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CONGRESSIONAL OVERSIGHT PANEL

MARCH OVERSIGHT REPORT*

THE UNIQUE TREATMENT OF GMAC UNDER THE TARP

MARCH 10, 2010.—Ordered to be printed

*Submitted under Section 125(b)(1) of Title 1 of the Emergency Economic Stabilization Act of 2008, Pub. L. No. 110–343

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GMAC EXECUTIVE SUMMARY *

In 1919, to meet the growing demand of American families hoping to purchase their own automobiles, General Motors Company (GM) founded its own in-house credit arm, General Motors Acceptance Corporation. GM's goal was to lay the groundwork for a successful automotive industry by providing credit for car dealers to purchase inventory and by extending loans to individual borrowers to buy their own cars from those dealers.

Over the decades, GM's once-small credit arm expanded far beyond the realm of automotive lending, providing home mortgages beginning in 1985, auto insurance for both dealers and consumers, and even financing to manufacturers and distributors in the non-automotive sectors. In 2006, GM spun the General Motors Acceptance Corporation off into an independent company, GMAC Inc. (GMAC), which today ranks as the fourteenth largest bank holding company (BHC) in the United States.

Soon after GMAC began its independent life, its existence came under threat when the U.S. financial system plunged into crisis. By late 2008, GMAC's residential mortgage unit was suffering crippling losses due to the downturn in the housing market, and its automotive financing operations faced an uncertain future as GM barreled toward bankruptcy.

GMAC's historic ties to GM would, in the end, prove to be its salvation. As Treasury considered using funds from the Troubled Asset Relief Program (TARP) to rescue GM and Chrysler, it quickly came to the conclusion that GM could not survive without GMAC's financial underpinning. In particular, GMAC provided GM dealers with almost all of their "floorplan financing"—that is, loans to pur-

* The Panel adopted this report with a 4–0 vote on March 10, 2010.

chase their inventory. Without access to this credit, many dealers would be forced to close their doors. On December 29, 2008, as part of its bailout of the domestic automotive industry, the federal government provided GMAC with $5 billion in emergency funding.

In the months that followed, GMAC became further entwined in the government's financial rescue efforts. It was one of 19 banks subjected to "stress tests" to ensure that it could withstand even a sharp economic downturn. When the stress tests revealed that GMAC needed to increase its capital buffers and it could not raise that capital in the markets, the government provided further investments of $7.5 billion in May 2009 and of $3.8 billion in December 2009. As its lending capacity shrank, GMAC continued financing GM's dealerships, even as it was forced to shrink the availability of loans to customers to buy cars. Over the same period, GMAC also acquired part of the operations of Chrysler Financial Services Americas LLC (Chrysler Financial) and took on the role of the dominant floorplan financer for Chrysler dealerships as well.

Although the Panel takes no position on whether Treasury should have rescued GMAC, it finds that Treasury missed opportunities to increase accountability and better protect taxpayers' money. Treasury did not, for example, condition access to TARP money on the same sweeping changes that it required from GM and Chrysler: it did not wipe out GMAC's equity holders; nor did it require GMAC to create a viable plan for returning to profitability; nor did it require a detailed, public explanation of how the company would use taxpayer funds to increase consumer lending.

Moreover, the Panel remains unconvinced that bankruptcy was not a viable option in 2008. In connection with the Chrysler and GM bankruptcies, Treasury might have been able to orchestrate a strategic bankruptcy for GMAC. This bankruptcy could have preserved GMAC's automotive lending functions while winding down its other, less significant operations, dealing with the ongoing liabilities of the mortgage lending operations, and putting the company on sounder economic footing. The Panel is also concerned that Treasury has not given due consideration to the possibility of merging GMAC back into GM, a step which would restore GM's financing operations to the model generally shared by other automotive manufacturers, thus strengthening GM and eliminating other money-losing operations.

There is no doubt that Treasury's actions to preserve GMAC played a major role in supporting the domestic automotive industry. These same steps, however, have reinforced GMAC's dominance in automotive floorplan financing, perhaps obstructing the growth of a more competitive lending market. The rescue also came at great public expense. The federal government has so far spent $17.2 billion to bail out GMAC and now owns 56.3 percent of the company. Both GMAC and Treasury insist that the company is solvent and will not require any additional bailout funds, but taxpayers already bear significant exposure to the company, and the Office of Management and Budget (OMB) currently estimates that $6.3 billion or more may never be repaid.

In light of the scale of these potential losses, the Panel is deeply concerned that Treasury has not required GMAC to lay out a clear path to viability or a strategy for fully repaying taxpayers. Moving forward, Treasury should clearly articulate its exit strategy from

GMAC. More than a year has elapsed since the government first bailed out GMAC, and it is long past time for taxpayers to have a clear view of the road ahead.

SECTION ONE: GMAC

A. Overview

The U.S. government has spent a total of $17.2 billion to support GMAC under the TARP. GMAC received funds on three separate occasions, spanning both the Bush and Obama Administrations: in December 2008, May 2009, and December 2009. As part of the government bail-out effort, GMAC has received special treatment apart from the funds that it has received. In an unusual divided vote, the Federal Reserve approved GMAC's application as a BHC. GMAC was the only bank that needed TARP funds in order to meet the capital buffers established under the bank "stress tests" because it could not raise funds from private sources. GMAC is now 56.3 percent owned by Treasury. Although the total amount of money given to GMAC is significantly less than that received by some other institutions, it still constitutes a significant use of taxpayers' funds and has resulted in a company that is majority-owned by the U.S. government.

Although often misunderstood as the financial services arm of GM, which is how it started, GMAC is a diversified financial services firm that derives its revenues from automotive finance, where it holds a dominant position, as well as mortgage operations, insurance operations, and commercial finance. GMAC is the fourteenth largest BHC in the United States, with $172 billion in assets on December 31, 2009.

In previous reports, the Panel has examined TARP programs that affected numerous financial institutions. This report examines the ways the TARP was used to support a single institution. The report considers GMAC's financial status at the various times Treasury provided support and discusses how GMAC reached the point of needing such assistance. The report analyzes Treasury's justification for support, which is founded on the dual pillars of support to the automotive industry and GMAC's participation in the stress tests, and asks whether alternative approaches might have been possible. The report also compares the way GMAC and other banks were treated under the stress tests and the way GMAC, GM, and Chrysler were treated under the TARP's Automotive Industry Financing Program (AIFP).

Looking forward, the report examines the approach that GMAC's new management is taking to return the company to profitability and considers whether taxpayers can expect to receive a return on their investment. The report also evaluates Treasury's role as the largest shareholder of GMAC.

These questions fall clearly within the Panel's mandate under the Emergency Economic Stabilization Act of 2008 (EESA).[1] Specifically, they implicate the use of the Secretary's authority under EESA, the impact of Treasury's actions on the financial markets, the TARP's costs and benefits for the taxpayer, and transparency on the part of Treasury. The report builds on the Panel's previous work, including its June 2009 report on the stress tests, its September 2009 report on TARP assistance to the automotive industry,

[1] *See* Emergency Economic Stabilization Act of 2008 (EESA), Pub. L. No. 110–343 § 125.

and its January 2010 report on exit strategies from TARP investments.

B. Automotive Industry Financing

The government's intervention in GMAC cannot be properly evaluated without understanding the role that credit plays in the automotive industry. Financing is crucial to the distribution and sale of automobiles because of the substantial capital outlays involved in the purchase of automobiles by dealers and consumers. There are two distinct types of lending in the automobile sales industry: wholesale lending, which enables dealers to stock and replenish their inventories, and retail lending to consumers. In the United States, substantially all wholesale purchases by automobile dealers and about three-quarters of retail consumer purchases are financed with borrowed funds.[2] Automobile dealers, which typically operate as independent franchises affiliated with one or more automobile manufacturer, serve as intermediaries between manufacturers and consumers. Dealers finance their wholesale purchases of automobiles through floorplan financing—a form of inventory goods financing in which a loan is made against specific collateral.[3] Individual customers finance their automobile purchases or leases by obtaining consumer credit.

For many consumers, the purchase of a new automobile represents the largest purchase that they will make other than the purchase of a house.[4] Consumer automobile financing is a type of consumer credit, a category that also includes credit cards, unsecured cash loans, and student loans.[5] As of December 2009, 56 percent of all consumer automobile acquisitions were financed purchases, 18 percent were financed leases, and 26 percent were cash transactions—a distribution that has been broadly stable over the last five years.[6] A broad array of automobile financing companies, national and regional banks, credit unions, and other financial institutions provide consumer automobile credit, which has lower barriers to entry than floorplan financing.

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[2] *See* Senate Committee on Banking, Housing, and Urban Affairs, Written Testimony of Ron Bloom, Senior Advisor, U.S. Department of the Treasury, *The State of the Domestic Automobile Industry: Impact of Federal Assistance* (June 10, 2009) (online at banking.senate.gov/public/index.cfm?FuseAction=Files.View&FileStore__id=40341601-355c-4e6f-b67f-b9707ac88e32) (hereinafter "Ron Bloom Testimony before the Senate Banking Committee"). As of December 2009, 26 percent of all automobile purchases were cash transactions. This figure has been relatively constant over the past five years, fluctuating between 22 and 32 percent. Data provided to the Panel by J.D. Power and Associates.

[3] *See* U.S. Comptroller of the Currency, *Comptroller's Handbook: Floor Plan Loans*, at 1 (Mar. 1990) (online at www.occ.treas.gov/handbook/floorplan1.pdf) (hereinafter "Comptroller's Handbook: Floor Plan Loans").

[4] The average price of a new vehicle is $28,000. *See* National Automobile Dealers Association, *Understanding Vehicle Financing* (online at www.nada.org/NR/rdonlyres/A7731694-50E7-48CE-94E3-2EC33B446287/0/Understanding__Vehicle__Financing.pdf) (hereinafter "Understanding Vehicle Financing") (accessed Mar. 8, 2010).

[5] *See* Board of Governors of the Federal Reserve System, *Report to the Congress on Practices of the Consumer Credit Industry in Soliciting and Extending Credit and Their Effects on Consumer Debt and Insolvency*, at 1 (June 2006) (online at www.federalreserve.gov/boarddocs/rptcongress/bankruptcy/bankruptcybillstudy200606.pdf).

[6] Data provided to the Panel by J.D. Power and Associates.

FIGURE 1: CONSUMER AUTOMOBILE PURCHASES BY TYPE [7]

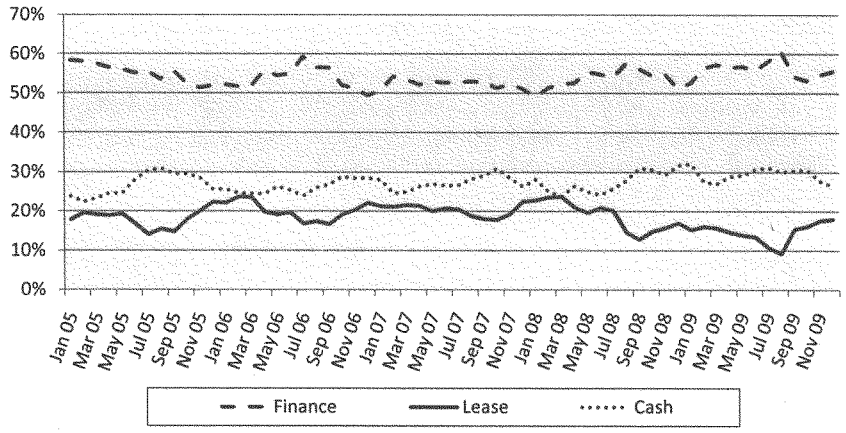
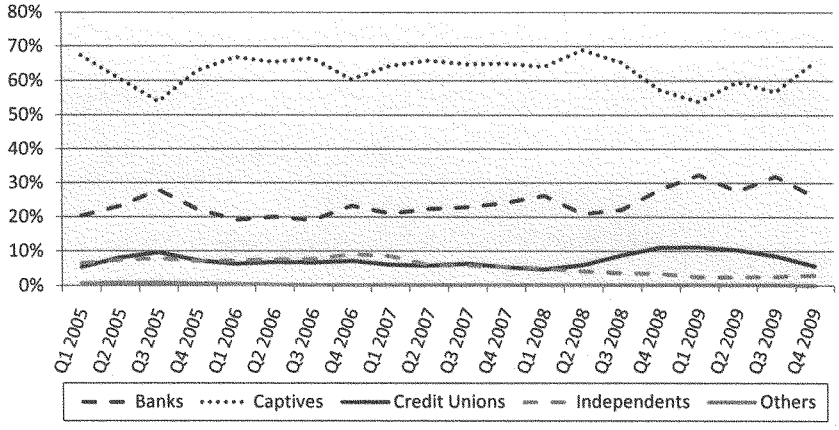


FIGURE 2: FINANCED CONSUMER AUTOMOBILE PURCHASES BY CREDIT SOURCE [8]



Floorplan financing is a vital cog in the U.S. automotive market, as it allows dealers to offer cars to consumers. Floorplan financing is crucial for dealers because of the significant cost associated with financing their entire inventories via wholesale automobile purchases from the manufacturers. The average floorplan loan is $4.9 million, and collectively U.S. automobile dealers hold about $100 billion worth of inventory.[9] Floorplan loans provide dealers with a revolving line of credit that allows dealers to maintain their inventories for sale to customers. This also helps manufacturers manage their inventory, facilitating the transfer of automobiles from the

[7] Data provided to the Panel by J.D. Power and Associates.
[8] Data provided to Panel by J.D. Power and Associates.
[9] *See* National Automobile Dealers Association, *Understanding the "TALF"* (Mar. 30, 2009) (online at www.nada.org/NR/rdonlyres/38703F1F-DC88-4870-9170-7B4778B59261/0/Understanding__the__TALF__MAR__30__2009.pdf).

plant to the dealer. For the lender, the generally low profit margins in floorplan financing are balanced by an attractive credit profile and gateway business opportunities to other, potentially more lucrative product lines (e.g., consumer auto and dealer real estate lending).

