7470

Congressional Relations

Ralph Dawn, Managing Director, dawnr@gao.gov, (202) 512-4400
U.S. Government Accountability Office, 441 G Street NW, Room 7125
Washington, DC 20548

Public Affairs

Chuck Young, Managing Director, youngc1@gao.gov, (202) 512-4800
U.S. Government Accountability Office, 441 G Street NW, Room 7149
Washington, DC 20548