A floorplan loan is essentially a two-party contract between the automobile manufacturer and the dealer, with the lender serving as a third-party financier. In a typical floorplan loan, a dealer agrees to purchase a certain number of cars from a manufacturer for a set price. The lender will advance the amount of the purchase price of the automobiles to the dealer and, in turn, take a security interest in the automobiles as collateral for the loan. Floorplan loans typically have a set interest rate, require monthly interest payments by the borrower, and call for a portion of the loan principal to be repaid upon the sale of part of the loan's collateral—i.e., each automobile.[10] Many floorplan loans also include buyback provisions in which a manufacturer agrees to repurchase cars that have not been sold after a certain amount of time.[11] Floorplan financing is a low-risk business, particularly in comparison to consumer automotive lending. Repayment rates have historically exceeded 99 percent, and delinquency rates have been correspondingly low.[12] In fact, losses—to the extent they occur—have been primarily attributable to fraud, as opposed to credit problems.[13]

In contrast to the highly competitive and relatively unconsolidated consumer finance market, the floorplan finance market is dominated by two types of players: (1) the captive and former captive automobile finance companies, which are described as such because they are owned by or have deep ties to specific automobile manufacturers and which finance about 80 percent of floorplan lending; and (2) national and regional banks, which finance most of the remainder. Detroit's Big Three automobile manufacturers—Ford Motor Company, GM, and Chrysler Group LLC—have traditionally relied on their captive financing arms to provide the vast majority of floorplan financing for their dealers and a substantial portion of consumer credit.[14] GMAC and Chrysler Financial were

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[10] GMAC, LLC, *Form 10–K for the Fiscal Year Ended December 31, 2008,* at 46 (Feb. 27, 2009) (online at www.sec.gov/Archives/edgar/data/40729/000119312509039567/0001193125-09-039567-index.htm) (hereinafter "GMAC Form 10–K for 2008") ("[W]e generally require payment of the principal amount financed for a vehicle upon its sale or lease by the dealer to a customer. Ordinarily a dealer has between one and five days, based on risk and exposure to the account, to satisfy the obligation").

[11] *See* Comptroller's Handbook: Floor Plan Loans, *supra* note 3, at 2.

[12] *See* Congressional Oversight Panel, *Transcript: COP Hearing on GMAC Financial Services* (Feb. 25, 2010) (publication forthcoming) (online at cop.senate.gov/hearings/library/hearing-022510-gmac.cfm) (hereinafter "Transcript of COP Hearing on GMAC") (Testimony of Paul Atkins, Michael Carpenter, and Chris Whalen). For example, GMAC net charge-offs on floorplan loans (i.e., losses) increased from $15 million in 2008 to $69 million in 2009, driving a corresponding increase in charge-offs as a percentage of outstanding loans (charge-off ratio) from 0.1 percent to 0.4 percent, or 30 basis points. *See* GMAC, Inc., *Form 10–K for the Fiscal Year Ended December 31, 2009,* at 73 (Mar. 1, 2010) (online at www.sec.gov/Archives/edgar/data/40729/000119312510043252/0001193125-10-043252-index.htm) (hereinafter "GMAC Form 10–K for 2009"). While the increase is significant, the absolute level of losses on floorplan loans is quite modest given the severe economic, financial, and industrial dislocation affecting GMAC in 2009.

[13] Industry analysts conversations with Panel staff; market participants conversations with Panel staff. To the extent there has been a recent moderate uptick in floorplan lending loss rates, this reflects strains on the value of dealer collateral resulting from the economic downturn, credit crisis, and restructuring of the domestic automotive industry. *Id.*

[14] Captive financing organizations can be structured as legally separate subsidiaries or distinct business lines, but they exist primarily as extensions of their corporate parents. Their pur-

Continued

spun off from their parents in 2006 and 2007, respectively, but their enduring operational and economic interdependence is illustrated by the largely stable share of GM dealer financing provided by GMAC and Chrysler dealer financing provided by Chrysler Financial (until GMAC took over Chrysler Financial's floorplan business in May 2009). While all major foreign manufacturers operating in the United States have their own captive finance companies, among the Big Three, only Ford retains a captive finance subsidiary.[15]

An independent financing company makes a profit by lending at a rate higher than its cost of funds, at a sufficient spread to cover credit losses. Captives, however, are able to forgo some of this spread owing to the economics that underpin their relationship with the original equipment manufacturer (OEM).[16] Captive finance companies have an alignment of interests with their parents; they exist to facilitate the sale of their parent companies' products. Therefore, parent companies have historically been willing to subvent the loans made by their captives (in the case of the consumer loan market)[17] or provide dealer incentives (in the case of the floorplan financing market) in order to increase sales of the product—creating fungibility of profits between the OEM and the captive finance company.

Accordingly, GMAC is crucial to driving sales of GM automobiles. When GMAC lost its status as a wholly-owned subsidiary of GM, its historical relationship as a captive financing arm was largely replicated in practice (and in many cases contractually, particularly in the consumer space).[18] The contracts attempted to replicate the longstanding relationship between the two entities in the provision of consumer finance; GM agreed to provide subventing opportunities to GMAC, and GMAC, in return, agreed to supply consumer credit.

In the consumer market, the captive credit organizations frequently coordinate with their parents in sales promotions, by which consumers receive below-prime interest rates on automobile purchases and additionally benefit from the convenience of "one-stop shopping."[19]

In the floorplan market, the captive or "semi-captive" relationship is best exemplified in the tripartite finance relationship among

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pose is to facilitate the parent corporation's sale of goods or services by providing debt and/or lease financing to the parent's customers. *See* Standard & Poor's, *Captive Finance Operations* (Apr. 17, 2009) (online at www2.standardandpoors.com/spf/pdf/media/Captive_Finance_Operations.pdf).

[15] Although not as substantial as the Big Three in terms of sales or financing operations, several smaller automakers have licensed third party banks as their exclusive financing providers. For example, following changes in Ford ownership of Jaguar Land Rover and Mazda, both automakers replaced Ford Motor Credit with Chase Auto Finance. *See* JPMorgan Chase & Co., *Jaguar Land Rover Selects Chase as Exclusive U.S. Financing Provider* (Nov. 6, 2008) (online at investor.shareholder.com/jpmorganchase/releasedetail.cfm?releaseid=346487); Donna Harris, *Mazda Names Chase Auto As Dealer Lender,* Automotive News (Sept. 30, 2008) (online at www.autonews.com/article/20080930/ZZZ_SPECIAL/309309943). Chase Auto Finance has also served as the captive financing arm of Subaru of America since 2001.

[16] Industry analysts conversations with Panel staff.

[17] See Section C.3(a) of this report. General Motors may elect to sponsor incentive programs (on both retail contracts and leases) by supporting financing rates below standard rates at which GMAC purchases retail contracts. Subvention is the manner in which GM pays for exclusive promotions offered through GMAC. Through this practice, which is akin to a marketing expense, GM underwrites customer financing rates at levels below what GMAC would otherwise offer.

[18] *See* Section C.3(b) of this report.

[19] *See* Understanding Vehicle Financing, *supra* note 4 (accessed Mar. 8, 2010).

a captive finance company, the OEM, and the dealers. The OEM allows the auto dealer effectively to borrow interest-free (generally up to 60 days) by extending a credit to the dealer for helping to finance the OEM's inventory. This credit, as well as other incentives, helps subsidize the daily interest charges assessed by the captive finance subsidiary to the dealer as part of the floorplan finance relationship. The OEM credit is completely realized by the dealer upon the OEM's delivery of the inventory. As a result, and because the financing company's interest charges accumulate daily, the dealer's net return on the floorplan finance transaction is higher if the inventory is sold sooner. This arrangement provides sufficient incentive to the dealer to move inventory off its lot (i.e., sell cars), aligning its interests with that of the OEM.[20]

The difference between the scale of the operating models of the captives and the banks helps explain why captive finance companies have traditionally penetrated the floorplan lending market to a much greater extent than the banks. The OEMs' finance arms can offer dealers credit that is enhanced by both the inventory credit underwritten by the OEM (which is also available to banks) as well as other promotions that the OEM may sponsor to encourage financing via a captive. Also, in certain instances, captive finance companies may be willing to realize lower profits on floorplan lending. Industry sources add that this market position is enhanced by the stickiness of these relationships. This owes largely to cultural factors (long-term relationships, desire to work closely with their primary manufacturer) as well as logistical ones (integrated manufacturer and dealer systems). Ultimately, many industry sources believe that these benefits help captives overcome an otherwise higher cost of funds versus the lower cost of capital at many of their third-party bank competitors.[21]

In recent years, the traditional retail and floorplan finance relationships between GMAC and GM, GM dealers, and GM customers have been strained by a number of factors, including GMAC's shift to non-captive status, the higher cost of funds for GMAC caused by the financial crisis and the associated credit crisis, and the effects of the restructuring of GM and Chrysler.

C. GMAC's Business, its Structure, and Why it was Failing

1. Company Overview and Recent History

GMAC Financial Services, formerly known as General Motors Acceptance Corporation, was founded in 1919 as a wholly owned subsidiary of GM to provide GM dealers with the financing necessary to acquire and maintain automobile inventories and to provide customers with a means to finance automobile purchases.[22]

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[20] Industry analysts conversations with Panel staff; market participants conversations with Panel staff.

[21] Industry analysts conversations with Panel staff; market participants conversations with Panel staff. There was also a perception among some market participants that GMAC would be more willing to facilitate the consumer credit needs of the dealers' customers—especially less credit-worthy borrowers—if the dealers were willing to have GMAC also supply their floorplan financing. The relative advantages of the captives in the auto dealer financing market are discussed in more detail in section E.1, *infra*.

[22] GMAC, Inc., *Form 10–Q for the Quarter Ended September 30, 2009,* at 65 (Nov. 10, 2009) (online at www.sec.gov/Archives/edgar/data/40729/000119312509230634/0001193125-09-230634-

Continued

GMAC opened branches in Detroit, New York, Chicago, San Francisco, and Toronto in 1919 and expanded its automotive finance business to the United Kingdom a year later. GMAC had financed its 100 millionth vehicle by 1985 and by 2001, had attained net income of $1 billion and arranged more than $1 trillion of financing for 150 million cars and trucks across the world.[23] In 2004, GMAC-SAIC Automotive Finance Company, China's first automotive finance company, opened for business.

The company's operations have expanded and diversified to include insurance, mortgages, commercial finance, and online banking.[24] GMAC's first expansion outside automotive finance occurred in 1939, when it entered the automobile insurance sector with the formation of Motors Insurance Corporation (now part of GMAC Insurance Holdings).[25] In 1985, GMAC expanded into the mortgage sector with the creation of GMAC Mortgage following the acquisitions of Colonial Mortgage from Philadelphia National Bank and a mortgage servicing platform from Norwest Mortgage.[26] GMAC also formed a real estate services subsidiary, GMAC Home Services, by purchasing Better Homes and Gardens Real Estate in 1998.[27] GMAC's mortgage operations later expanded to Europe and Latin America with the formation of International Business Group (IBG) in 2001. GMAC entered the Canadian residential market with the launching of GMAC Residential Funding of Canada Ltd. in 2002. GMAC restructured its mortgage operations in 2005, creating a new parent holding company for its mortgage business, Residential Capital, LLC (ResCap), a global real estate finance business. In 1999, GMAC created the GMAC Commercial Finance Group after purchasing the Bank of New York's asset-based lending and factoring business unit.[28] GMAC entered the banking sector in 2000 by forming GMAC Bank, which received its charter in 2001.[29] Fi-

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index.htm) (hereinafter "GMAC Form 10–Q for Q3 2009") (stating that "GMAC was established to provide dealers with the automotive financing necessary to acquire and maintain vehicle inventories and to provide retail customers the means by which to finance vehicle purchases through GM dealers").

[23] GMAC, Inc., *History* (online at www.gmacfs.com/us/en/about/who/who__history.html) (hereinafter "GMAC: History") (accessed Mar. 8, 2010).

[24] GMAC, Inc., *Who We Are* (online at www.gmacfs.com/us/en/about/who/index.html) (accessed Mar. 8, 2010).

[25] *Id.*

[26] *Id.* As GMAC CEO Michael Carpenter stated at the Panel's recent GMAC hearing, "General Motors decided to diversify its financial services business many years ago and built up this mortgage banking business." Transcript of COP Hearing on GMAC, *supra* note 12 (Testimony of Michael Carpenter).

[27] In September 2008, ResCap entered into an agreement to sell the GMAC Home Services business to Brookfield Residential Property Services.

[28] GMAC: History, *supra* note 23.

[29] GMAC Bank, an insured federal savings bank, received its charter from the Office of Thrift Supervision (OTS) on August 22, 2001. Headquartered in Wilmington, Delaware, GMAC Bank was designed to offer or make available a variety of banking and personal financial services products, including FDIC-insured money market accounts, certificates of deposit, and transactional checking accounts, and also to originate and purchase residential mortgage loans, home equity loans, and lines of credit. According to GMAC, "GMAC Bank will not provide any funding for GMAC's auto finance business and will not make loans to dealers for wholesale auto financing or loans to consumers for retail auto financing." GMAC, LLC, *GMAC Receives OTS Charter to Open New Federal Savings Bank* (Aug. 22, 2001) (online at media.gmacfs.com/index.php?s=43&item=178).

In connection with GMAC's 2006 spin-off from GM, GMAC Automotive Bank, an insured state nonmember industrial loan company based in Utah, purchased certain assets totaling approximately $11.7 billion and assumed certain liabilities totaling approximately $10.7 billion of GMAC Bank. At that time, GMAC Automotive Bank was renamed GMAC Bank, and the federal savings bank charter of GMAC Bank remained active while that institution was renamed National Motors Bank, FSB. Cerberus was temporarily allowed to acquire the ILC as a special exception to the FDIC's then-existing moratorium on such applications. These steps were taken

nally, in 2004, GMAC created GMAC Automotive Bank to purchase retail installment sale and lease contracts from automobile dealers, and this institution's application for federal deposit insurance was approved by the Federal Deposit Insurance Corporation (FDIC) in June 2004.[30]

The decline in the last decade in GM's credit position—caused by the downgrade of its debt to non-investment grade status, decreased sales, and the looming bankruptcy of Delphi Corporation, GM's biggest parts supplier—negatively impacted GMAC's credit ratings and increased the cost of financing GM automobile sales. As noted above, GMAC as a finance arm had also branched out into other lending sectors besides the auto industry. These circumstances called into serious question GMAC's ownership and governance structure. As a result, on November 30, 2006, GM sold 51 percent of the equity in GMAC to an investment consortium led by Cerberus Capital Management, L.P. (Cerberus) for about $14 billion.[31] GMAC emerged as an independent global financial services company, which company management stated provided an opportunity to "transform GMAC from a captive operation to a more globally diversified operation."[32]

GMAC's core businesses—automotive finance and residential mortgages—were previously very profitable. GMAC's Global Automotive Finance (GAF) segment was profitable through 2007, and its mortgage operations remained profitable through 2006.

GMAC's results of operations have been recorded in four business segments, which were recently reduced to three:[33]

- Dealer and retail automotive financing services (recorded in the GAF segment, which is now part of an enlarged Global Automotive Services segment);
- Insurance for consumers, automotive dealerships, and other businesses (included within Global Automotive Services, and no longer a standalone segment);

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in order to allow GMAC, then controlling two insured depository institutions, to consolidate some of its operations. *See* Federal Deposit Insurance Corporation, *Order and Basis for Corporation Approval* (Nov. 15, 2006) (online at www.fdic.gov/regulations/laws/bankdecisions/Merger/gmacmerger.pdf). GMAC Bank is a U.S. online bank that offers a variety of savings products, including certificates of deposit (CDs), online savings accounts and money market accounts, and remains subject to regulation and examination primarily by the FDIC and the Utah UDFI.

[30] Federal Deposit Insurance Corporation, *Decisions on Bank Applications: GMAC Automotive Bank, Application for Federal Deposit Insurance* (June 25, 2004) (online at www.fdic.gov/regulations/laws/bankdecisions/DepIns/gmacauto.html).

[31] GM received approximately $14 billion in cash from this transaction over three years, including distributions from GMAC. The $14 billion in cash that GM receives as part of the transaction included $7.4 billion from the Cerberus-led consortium and an estimated $2.7 billion cash distribution from GMAC related to the conversion of most of GMAC and its U.S. subsidiaries to limited liability companies. In addition, GM retained about $20 billion of GMAC automotive lease and retail assets and associated funding with an estimated net book value of $4 billion that monetized over three years.

[32] GMAC, LLC, *GMAC Financial Services Reports 2006 and Fourth Quarter Earnings* (Mar. 13, 2007) (online at media.gmacfs.com/index.php?s=43&item=218) (hereinafter "GMAC Q4 2006 Earnings").

[33] As of December 31, 2009, GMAC reclassified the presentation of the business activities comprising its operating segments. This reclassification makes it difficult to compare business segments for the period prior to 2007 to business segments for the restated period between 2007 and 2009. GMAC now reports its Insurance segment within Global Automotive Services. Introduction of funds-transfer-pricing (FTP) methodology shifted certain interest revenue and expenses to Corporate & Other. For example, prior to the restatement, GMAC reported $70 million in Corporate & Other net income for 2007, whereas after the restatement, the company reported a $1.33 billion Corporate & Other loss. Global Automotive Finance was the primary segment beneficiary of this reporting change, with net income increasing from $1.5 billion to $2.9 billion in 2007. See GMAC Form 10–K for 2009, *supra* note 12, at 203.

• Mortgage activities focusing primarily on the residential real estate market in the United States, with some international operations; this segment includes the operations of ResCap;[34] and

• Commercial finance activities that provide secured lending products and other financing (reflected in the "Corporate and Other" segment, which also includes corporate operations and interest rate risk management).

As of December 31, 2009, the company had 15 million customers and operations in approximately 40 countries, along with approximately $172 billion in assets, making it one of the largest U.S. bank holding companies.[35] The following tables show the contribution made by its business segments to GMAC's overall performance and profitability.

FIGURE 3: GMAC NET REVENUE BY SEGMENT (MILLIONS OF DOLLARS)[36]

	2005*	2006*	2007	2008	2009[37]
Global Automotive Finance (GAF)	$4,375	$4,361	$6,323	$4,058	$5,029
Mortgage	4,860	4,318	1,772	953	609
Insurance	4,259	5,616	3,164	2,961	2,271
Corporate & Other[38]	1,423	527	(1,512)	7,463	(1,648)
Net Revenue	$14,917	$14,822	$9,747	$15,435	$6,261

[36] GMAC Form 10–K for 2009, *supra* note 12; GMAC, LLC, *Amendment No. 1 to the Form 10–K for the Fiscal Year Ended December 31, 2008* (May 14, 2009) (online at www.sec.gov/Archives/edgar/data/40729/000119312509111453/d10ka.htm) (hereinafter "Amendment to GMAC Form 10–K for 2008"); GMAC, LLC, *Form 10–K for the Fiscal Year Ended December 31, 2007* (Feb. 27, 2008) (online at www.sec.gov/Archives/edgar/data/40729/000095012408000900/k23730e10vk.htm) (hereinafter "GMAC Form 10–K for 2007"); GMAC, LLC, *Form 10–K for the Fiscal Year Ended December 31, 2006* (Mar. 3, 2007) (online at www.sec.gov/Archives/edgar/data/40729/000095012407001471/k12221e10vk.htm) (hereinafter "GMAC Form 10–K for 2006"); GMAC, LLC, *Form 10–K for the Fiscal Year Ended December 31, 2005* (Mar. 28, 2006) (online at www.sec.gov/Archives/edgar/data/40729/000095012406001524/k01870e10vk.htm) (hereinafter "GMAC Form 10–K for 2005").

[37] For further discussion on GMAC's changes to reporting segments that occurred in the fourth quarter of 2009, *see* note 33.

[38] The large "Other" revenue in 2008 reflects the effects of a pretax gain arising upon the extinguishment of $11.5 billion of debt in the exchange offer conducted in the fourth quarter of 2008. For further discussion of the exchange offer, *see* Section C.2.(b)1, *infra*.

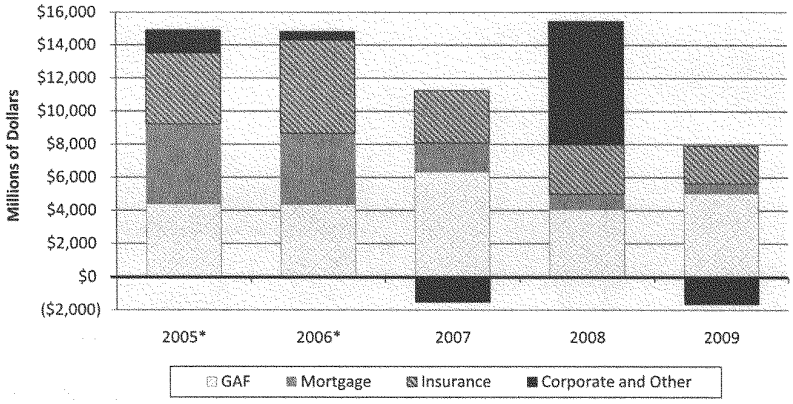
* Note: Historic 2005–2006 segment results do not correspond with restated segment data for 2007–2009 period. See footnote 33 for further discussion.

[34] The GMAC Board of Directors continues to review various strategic alternatives related to the wind-down of ResCap, including asset sales. ResCap no longer provides public financial statements (the company last provided public financial statements as of June 30, 2009).

For further discussion of GMAC's plans to dispose of some of ResCap's portfolio through asset sales, *see* Section H.2, *infra*.

[35] GMAC Form 10–K for 2009, *supra* note 12, at 1. At the time of the stress tests, GMAC was the 11th largest BHC, with approximately $189 billion in assets as of December 31, 2008. For comparative purposes, the four largest BHCs covered by the stress tests—JPMorgan Chase, Citigroup, Bank of America, and Wells Fargo—had assets of $2.2 trillion, $1.9 trillion, $1.8 trillion, and $1.3 trillion as of December 31, 2008, respectively.

FIGURE 4: GMAC NET REVENUE BY SEGMENT[39]



* Note: Historic 2005–2006 segment results do not correspond with restated segment data for 2007–2009 period. See footnote 33 for further discussion.

FIGURE 5: GMAC NET INCOME/(LOSS) BY SEGMENT

[Dollars in millions][40]

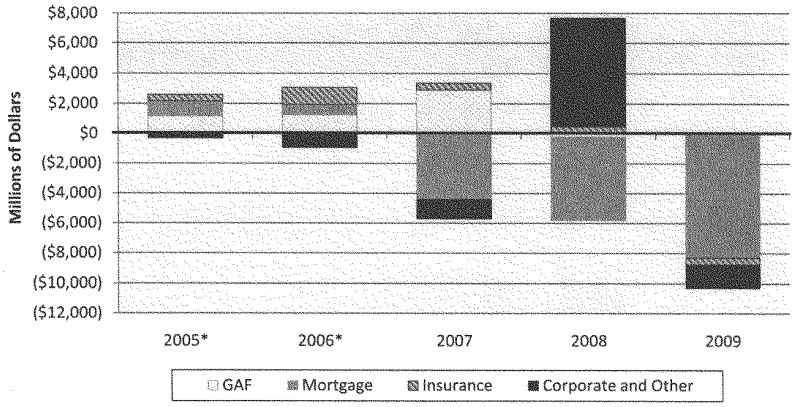
	2005*	2006*	2007	2008	2009
GAF	$1,153	$1,243	$2,913	$(216)	$(19)
Mortgage	1,021	705	(4,379)	(5,587)	(8,273)
Insurance	417	1,127	459	459	(439)
Corporate & Other	(309)	(950)	(1,325)	7,212	(1,567)
Net Income/(Loss)	$2,282	$2,125	$(2,332)	$1,868	$(10,298)

[40] GMAC Form 10–K for 2009, *supra* note 12; Amendment to GMAC Form 10–K for 2008, *supra* note 36; GMAC Form 10–K for 2007, *supra* note 36; GMAC Form 10–K for 2006, *supra* note 36; GMAC Form 10–K for 2005, *supra* note 36.

* Note: Historic 2005–2006 segment results do not correspond with restated segment data for 2007–2009 period. See footnote 33 for further discussion.

[39] GMAC Form 10–K for 2009, *supra* note 12; Amendment to GMAC Form 10–K for 2008, *supra* note 36; GMAC Form 10–K for 2007, *supra* note 36; GMAC Form 10–K for 2006, *supra* note 36; GMAC Form 10–K for 2005, *supra* note 36.

FIGURE 6: GMAC NET INCOME/(LOSS) BY SEGMENT[41]



* Note: Historic 2005–2006 segment results do not correspond with restated segment data for 2007–2009 period. See footnote 33 for further discussion.

Along with numerous other financial institutions, GMAC was severely impacted by the downturn in the residential real estate and capital markets. By early 2007, GMAC started seeing some signs of distress. In March 2007, it reported 2006 net income of $2.1 billion, compared to net income of $2.3 billion for 2005. While GMAC indicated that its performance reflected "record earnings in the insurance business and continued strong profitability in automotive finance," it reported significantly reduced net income at ResCap due to the declining U.S. residential housing market.[42] As a result of these market conditions, GMAC incurred a net loss of $2.3 billion for 2007. The housing price depreciation and the frozen credit markets seen in the fall of 2008 (the peak of the financial crisis) severely impacted (if not virtually halted) GMAC's core operations—its mortgage and automotive lending businesses.[43] These circumstances reduced liquidity, depressed asset valuations, and required GMAC to post additional loan loss provisions due to credit deterioration.[44]

2. BHC Application and Approval

a. Rationale for Application

Since the 2006 spin-off, GMAC Bank had operated as an industrial loan company (ILC) because it did not meet the Bank Holding Company Act (BHCA)'s definition of a "bank."[45] In response to de-

[41] GMAC Form 10–K for 2009, *supra* note 12; Amendment to GMAC Form 10–K for 2008, *supra* note 36; GMAC Form 10–K for 2007, *supra* note 36; GMAC Form 10–K for 2006, *supra* note 36; GMAC Form 10–K for 2005, *supra* note 36.

[42] GMAC Q4 2006 Earnings, *supra* note 32.

[43] GMAC Form 10–K for 2008, *supra* note 10, at 20.

[44] GMAC Form 10–K for 2008, *supra* note 10, at 29.

[45] GMAC Bank did not qualify as a "bank" under the BHCA because it was an ILC that did not offer demand deposits. *See* 12 U.S.C. § 1841(c)(2)(H). ILCs and industrial banks are FDIC-supervised and insured financial institutions operating under specific charters that have "nearly all of the same powers as commercial banks" and whose distinct features include the fact that they can be owned by commercial firms that are not regulated by a federal banking agency. Kenneth Spong and Eric Robbins, *Industrial Loan Companies: A Growing Industry Sparks a Public Policy Debate*, Federal Reserve Bank of Kansas City Economic Review, at 41 (Fourth

teriorating market conditions, significant third quarter losses, and the prospect of looming fourth quarter losses, on November 20, 2008, GMAC requested the approval of the Board of Governors of the Federal Reserve System (the Board) under section 3 of the BHCA[46] to become a BHC upon the conversion of GMAC Bank to a commercial bank. GMAC took this step after conversations with the FDIC and Treasury about strategies for surviving the financial crisis.[47] GMAC's management maintains that the final decision to seek BHC status was a joint decision resulting from discussions between GMAC management, the board of directors, Treasury, the Federal Reserve, and the FDIC.[48] At the time, GMAC's board of directors was dominated by GM and Cerberus.

The primary reason GMAC sought to convert to a BHC appears to be to gain access to government assistance related to the financial crisis. The conversion made GMAC eligible for access to the FDIC's Temporary Liquidity Guarantee Program (TLGP) facility and the TARP's Capital Purchase Program (CPP).[49] The December 2008 announcement of the AIFP—and the subsequent funding of GMAC under this program—suggests that it may not have been necessary for GMAC to become a BHC in order to gain access to TARP funds. When GMAC submitted its BHC application one month earlier, however, TARP funds could not have been allocated to the company unless it became a BHC; it was not clear at that time that funding for non-BHCs would be provided under the AIFP.

GMAC's management maintains that converting to a BHC also addressed a weakness in the company's business model.[50] In GMAC's view, the financial crisis had taught them that their reliance on the wholesale funding and securitization markets was untenable in the long run. GMAC's management believed that a more

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Quarter 2007) (online at www.kc.frb.org/Publicat/Econrev/PDF/4Q07Spong.pdf). The ILC is subject to oversight by federal and state bank regulators; however, the controlling company in many cases is not.

While ILCs were initially developed in the early 1900s to provide small loans to industrial workers, they have recently "reemerged as a way for commercial and financial firms to offer banking services without being subject to the ownership restrictions and parent company supervision that typically apply to other companies owning depository institutions." *Id.* at 43. ILCs support a company's operations by allowing commercial firms such as auto companies and manufacturers to offer financing to their customers, clients, or dealers.

For further discussion of the details of GMAC's spin-off from GM in 2006, *see* Note 29, *supra*.

[46] 12 U.S.C. § 1842.

[47] GMAC conversations with Panel staff (Feb. 16, 2010).

[48] GMAC conversations with Panel staff (Feb. 16, 2010).

[49] GMAC conversations with Panel staff (Feb. 16, 2010); GMAC, LLC, *GMAC Files Application With Federal Reserve to Become Bank Holding Company* (Nov. 20, 2008) (online at media.gmacfs.com/index.php?s=43&item=288) (hereinafter "GMAC Files BHC Application"); Federal Deposit Insurance Corporation, *Temporary Liquidity Guarantee Program Frequently Asked Questions* (Nov. 17, 2009) (online at www.fdic.gov/regulations/resources/TLGP/faq.html) (hereinafter "Temporary Liquidity Guarantee Program FAQs") (stating that eligible institutions include any U.S. BHC or financial holding company); U.S. Department of the Treasury, *Process-Related FAQs for Capital Purchase Program* (Mar. 3, 2009) (online at www.financialstability.gov/roadtostability/CPPappdocs_faq1.htm) (stating that eligible institutions include "any bank, savings association, bank holding company and savings and loan holding company organized under the laws of the United States"). As an ILC, GMAC Bank (renamed Ally Bank in May 2009) would have had access to CPP funds regardless of whether GMAC became a BHC. However, even if GMAC Bank was eligible to receive CPP funds, its parent, GMAC, was not eligible until it became a BHC. See U.S. Department of the Treasury, *TARP Capital Purchase Program: Term Sheet—Privately Held Institutions* (online at www.financialstability.gov/docs/CPP/Term%20Sheet%20-%20Private%20C%20Corporations.pdf) (accessed Feb. 22, 2010) (stating that "[q]ualifying Financial Institution ('QFI') means any (i) top-tier Bank Holding Company").

[50] GMAC conversations with Panel staff (Feb. 16, 2010).

sustainable business model could be created by becoming a "classic bank" with access to deposits.[51]

In fact, GMAC Bank would have been able to accept certain types of deposits even if it had remained an ILC.[52] As Daniel Tarullo, member of the Board of Governors of the Federal Reserve System, has testified, ILCs "have virtually all of the deposit-taking powers of commercial banks; and may engage in the full range of other banking services, including commercial, mortgage, credit card, and consumer lending activities, as well as cash management services, trust services, and payment-related services, such as Fedwire, automated clearinghouse, and check-clearing services."[53] The primary restriction that GMAC Bank faced as an ILC was that it was not permitted to offer demand deposits.[54]

b. BHC Approval

The Board expedited GMAC's BHC application, citing the "emergency conditions" caused by the "unusual and exigent circumstances affecting the financial markets."[55] After its review, the Board, in an unusual 4–1 vote,[56] approved the GMAC proposal on December 24, 2008 finding that GMAC had satisfied the requisite criteria under the BHCA[57] and determining that the "performance of the proposed activities by GMAC can reasonably be expected to produce benefits to the public . . . that outweigh possible adverse effects, such as undue concentration of resources, decreased or unfair competition, conflicts of interests, or unsound banking prac-

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[51] GMAC conversations with Panel staff (Feb. 16, 2010). When GMAC announced that it would apply for BHC status, its press release made no reference to the desire to access deposits, instead couching the application as an effort to "obtain increased flexibility and stability" with "expanded opportunities for funding and for access to capital." GMAC Files BHC Application, *supra* note 49.

[52] In addition, GMAC did not need to become a BHC to gain access to the Federal Reserve's discount window because GMAC Bank (its bank subsidiary) was already a "depository institution." *See* Federal Reserve Banks, *The Federal Reserve Discount Window* (Feb. 19, 2010) (online at www.frbdiscountwindow.org/discountwindowbook.cfm?hdrID=14&dtlID=43#eligibility) ("By law, depository institutions that maintain reservable transaction accounts or nonpersonal time deposits (as defined in Regulation D) may establish borrowing privileges at the Discount Window"); Senate Committee on Banking, Housing, and Urban Affairs, Written Testimony of Daniel K. Tarullo, member, Board of Governors of the Federal Reserve System, *Strengthening and Streamlining Prudential Bank Supervision*, at 11–12 (Aug. 4, 2009) (online at banking.senate.gov/public/index.cfm?FuseAction=Files.View&FileStore_id=0656fee8-e81c-4081-b99b-7a7c1571fb4d) (hereinafter "Written Testimony of Daniel Tarullo") ("ILCs are state-chartered banks that have full access to the federal safety net, including FDIC deposit insurance and the Federal Reserve's discount window and payments systems").

[53] Written Testimony of Daniel Tarullo, *supra* note 52, at 12.

[54] *See* 12 U.S.C. § 1841(c)(2)(H)(i)(I).

[55] Board of Governors of the Federal Reserve System, *Order Approving Formation of Bank Holding Companies and Notice to Engage in Certain Nonbanking Activities*, at 2 (Dec. 24, 2008) (online at www.federalreserve.gov/newsevents/press/orders/orders20081224a1.pdf). Typically, Section 3(b)(1) of the BHCA requires the Board to provide notice of an application to the appropriate federal or state supervisory authority for the banks to be acquired and provide the supervisor with a period of time (usually 30 days) to submit views and recommendations on the proposal. 12 U.S.C. § 1842(b)(1); 12 CFR § 225.15(b), 12 CFR § 225.16(b)(3).

[56] The breakdown of this vote is unusual since the votes have typically been unanimous in recent years. See, e.g., Board of Governors of the Federal Reserve System, *Order Approving the Formation of a Bank Holding Company, Sandhills Bancshares, Inc.* (Oct.1, 2009) (online at www.federalreserve.gov/newsevents/press/orders/orders20091001a1.pdf); Board of Governors of the Federal Reserve System, *Order Approving Formation of Bank Holding Companies, The Goldman Sachs Group Inc.* (Sept. 21, 2008) (online at www.federalreserve.gov/newsevents/press/orders/orders20080922a1.pdf); Board of Governors of the Federal Reserve System, *Order Approving Formation of Bank Holding Companies and Notice to Engage in Certain Nonbanking Activities, American Express Company* (Nov. 10, 2008) (online at www.federalreserve.gov/newsevents/press/orders/orders20081110a1.pdf) (all 5–0 votes by the Board).

[57] 12 U.S.C. § 1841(a)(2); 12 CFR § 225.2(e); *see also* 12 CFR § 225.31(d) (Regulation Y).

tices."[58] The Board stated that it considered the six relevant statutory factors in reaching its decision.[59] It also stated that it took into account Treasury's actions to assist GM "and thereby help ensure the viability of a major business partner of GMAC and GMAC Bank."[60] The Board also found that GMAC Bank was "well capitalized" under regulatory guidelines.[61] Upon the Board's approval of the BHC application, GMAC Bank converted into a Utah state-chartered commercial non-member bank. As a BHC, GMAC is subject to the comprehensive, consolidated supervision of the Federal Reserve, including risk-based and leverage capital requirements and information reporting requirements.

When the Board granted GMAC's BHC application, it addressed the existence of certain nonbanking operations that are explicitly permitted under the BHCA, such as credit extension, servicing, and leasing.[62] The Board concluded that the "conduct of the proposed nonbanking activities within the framework of Regulation Y and Board precedent can reasonably be expected to produce public benefits that would outweigh any likely adverse effects."[63] Additionally, even if GMAC currently engages in some nonbanking activities that do not conform to the requirements of the BHCA, it has at least two years to bring these activities into conformity with the statute.[64]

As a condition of approval for GMAC's application, neither GM nor Cerberus was allowed to maintain a controlling interest in GMAC, and GMAC was required to enter into passivity agreements

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[58] Board of Governors of the Federal Reserve System, GMAC LLC; *IB Finance Holding Company, LLC: Order Approving Formation of Bank Holding Companies and Notice to Engage in Certain Nonbanking Activities*, Federal Reserve Bulletin, Vol. 95, Legal Developments: Fourth Quarter, 2008 (May 29, 2009) (online at www.federalreserve.gov/pubs/bulletin/2009/legal/q408/order6.htm) (hereinafter "Order Approving GMAC's BHC Formation"). In this case, the Board provided notice to GMAC Bank's primary federal and state supervisors, the FDIC, and the Commissioner of the Utah Department of Financial Institutions (UDFI), and the Board noted that they expressed no objection to the application's approval.

[59] The BHCA establishes the factors that the Board considers when reviewing the formation of a BHC or the acquisition of a bank. 12 U.S.C. § 1842(c)(1)–(6). These standards, and in particular the language contained in Section 1842, suggest that the Board has a substantial amount of discretionary power in approving BHC applications.

[60] Order Approving GMAC's BHC Formation, *supra* note 58.

[61] Order Approving GMAC's BHC Formation, *supra* note 58. At the end of 2008, GMAC's solvency ratio was below what is generally considered to be adequately solvent to meet short- and long-term obligations. GMAC Form 10–K for 2008, *supra* note 10, at 107–108.

[62] See Order Approving GMAC's BHC Formation, *supra* note 58 (citing 12 CFR § 225.28(b)(1)-(3).

[63] Order Approving GMAC's BHC Formation, *supra* note 58. According to Regulation Y, the Board must also find that a proposed activity is "so closely related to banking, or managing or controlling banks as to be a proper incident thereto." The Board's conclusion that the "proposed nonbanking activities" are "within the framework of Regulation Y" implies that it determined that these proposed activities are sufficiently "related to banking" so as to satisfy the regulation. 12 CFR § 225.21(a)(2).

[64] Order Approving GMAC's BHC Formation, *supra* note 58 (citing 12 U.S.C. § 1843(a)(2) ("Section 4 of the BHCA by its terms also provides any company that becomes a bank holding company two years within which to conform its existing nonbanking investments and activities to the section's requirements, with the possibility of three one-year extensions")). While GMAC has a period of time to conform its existing nonbanking activities to the BHCA, its public statements suggest that it may convert to a financial holding company, allowing it to "engage in a broader range of financial and related activities than those that are permissible for bank holding companies, in particular securities, insurance, and merchant banking activities." GMAC Form 10–K for 2009, *supra* note 12, at 6. According to GMAC, as a BHC, it is "eligible to convert to a financial holding company subject to satisfying certain regulatory requirements applicable to [GMAC] and to Ally Bank (and any depository institution subsidiary that [it] may acquire in the future)." *Id.*

with both companies.[65] GM was required to reduce its ownership stake to less than 10 percent and transfer that interest to an independent trust, to be approved by the Board and Treasury. The Board noted that it has permitted trusts historically only "as an interim measure in extraordinary and unusual circumstances when warranted by the public interest to allow an orderly divestiture of shares to conform with the requirements of the BHC Act." It approved of the trust structure in this case because "the divestiture plan is part of a proposal negotiated with Treasury to provide temporary assistance to GM and GMAC." Cerberus agreed to reduce its GMAC equity interest to less than 25 percent of the voting equity, with no single investor owning or controlling more than 5 percent.[66] Pursuant to these agreements, GM and Cerberus executed these reductions in ownership in May 2009. GM also committed to remove any voting representatives from GMAC's board of directors, but it requested the right to appoint a nonvoting observer. Cerberus reduced its director representation from five directors to one.

In connection with its BHC application, at the end of 2008 GMAC made exchange and cash tender offers to restructure GMAC and ResCap's capital structures. These steps were taken in order to satisfy the Federal Reserve's requirements that GMAC, among other things, attain a minimum amount of total regulatory capital of $30 billion.[67] In its public statements, GMAC signaled to the market that meeting this target in the debt exchange was a necessary condition for the Federal Reserve to approve its BHC application.[68] In order to satisfy this condition, GMAC needed the overall participation rate in the offers to be approximately 75 percent on a pro-rata basis.[69]

GMAC's bondholders were resistant to the exchange, however, and did not initially tender the principal amount of bonds necessary for the BHC conversion.[70] Only 58 percent of the GMAC

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[65] GM and Cerberus were previously not subject to the BHCA because GMAC's subsidiary insured depository institution, GMAC Bank, was an industrial loan company, exempt from the definition of "bank" under the BHCA. Board of Governors of the Federal Reserve System, Letter to B. Robbins Kiessling, Esq., advising that General Motors Corporation would not control GMAC LLC, both of Detroit, Michigan, under the Bank Holding Company Act (Mar. 24, 2009) (online at www.federalreserve.gov/boarddocs/legalint/BHC__ChangeInControl/2009/20090324b.pdf) (hereinafter "March 24 Letter to B. Robbins Kiessling, Esq."); Board of Governors of the Federal Reserve System, Letter to Joseph P. Vitale, Esq., advising that Stephen A. Feinberg and the entities he controls or advises would not control GMAC LLC, Detroit, Michigan, under the Bank Holding Company Act (Mar. 24, 2009) (online at www.federalreserve.gov/boarddocs/legalint/BHC__ChangeInControl/2009/20090324.pdf) (hereinafter "March 24 Letter to Joseph P. Vitale, Esq.").

[66] March 24 Letter to Joseph P. Vitale, Esq., *supra* note 65.

[67] GMAC, LLC, *GMAC Announces That the Results of Its Exchange Offers Are Insufficient To Meet Regulatory Capital Requirements To Become a Bank Holding Company* (Dec. 10, 2008) (online at media.gmacfs.com/index.php?s=43&item=293) (hereinafter "GMAC Announces Results of Exchange Offers"). Capital adequacy is one of the factors that the Federal Reserve Board shall consider when reviewing the formation of a BHC or the acquisition of a bank. *See* 12 U.S.C. § 1842(c)(2).

[68] *See*, *e.g.*, GMAC Announces Results of Exchange Offers, *supra* note 67 (stating that the "Federal Reserve has required GMAC to, among other things, achieve a minimum amount of total regulatory capital of $30 billion in connection with its application."); GMAC, LLC, *GMAC Makes Final Amendments to the Exchange Offers After Reaching Agreement With a Substantial Portion of Bondholders* (Dec. 12, 2008) (online at media.gmacfs.com/index.php?s=43&item=294) (referencing "the estimated overall participation that would be required to satisfy the condition for a minimum amount of regulatory capital in connection with GMAC's application to become a bank holding company").

[69] GMAC Announces Results of Exchange Offers, *supra* note 67.

[70] Although GMAC's equity holders were left (all else being equal) relatively whole (although they were substantially diluted upon Treasury's series of TARP investments, they were not wiped out completely), the GMAC bondholders were required to take significant haircuts in connection with GMAC's application to become a BHC. One investor, William Gross of Pimco, re-

notes and 37 percent of the ResCap notes were tendered as of December 24, 2008, the date of GMAC's BHC approval.[71] Ultimately, however, the Federal Reserve approved GMAC's BHC application despite the shortfall in the amount of tendered bonds on the grounds that GMAC's capital ratio was nonetheless adequate.[72] It is impossible, in retrospect, to determine what would have happened if GMAC had continued to press its bondholders in the absence of the Federal Reserve's intervening BHC application approval.

In connection with the renaming of GMAC Bank to Ally Bank in May 2009 and the FDIC's decision to increase the amount of brokered deposits that the bank could raise, Ally Bank launched a major brand-building and deposit-generation initiative.[73] As of December 31, 2009, the deposit base at Ally Bank was $28.8 billion, an increase of 50 percent from the previous year.[74]

c. GMAC's Section 23(a) Exemption

After it became a BHC, GMAC requested on two occasions that the Board grant Ally Bank an exemption from Section 23(a) of the Federal Reserve Act.[75] Section 23(a) restricts the amount of "covered transactions" between a bank and its affiliates.[76] "Covered transactions" are transactions between a bank and an affiliate, including the purchase of assets and extensions of credit. Transactions between a bank and a third party are also considered "covered transactions" if the transactions' proceeds are used to benefit an affiliate of the bank. Section 23(a) authorizes the Board to grant an exemption if it finds that doing so is in the public interest and consistent with the statute's purposes.[77]

The purpose of the provision is to preserve the safety and soundness of banks that receive FDIC backing and to promote competition by reducing the likelihood that banks would favor certain cus-

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sisted the offer on the grounds that it would require bondholders to forgo 50 percent of what GMAC owed them. Leslie Wayne, New York Times, *GMAC Hopes Bondholders Approve Bank Deal* (Dec. 23, 2008) (online at www.nytimes.com/2008/12/24/business/24gmac.html). The exchange offer was fraught with difficulty, as many bondholders refused to tender. GMAC Announces Results of Exchange Offers, *supra* note 67 (noting that "[b]ased on the results of the GMAC and ResCap offers to date, GMAC would not obtain a sufficient amount of total regulatory capital in connection with the GMAC and ResCap offers to meet the requirements set forth by the Federal Reserve for GMAC to become a bank holding company under the Bank Holding Company Act of 1956").

[71] GMAC, LLC, *GMAC Receives Significant Participation and Extends Early Delivery Time of its Notes Exchange Offers* (Dec. 16, 2008) (online at media.gmacfs.com/index.php?s=43&item=295).

[72] Federal Reserve conversations with Panel staff (Feb. 19, 2010).

[73] Congressional Oversight Panel, Written Testimony of Ron Bloom, senior advisor to the Secretary of the Treasury, and Jim Millstein, chief restructuring officer, U.S. Department of the Treasury, *COP Hearing on GMAC Financial Services*, at 9 (Feb. 25, 2010) (online at cop.senate.gov/documents/testimony-022510-treasury.pdf) (hereinafter "Written Testimony of Ron Bloom and Jim Millstein"). Treasury, among others, has seemingly endorsed Ally Bank's increasing role in GMAC's business model, noting that GMAC has "access to deposits now through Ally Bank that they hadn't had before, which lowers their cost of capital." Transcript of COP Hearing on GMAC, *supra* note 12 (Testimony of Jim Millstein).

[74] GMAC Form 10–K for 2009, *supra* note 12, at 82.

[75] 12 U.S.C. § 371c; 12 CFR part 223.

[76] Section 23(a) limits the "amount of 'covered transactions' between a bank and any single affiliate to 10 percent of the bank's capital stock and surplus and . . . the amount of covered transactions between a bank and all its affiliates to 20 percent of the bank's capital stock and surplus." Letter from Robert deV. Frierson, deputy secretary of the Board, Board of Governors of the Federal Reserve System, to Richard K. Kim, partner, Corporate Department, Wachtell, Lipton, Rosen, & Katz (May 21, 2009) (online at www.federalreserve.gov/boarddocs/legalint/FederalReserveAct/2009/20090521/20090521.pdf) (hereinafter "May 21 Letter from Robert deV. Frierson").

[77] 12 U.S.C. § 371c(f)(2); 12 CFR § 223.43(a).

tomers over others.[78] Section 23(a) is considered a critical component of the firewall separating banking and commerce, a principle that stands at the center of banking law.[79] One expert referred to Section 23(a) as the "Magna Carta" of banking law.[80] Exemptions are granted rarely.[81]

Section 23(a) applies to dealer loans and retail loans made by Ally Bank because GM and GMAC are both affiliates of Ally Bank. GMAC applied for an exemption because it sought to engage in transactions in excess of the limitations imposed by Section 23(a).[82]

On December 24, 2008, the Board granted GMAC's request for an exemption for retail loans,[83] and on May 21, 2009, it granted GMAC's extended request for an exemption for both retail and dealer loans. In granting this extended exemption, the Board stated that "covered transactions" would "benefit the public because they would allow [Ally] Bank to extend credit to a greater number of retail customers and provide dealers with greater access to financing, thereby avoiding further disruption in the credit market for automobile purchases."[84] The exemption does not expire.

To address concerns about the impact of the exemption on competitiveness and on the safety and soundness of Ally Bank, the Board required GMAC to satisfy certain conditions.[85] These conditions apply only to funds originated by Ally Bank. In other words, if GMAC makes loans using funds from other sources—such as the securitization market—it does not need to comply with these conditions. Regardless of the source of funds, GMAC must abide by

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[78] *See* Jonathan R. Macey, Geoffrey P. Miller, and Richard Scott Carnell, *Banking Law and Regulation*, 3d edition 472 (2001). The Federal Reserve Board has indicated that the "twin purposes of section 23(a) are (i) to protect against a depository institution suffering losses in transactions with affiliates and (ii) to limit the ability of an institution to transfer to its affiliates the subsidy arising from the institution's access to the federal safety net." Board of Governors of the Federal Reserve System, *Transactions Between Member Banks and Affiliates*, 67 Fed. Reg. 76560, 76560 (Dec. 12, 2002) (final rule). The safety net consists of deposit insurance, the Federal Reserve's discount window, and other banking regulatory tools designed to protect financial markets and participants.

[79] For example, the Senate Report on the Gramm-Leach-Bliley Act stated that the law intended to preserve the separation of banking and commerce. Senate Committee on Banking, Housing, and Urban Affairs, *Report on the Financial Services Modernization Act of 1999*, S.Rep. 106–44, at 21 (Apr. 28, 1999) (online at www.gpo.gov/fdsys/pkg/CRPT-106srpt44/pdf/CRPT-106srpt44.pdf) ("This authority provides the Board with some flexibility to accommodate the affiliation of depository institutions with insurance companies, securities firms, and other financial services providers while continuing to be attentive not to allow the general mixing of banking and commerce in contravention of the purposes of this Act"); see also Arthur E. Wilmarth, Jr., *Subprime Crisis Confirms Wisdom of Separating Banking and Commerce*, Banking & Financial Services Policy Report, at 3 (May 2008) (hereinafter "Wisdom of Separating Banking and Commerce").

[80] Analyst conversations with Panel staff (Mar. 1, 2010).

[81] Prior to the onset of the financial crisis, the Board granted only a small number of Section 23(a) exemptions. In the past, typical 23(a) exemptions dealt with one-off sales/purchases of assets as between the bank and its affiliates (e.g., purchase of the premises from the parent, purchase by the bank of an aircraft from an affiliate, etc.), corporate reorganizations, and allowing banks to establish securities lending or borrowing programs with their securities affiliates. Other examples include blanket exemptions given during times of significant upheaval or crisis, such as the period following the attacks of September 11, 2001. Wisdom of Separating Banking and Commerce, *supra* note 79, at 9.

[82] May 21 Letter from Robert deV. Frierson, *supra* note 76.

[83] Letter from Robert deV. Frierson, deputy secretary of the Board, Board of Governors of the Federal Reserve System, to Richard K. Kim, partner, Corporate Department, Wachtell, Lipton, Rosen, & Katz (Dec. 24, 2008) (online at www.federalreserve.gov/boarddocs/legalint/federalreserveact/2008/20081224/20081224.pdf).

[84] May 21 Letter from Robert deV. Frierson, *supra* note 76; *see also* GMAC Form 10–Q for Q3 2009, *supra* note 22, at 95.

[85] May 21 Letter from Robert deV. Frierson, *supra* note 76.

BHC-specific regulations and is subject to ongoing oversight by the Federal Reserve.

The Board also noted that it granted the exemption "in light of the unique circumstances surrounding" GMAC and Treasury's provision of "substantial capital support" to GMAC "to allow it to continue its financing of GM automobile purchases and to expand its activities to include financing Chrysler automobiles."[86] While the Board historically has required a parent company to provide a collateralized guarantee when it transfers assets to an affiliate, it did not obligate GMAC to provide collateral here because "GMAC's financial position will be strengthened by an additional equity investment by Treasury." As a result, the Board determined that "Treasury's support helps ensure that GMAC will be in a position to honor its obligations under the guarantee." The ongoing consequences and implications of these determinations are reflected in the rest of the report.

d. Impact of BHC Approval

The Board's decision to approve GMAC's BHC application produced a number of results. The market appears to have had mixed reactions to the Board's approval of GMAC's BHC application. The value of some of GMAC's debt increased over the course of one week after the BHC approval.[87] That said, Standard & Poor's (S&P) downgraded certain debt ratings for GMAC and ResCap, voicing concerns that "the exchange and the application for BHC status illustrate the gravity of the company's financial position."[88]

Perhaps most significantly, the government's intervention and "guarantee" of GMAC's debt raise substantial moral hazard concerns. The bondholders who participated in the debt exchange received significant haircuts, meaning that they incurred some loss.[89] Once the Board had approved GMAC's BHC application and Treasury had provided GMAC with TARP funds, however, the bondholders who chose not to exchange their debt ranked senior to the United States and were likely to receive full payment on their notes. The bondholders learned that in the face of a potential government rescue, sitting on the sidelines and holding out may very well result in higher returns and greater value.

GMAC's conversion to a BHC failed to stop the tide of losses. Upon the release of its 2008 financial results in February 2009, then-GMAC CEO Alvaro G. de Molina commented that "[t]he past year was clearly an extraordinary period for GMAC. Our business, like many others, was significantly affected by the U.S. recession, the global capital and credit market disruption, falling auto sales

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[86] May 21 Letter from Robert deV. Frierson, *supra* note 76; March 24 Letter to B. Robbins Kiessling, Esq., *supra* note 65; March 24 Letter to Joseph P. Vitale, Esq., *supra* note 65.

[87] GMAC's BHC approval had a dramatic effect on the price of GMAC's outstanding debt. For example, the price of GMAC's $2 billion, 7.25 percent senior unsecured note with a March 2, 2011 maturity increased from 40.8 on December 1, 2008 to 87.9 on January 2, 2009. The price of another issue, GMAC's 7 percent senior unsecured $1 billion note with a maturity of February 2, 2012, increased from 33 on December 1, 2008 to 80.3 on January 5, 2009. Bloomberg Data (accessed Mar. 9, 2010).

[88] Standard & Poor's, GMAC LLC, *Residential Capital LLC Ratings Lowered to 'SD' From 'CC', Taken Off Credit Watch* (Dec. 31, 2008).

[89] For further discussion about the debt exchange, *see* note 68, *supra*.

and a mortgage market in turmoil."[90] GMAC reported net income of $3.4 billion for the 2008 year (which was due solely to an exceptional one-time gain on the debt exchange in the fourth quarter of 2008), compared to a net loss of $8.0 billion for the 2009 year.[91]

3. GMAC's Relationship with GM

a. Captive Era

GMAC's current relationship with GM is shaped by the shared historical relationship between the two entities since 1919. Until 2006, GMAC was a wholly owned subsidiary of GM, functioning as GM's captive financing arm with the interests of both entities very closely aligned. During the time that GMAC functioned as a captive, GM and GMAC shared the objective of maximizing profits by selling and leasing as many cars as possible. GMAC's role was to provide GM dealers with the financing necessary to acquire and maintain automobile inventories and to provide GM consumers with a financing source to purchase or lease automobiles. GMAC's relationship with GM has been significantly affected by subvention—the way in which GM pays for incentive programs that it offers through GMAC exclusively. As GMAC has stated:

> General Motors may elect to sponsor incentive programs (on both retail contracts and leases) by supporting financing rates below standard rates at which GMAC purchases retail contracts. Such marketing incentives are also referred to as rate support or subvention. General Motors pays the present value difference between the customer rate and GMAC's standard rates either directly or indirectly to GM dealers. GMAC purchases these contracts at a discount, which is deferred and recognized as a yield adjustment over the life of the contract. GM may also provide

[90] GMAC, LLC, *GMAC Financial Services Reports Preliminary Fourth Quarter and Full-Year 2008 Financial Results* (Feb. 3, 2009) (online at media.gmacfs.com/index.php?s=43&item=305) (hereinafter "GMAC Reports Preliminary Q4 and Full-Year 2008 Results"). Treasury has never argued that GMAC itself was systemically important, although in December 2008 some communications indicated a belief in Treasury that GMAC's failure—independent of its effects on the domestic automobile industry—could have thrown an already precarious financial system into further disarray during the depths of the financial crisis. For example, there was mention of potential losses that could be incurred by holders of GMAC debt, representing a number of other financial institutions across the industry. Treasury conversations with Panel staff (Feb. 2, 2010). Chrysler Financial was also adversely affected by the deterioration in the credit markets, the changed landscape of the automotive industry in late 2008, and the maturity of outstanding debt. The situation was more ominous for Chrysler Financial, however, because its debt situation was even worse. Unlike GMAC, Chrysler Financial faced the maturity of all of its outstanding debt in July 2009. In the early spring of 2009, Treasury concluded that Chrysler Financial would be unable to meet its financing requirements by July 2009. In order to prevent the collapse of Chrysler, Treasury claimed that the government acted to orchestrate the continued existence of a viable financing source for Chrysler dealers and consumers by folding Chrysler Financial's core operations into GMAC. For further discussion of GMAC's assumption of Chrysler Financial's business, *see* Section E.1, *infra*.

[91] GMAC Form 10–K for 2009, *supra* note 12, at 29. In the first quarter of 2009, the company still reported as GMAC, LLC and GMAC Bank before changing to GMAC, Inc. and Ally Bank, respectively. Effective June 30, 2009, GMAC LLC was converted from a Delaware limited liability company into a Delaware corporation, and was renamed "GMAC Inc." The Tier 1 risk-based capital ratio represents the percentage of risk-based capital to total risk-weighted assets and is used by regulators to measure a financial institution's capital adequacy. According to the FDIC guidelines, a financial institution is considered "well capitalized" if the Tier 1 risk-based capital ratio is equal to or greater than 6 percent and "adequately capitalized" (i.e., minimum capitalization ratio) if the ratio is equal to or greater than 4 percent. Based upon the most recent available information, GMAC, Inc.'s Tier 1 risk-based capital ratio was 14.1 percent (at the end of 2009), and Ally Bank's Tier 1 risk-based capital ratio was 22.1 percent (for the third quarter of 2009).

> incentives on leases by supporting residual values (established at lease inception) in excess of GMAC's standard residual values and by reimbursing the Company to the extent vehicle remarketing proceeds are less than contract residuals. Such lease incentives are also referred to as residual support. . .[92]

Under the arrangements with GM, while GMAC generally incurred the risk of loss if the value of a leased vehicle upon resale fell below the projected residual value of the vehicle at the time the lease contract was signed, GM would reimburse GMAC if the resale proceeds were less than the residual value set forth in the lease contract at lease termination.[93]

In addition, GMAC carved out a particularly critical niche in automotive finance by providing the vast majority of floorplan financing to GM dealers,[94] which, as noted above, ensures that car dealers will have inventory in place when sales opportunities arise.

b. Post-captive Era

While GMAC may no longer be a captive in the legal sense after it became an independent finance company in 2006, it essentially functions as a captive in many ways as a result of the contractual codification of its historical relationship with GM.[95] As part of the 2006 sale, GMAC and GM entered into several service agreements that "codified the mutually beneficial historic relationship between the companies."[96] One of these agreements was the United States Consumer Financing Services Agreement (USCFSA), which, among other things, provided that GM would use GMAC exclusively whenever it offered vehicle financing and leasing incentives to customers.[97] The parties agreed to maintain this relationship for ten years and, as consideration for this arrangement, GMAC pays GM an annual exclusivity fee and agrees to meet specified targets with respect to consumer retail and lease financings of new GM vehicles.[98]

On December 29, 2008, after the Federal Reserve approved GMAC's application to become a BHC, GM and GMAC agreed to

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[92] GMAC, LLC, *Form 10–K for the Fiscal Year Ended December 31, 2004,* at 11 (online at www.sec.gov/Archives/edgar/data/40729/000095012405001563/k91417e10vk.htm). While GMAC made this statement in its 2004 Annual Report, its more recent annual reports have repeated this discussion, indicating that such subvention agreements have continued between GM and GMAC.

[93] GMAC Form 10–K for 2005, *supra* note 36, at 23.

[94] For further discussion regarding GMAC's importance to GM and the need for GMAC to continue operating in the floorplan lending arena in particular, *see* Section E, *infra.*

[95] In conversations with Panel staff, industry analysts also presented the same view of GMAC's role in the automotive finance industry.

[96] GMAC Form 10–K for 2008, *supra* note 10, at 40.

[97] GMAC Form 10–K for 2008, *supra* note 10, at 40.

[98] In 2009, GMAC paid GM a total of $122 million for services provided. This includes $75 million for the exclusivity arrangement under the U.S. Consumer Financing Services Agreement for the GM-supported U.S. retail business, $15 million for the GM-supported Canadian retail business, $10 million for the GM-supported retail business in international operations, marketing royalties of $15 million in connection with the use of the GM name in GMAC's insurance products, and rent for GMAC's primary executive and administrative offices located in the Renaissance Center in Detroit, Michigan. For further information about GMAC's exclusivity arrangement and royalty agreement with GM, *see* GMAC Form 10–K for 2009, *supra* note 12, at 180, 183.

modify certain terms and conditions of the USCFSA.[99] These amendments include the following:

• The parties agreed that for a two-year period, GM could offer retail financing incentive programs through an alternative financing source under certain conditions (and sometimes with the limitation that the alternative financing source's pricing meets certain restrictions).[100] Following that two-year period, GM would be able to offer any incentive programs on a graduated basis through alternative financing sources, along with GMAC, provided that the pricing satisfies certain requirements.[101]

• The parties agreed to eliminate the requirement that GMAC satisfy certain lending and underwriting targets in order to remain the exclusive underwriter of special promotional loan programs offered by GM.[102] GM offered GMAC the right to finance these special programs for retail consumers for a five-year period.[103]

• The parties eliminated the exclusivity arrangement with respect to promotional programs for GM dealers, and this change will be phased out over time.[104]

• The parties agreed that GMAC would no longer have an obligation to lend to a particular wholesale or retail customer, provide operating lease financing products, or be required to pay a penalty or receive lower payments or incentives for refusing to lend to a customer or for failing to satisfy individual or aggregate lending targets.[105] GMAC can also make loans to any third party and will use its own underwriting standards in making loans, including GM-related loans.[106]

The modified USCFSA is in effect until December 24, 2013.[107] In addition, the subvention agreements between GM and GMAC have been continued through these contractual agreements, and the same accounting and disclosure methods are used to account for such agreements.[108]

GMAC has noted that its profitability and the financial condition of its operations remain heavily dependent upon the performance, operations, and prospects of GM.[109] Despite the contractual modifications discussed above, GMAC notes that "[a] primary objective of the [United States Consumer] Financing Services Agreement continues to be supporting distribution and marketing of GM products."[110] While GMAC currently has a relationship with Chrysler after taking over a substantial component of Chrysler Financial's business, this does not necessarily mean that the captive issue disappears; GMAC's operations continue to have many attributes of a captive relationship, except that it now has those relationships with both GM and Chrysler. As GMAC CEO Michael Carpenter

[99] GMAC Form 10–K for 2008, *supra* note 10, at 40.
[100] GMAC Form 10–K for 2008, *supra* note 10, at 40.
[101] GMAC Form 10–K for 2008, *supra* note 10, at 40.
[102] March 24 Letter to B. Robbins Kiessling, Esq., *supra* note 65.
[103] March 24 Letter to B. Robbins Kiessling, Esq., *supra* note 65.
[104] March 24 Letter to B. Robbins Kiessling, Esq., *supra* note 65.
[105] GMAC Form 10–K for 2008, *supra* note 10, at 40; March 24 Letter to B. Robbins Kiessling, Esq., *supra* note 65.
[106] March 24 Letter to B. Robbins Kiessling, Esq., *supra* note 65.
[107] GMAC Form 10–K for 2008, *supra* note 10, at 40.
[108] *See, e.g.,* GMAC Form 10–K for 2008, *supra* note 10, at 162; GMAC Form 10–K for 2009, *supra* note 12, at 43–44.
[109] GMAC Form 10–K for 2009, *supra* note 12, at 15–16.
[110] GMAC Form 10–K for 2009, *supra* note 12, at 2, 44.

discussed recently, GMAC continues to enjoy an extremely close relationship with GM, which he described as GMAC's partner.[111] According to Mr. Carpenter, "the real difference between being a partner versus a captive is that, as a partner, the economic decisions that the manufacturer makes, in terms of, if you will, subsidizing the sale of the automobile by using financing, becomes obvious and transparent as opposed to buried."[112] At the Panel's recent GMAC hearing, Mr. Carpenter and CFO Robert Hull confirmed that GMAC continues to enjoy several advantages in the marketplace, including subvention agreements with GM, extensive knowledge of the dealership world, and integration with the dealers and manufacturers from a systems point of view.[113] GM also remains contractually obligated to cover some of GMAC's lease losses and to support the residual values of the vehicles on GMAC's books.

Both in GMAC's captive and non-captive states, GM and GMAC are so intertwined that providing assistance to one is essentially providing assistance to the other, meaning that the government's support for GMAC is essentially additional assistance to GM.

c. Other Issues Raised by GM/GMAC Relationship

The captive finance company model has created a variety of complications for GM and GMAC. At a certain level, the captive company model contributed to GMAC's poor performance in mortgage financing. Prior to GM's rating downgrade, and while it was still a captive, GMAC relied on its parent's high credit rating to obtain cheap credit, which it used in its mortgage operations. In addition, the funds at its ILC were FDIC-insured, and GMAC therefore had the ability to leverage government-guaranteed funds to serve its mortgage operations.[114] This structure lacked transparency and allowed the captive to gain leverage either from the health of the manufacturing parent or the FDIC insurance of the bank. GMAC's forays into home mortgages were ultimately disastrous, and when Treasury provided TARP funds to GMAC—given the destabilizing losses at ResCap—its investment was made in light of the business model that led GMAC astray. There is a possibility that Treasury's intervention will distort the competitive playing field for other captives. This could be detrimental to systemic and commercial stability, inasmuch as the economic incentives in the relationships between captives and parents can be difficult to unwind.[115]

As discussed above, although GMAC is no longer a subsidiary of GM, the TARP funds provided to GMAC have been cited by at least

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[111] GMAC, Inc., *GMAC—Q4 2009 GMAC Inc. Earnings Conference Call,* at 4 (Feb. 4, 2010) (online at www.gmacfs.com/us/en/about/investor/upcoming_events.html) (hereinafter "GMAC Q4 2009 Earnings Conference Call").

[112] GMAC Q4 2009 Earnings Conference Call, *supra* note 111, at 15.

[113] Transcript of COP Hearing on GMAC, *supra* note 12 (Testimony of Michael Carpenter and Robert Hull).

[114] Restrictions on affiliate transfers apply to ILCs as well as BHCs, and so GMAC Bank would have only been able to fund GM subject to the affiliate transfer restrictions. Because GMAC Bank was an ILC, however, GMAC, as GMAC Bank's parent, was not subject to supervisory oversight. *See* O. Emre Ergungor and James B. Thomson, *Industrial Loan Companies* (Oct. 1, 2006) (online at www.clevelandfed.org/research/Commentary/2006/1001.pdf).

[115] GMAC Q4 2009 Earnings Conference Call, *supra* note 111, at 15 ("I think the only—I think the real difference between being a partner versus a captive is that, as a partner, the economic decisions that the manufacturer makes, in terms of, if you will, subsidizing the sale of the automobile by using financing, becomes obvious and transparent as opposed to buried. And I actually think in the long term that is actually positive for the auto companies, because it forces them to make an economic decision in a very rigorous way").

one trading partner as giving rise to subsidy concerns under applicable WTO rules. Thus, another consequence of the GMAC/GM model, in which GM and GMAC (whether captive or otherwise) are almost inextricably entwined, is that funds provided to GMAC have also been viewed as a subsidy to GM itself. The Panel takes no position on whether funds provided to either GM or GMAC could in fact constitute a subsidy under WTO rules. However, one trading partner has included the aid to GMAC in that analysis, raising the question as to whether any trading partner could be successful in arguing that support for GMAC could constitute an actionable subsidy under World Trade Organization (WTO) rules.[116]

In September 2009, the People's Republic of China launched a countervailing duty investigation into the assistance given the U.S. automobile companies.[117] Among other things, the Chinese automotive industry cited aid to GMAC as a portion of its case. The legal theories are complicated, but the Chinese industry, at least, sees the GMAC bailout as part of a larger subsidy to the auto industry. It is not clear whether any other foreign auto industry will be interested in making such a claim. The politics are difficult, and as most countries with large automotive industries were engaged in providing some form of assistance to their own automobile companies at the time, maintaining the case might be politically untenable, even if reciprocity is not a factor in the analysis.[118] The possibility remains, however, that other trading partners may view the

[116] Some authors have already considered the relevance of WTO rules in this context, noting that when the United States first began discussing a variety of measures to assist the domestic automotive industry, the President of the European Commission, José Manuel Barroso, warned that the Europeans would ask the WTO if the aid to the automotive companies constituted illegal state aid. According to these authors, under the WTO Agreement on Subsidies and Countervailing Measures (ASCM), a subsidy is defined as a "financial contribution" made by a government that confers a benefit on the receiving party. Put another way, any government assistance must give the company an advantage that they would not have under normal market conditions. For example, because the interest rate on the loans to GM and Chrysler was, in all likelihood, substantially below that which GM and Chrysler would have been able to get in the market at the time, the loans could be seen to have conferred upon GM and Chrysler such an advantage. Accordingly, under the WTO subsidy rules, the loans and guarantees to the auto industry could be viewed as subsidies. Lastly, the loans and guarantees could meet the specificity requirement of the WTO, because they are not available to a wide spectrum of industrial enterprises. Claire Brunel and Gary Clyde Hufbauer, *Money for The Auto Industry: Consistent with WTO Rules?,* at 6–10 (Feb. 2009) (online at www.iie.com/publications/pb/pb09-4.pdf) (hereinafter "Money for The Auto Industry: Consistent with WTO Rules?"). The U.S. Government's equity investments further complicate the analysis, because not only the loans, but also the investments, must be evaluated according to the WTO standards. For a more detailed discussion of the various treaties in the context of aid to the automotive industry, *see* Rolf H. Weber and Mirina Grosz, Journal of World Trade, *Governments' Interventions into the Real Economy under WTO Law Revisited: New Tendencies of Governmental Support of the Automobile Industry* (Oct. 2009) (discussing a variety of topics, including environmental effects, applicable rules, and legal analysis).

[117] Ministry of Commerce, the People's Republic of China, *China Launches Anti-Dumping Probe into U.S. Auto, Chicken Products* (Sept. 14, 2009) (online at english.mofcom.gov.cn/aarticle/counselorsreport/americaandoceanreport/200909/20090906515261.html); *see also* Ministry of Commerce, the People's Republic of China, *Anti-dumping and Anti-Subsidy Investigation Application* (Sept. 9, 2009) (online at www.chinaustradelawblog.com/uploads/file/Petition(1)(1).pdf).

[118] GMAC, of course, also has a substantial international presence, and its business plan is the same in its international operations. *See* Section C.4, *infra.* For comparison, Peugeot and Renault appear to have captive finance arms that operate much like the U.S. manufacturing captive finance arms. *See* Banque PSA Finance, *Annual Results 2009* (Feb. 8, 2010) (online at www.banquepsafinance.com/docs/rapports/fr/rapports162.pdf); RCI Bankque, History (online at www.rcibanque.com/en/grou__historique.html) (accessed March 10, 2010). In its auto bailout, however, the French government offered loans directly to the automotive companies. *See* Money for The Auto Industry: Consistent with WTO Rules?, *supra* note 116, at 5.

support for GMAC as part of a case regarding actionable subsidies to the U.S. automobile companies.[119]

4. Global Automotive Finance

GMAC's GAF operations played a significant role in its declining performance. The GAF operations offer an array of wholesale and retail automotive financing products and services. This business unit provides vehicle financing through purchases of retail automotive and lease contracts primarily with GM customers, finances the purchase of new and used vehicles by GM dealers through wholesale financing, provides floorplan financing for GM dealers to purchase vehicles to rent or lease to others, provides wholesale vehicle inventory insurance to GM dealers, and provides automotive extended service contracts through GM dealers.[120]

Through its GAF operations, GMAC supports the sale of GM vehicles through floorplan financing new and used vehicles manufactured or distributed by GM and, less frequently, other automobile manufacturers before sale or lease to the retail consumer. Wholesale automotive financing represents a significant component of GMAC's GAF business and is the primary source of funding for GM dealers' purchases of new and used vehicles.[121] In 2009, GMAC financed 3.9 million new GM vehicles (representing a 78 percent share of GM sales to dealers), and financed approximately 249,000 new non-GM vehicles.[122] In 2008, GMAC financed 5.4 million new GM vehicles (representing 81 percent of GM sales to dealers), and financed approximately 196,000 new non-GM vehicles.[123]

Consumer retail financing represents a larger portion of the company's revenue (producing, on average, 32 percent of the GAF segment's total financing revenues between 2007 and 2009).[124] GMAC's share of GM retail sales was 20 and 32 percent for 2009 and 2008, respectively.[125] Mr. Hull stated in a conference call with investors that GMAC financed loans for about 17 percent of GM

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[119] Money for The Auto Industry: Consistent with WTO Rules?, *supra* note 116, at 9. This discussion only touches upon a very few of the possible legal regimes that may be implicated by government aid to industry generally, whether in the United States or elsewhere. For example, the European Commission state aid doctrine holds that state aid, which confers an improper benefit upon a domestic industry must be notified to and approved by the European Commission. A number of cases relating to actions taken during the financial crisis are currently working their way through the European Commission. The European Commission has taken the position that despite the crisis, it is important to maintain rules regarding anti-competitive practices, but to expedite consideration of the aid if necessary. *See generally* The Scottish Parliament, *State Aid Regulations (Update)* (Oct. 18, 2002) (online at www.scottish.parliament.uk/business/research/pdf_res_notes/rn01-43.pdf); *see also* European Commission, *The Contribution of Competition Policy to Economic Recovery* (online at ec.europa.eu/competition/recovery/index.html) (accessed Mar. 8, 2010). There may be other laws and doctrines addressing these issues, but they are beyond the scope of this report.

[120] GMAC Form 10–Q for Q3 2009, *supra* note 22, at 38.

[121] GMAC Form 10–K for 2009, *supra* note 12, at 3. Wholesale automotive financing's 10 percent contribution to the GAF segment's total financing revenues (which include total financing revenue and other interest income), on average, between 2007 and 2009, significantly understates the importance of this business. While this segment's contribution on a net revenue basis is not disclosed, lower financing and credit costs in the wholesale business indicate a more substantial contribution on a net revenue basis. Further, wholesale financing often serves as a gateway for other product offerings to the dealer community.

[122] GMAC Form 10–K for 2009, *supra* note 12, at 46.

[123] GMAC Form 10–K for 2008, *supra* note 10, at 46.

[124] GMAC Form 10–K for 2009, *supra* note 12, at 36, 39, 42. Total financing revenues include total financing revenue and other interest income.

[125] GMAC Form 10–K for 2009, *supra* note 12, at 2, 43.; GMAC Form 10–K for 2008, *supra* note 10, at 12. For further discussion of the decrease in this percentage through 2008, *see* Section E.1(a), *infra*.

customers in the first quarter of 2009.[126] During the fourth quarter of 2009, GMAC originated $894 million of new Chrysler retail loans, compared to $721 million in the third quarter of 2009, and its U.S. retail penetration for Chrysler reached 25.5 percent by the end of 2009.[127] Through operating leases, GMAC financed the leases for 624,000 new vehicles, 561,000 new vehicles, 309,000 new vehicles, and 6,000 new vehicles in 2006, 2007, 2008, and 2009, respectively.[128] Due to the deteriorating economic conditions and, in particular, the declines in demand and used vehicle sale prices in 2008, GAF operations recognized impairment of $1.2 billion on vehicle operating leases.[129] While the greater portion of GMAC's revenue source has historically derived from consumer as opposed to wholesale automotive financing, this does not necessarily reflect the relative importance of these sectors to the automotive industry.[130]

The financial crisis and the resulting slowdown in the credit markets had widespread economic implications beyond the housing sector, including a substantial impact on the automotive industry and credit markets in general. Weak economic conditions and the deterioration in the housing market exerted pressure on consumer automotive finance customers, resulting not only in a depressed automobile market, but also in higher delinquencies, repossessions, and losses. These conditions affected both GMAC's ability to fund its operations and the demand for its financial products.

GMAC relied heavily on the capital markets (and the securitization markets in particular) for its funding. Beginning in 2008 (and particularly after the events of September 2008 including the collapse of Lehman Brothers), there was a significant decline in the availability of consumer credit and a severe reduction in overall liquidity in the consumer finance industry, including substantial disruption in the automotive asset-backed securities (ABS) markets.

New vehicle demand also decreased as the unemployment rate increased, consumer demand fell and gasoline prices spiked. As a result, global vehicles sales declined rapidly across the board in 2008 and through much of 2009.[131] Automotive loan and lease production significantly contracted across the industry, particularly in the fourth quarter of 2008, due to stressed economic conditions and their impact on consumer spending habits, as well as increased interest rates and tightening of financing terms. The majority of automobile purchases in the United States are financed, including an estimated 80–90 percent of consumer purchases and substan-

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[126] GMAC, LLC, *Q1 2009 GMAC LLC Earnings Conference Call,* at 10 (May 5, 2009) (online at phx.corporate-ir.net/External.File?item=UGFyZW50SUQ9NDU0M3xDaGlsZElEPS0xfFR5cGU9Mw==&t=1).

[127] GMAC, Inc., *GMAC Financial Services Reports Preliminary Fourth Quarter and Full-Year 2009 Financial Results* (Feb. 4, 2010) (online at media.gmacfs.com/index.php?s=43&item=383) (hereinafter "GMAC Reports Preliminary Q4 and Full-Year 2009 Results").

[128] GMAC Form 10–K for 2009, *supra* note 12, at 43; GMAC Form 10–K for 2008, *supra* note 10, at 39.

[129] GMAC Form 10–K for 2008, *supra* note 10, at 46. GMAC did not recognize operating lease impairments in 2009, due to improvements in the used vehicle market.

[130] For further discussion of the importance of particular components of GMAC's automotive finance business to the automotive industry, *see* Section E.1(a).

[131] IHS Global Insights, *U.S. Executive Summary,* at 2, 9 (Aug. 2009) (noting that U.S. automobile sales fell to a 26-year low, from a high point of 17.3 million cars and light trucks in 2000 to 13.2 million in 2008. Sales fell much further in the first half of 2009 as a result of deteriorating economic conditions).

tially all dealer inventory purchases.[132] It has been estimated that 2 million to 2.5 million vehicle sales were lost because either dealers or customers could not obtain credit.[133] These conditions adversely impacted GMAC and many of its competitors.[134]

Without the liquidity provided by the securitization markets, GMAC made a strategic decision to preserve floorplan lending at the expense of its retail lending business.[135] In mid-October 2008, GMAC announced a more conservative policy for consumer automotive financing in the United States that included limiting purchases to consumers with credit scores of 700 or above.[136] GMAC stated that reduced access to funding "prompted GMAC to implement a more conservative purchase policy for consumer automotive financing in the United States which significantly affected origination volumes in the [fourth] quarter [of 2008]."[137] Following its approval to become a BHC and the receipt of its initial TARP investment in December 2008, GMAC lifted these restrictions and offered retail financing for consumers with a credit score of 621 or above.[138]

These factors, coupled with the deterioration in the credit markets in general, caused GMAC's share of the GM retail market in the fourth quarter of 2008 to fall to approximately five percent.[139] Declines in new vehicle financing originations due to tighter underwriting standards and higher interest rates, continued credit market disruption, and lower automotive industry sales, coupled with low consumer confidence and the company's strategic decision in late 2008 to curtail leasing substantially, adversely affected GMAC's revenue. GAF operations recorded a net loss of $2.1 billion for the year ended December 31, 2008 (losing money for the first time in its 90-year history), compared to net income of $1.5 billion for the year ended December 31, 2007.[140] GAF operations, however, were consistently profitable during 2009, with net income of $546 million.[141]

GMAC's difficulties had a significant effect on GM's vehicle sales overall, since, as GM notes, many of its competitors have "captive finance subsidiaries that were better capitalized than GMAC and

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[132] Written Testimony of Ron Bloom and Jim Millstein, *supra* note 73, at 2; Ron Bloom Testimony before the Senate Banking Committee, *supra* note 2. For further discussion of the nature and landscape of the automotive finance business, *see* Section B, *infra*.

[133] Office of the Special Inspector General for the Troubled Asset Relief Program (SIGTARP), *Quarterly Report to Congress,* at 112 (July 21, 2009) (online at www.sigtarp.gov/reports/congress/2009/July2009_Quarterly_Report_to_Congress.pdf) (citing SIGTARP interviews with Auto Task Force, June 1, 2009) (hereinafter "July 2009 SIGTARP Report").

[134] GMAC Form 10–K for 2008, *supra* note 10, at 3.

[135] GMAC conversations with Panel staff (Feb. 1, 2010).

[136] GMAC, LLC, *GMAC Financial Services Statement on Automotive Finance Purchase Policy* (Oct. 13, 2008) (online at media.gmacfs.com/index.php?s=43&item=280).

[137] GMAC Reports Preliminary Q4 and Full-Year 2008 Results, *supra* note 90.

[138] GMAC, LLC, *GMAC to Expand Retail Auto Financing* (Dec. 30, 2008) (online at media.gmacfs.com/index.php?s=43&item=300) (hereinafter "GMAC to Expand Retail Auto Financing").

[139] GMAC conversations with Panel staff (Feb. 2, 2010).

[140] GMAC Form 10–K for 2008, *supra* note 10, at 35. Congressional Oversight Panel, Written Testimony of Michael A. Carpenter, chief executive officer, GMAC Financial Services, *COP Hearing on GMAC Financial Services*, at 4 (Feb. 25, 2010) (online at cop.senate.gov/documents/testimony_022510_carpenter.pdf) (hereinafter "Written Statement of Michael Carpenter").

[141] GMAC Form 10–K for 2009, supra note 12, at 36; Written Statement of Michael Carpenter, *supra* note 140, at 2; Congressional Oversight Panel, Written Testimony of Robert S. Hull, chief financial officer, GMAC Financial Services, *COP Hearing on GMAC Financial Services*, at 5 (Feb. 25, 2010) (online at cop.senate.gov/documents/testimony-022510-hull.pdf) (hereinafter "Written Statement of Robert Hull").

thus were able to offer consumers subsidized financing and leasing offers."[142] According to GMAC, it continues to face competition from captive automotive finance companies, banks, savings and loan associations, credit unions, finance companies, mortgage banking companies, and insurance companies, many of whom "benefit from lower cost structures and frequently have fewer regulatory constraints."[143]

5. Mortgage Operations

The major contributor to GMAC's faltering results was its mortgage segment. GMAC's mortgage operations, which focus primarily on the origination, purchase, servicing, sale, and securitization of residential mortgage loans and mortgage-related products in the United States (with some international operations), include ResCap, the mortgage operations of Ally Bank, and the Canadian mortgage operations of ResMor Trust.

As noted above, GMAC, like other financial institutions, has been negatively impacted by the events and conditions in the mortgage banking industry and the broader economy. According to ResCap, its core mortgage subsidiary, beginning in 2007, "the mortgage and capital markets * * * experienced severe stress due to credit concerns and housing market contractions in the United States and foreign markets in which we operate, predominantly in the United Kingdom and continental Europe, and to the residential homebuilders domestically."[144]

GMAC's profitability and financial condition have been especially affected by ResCap due to its significant presence in the mortgage origination and servicing industry. Through ResCap, GMAC became the sixth largest residential mortgage originator and the fifth largest servicer in the United States (as ranked by *Inside Mortgage Finance*), originating approximately $55 billion in residential mortgage loans in 2008 and servicing approximately $365 billion in residential mortgage loans as of December 31, 2008.[145] In 2009, GMAC originated or purchased approximately $66.1 billion in mortgage loans.[146] In 2009, ResCap sold $54.8 billion in mortgage loans to government-sponsored enterprises (GSEs) such as Fannie Mae and Freddie Mac (87.0 percent of the total loans sold),[147] $6.9 billion to other investors through whole-loan sales.[148] While it did not make any non-GSE (also known as non-agency, or nonconforming) securitizations in 2008, it completed $1.3 billion of nonagency securitizations in 2009.[149] As GMAC notes, the "change in the U.S. mortgage market [since the second half of 2007] . . . limited [its]

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[142] General Motors, Corp., *Form 10–Q for the Quarter Ended March 31, 2009*, at 108 (May 8, 2009) (online at www.sec.gov/Archives/edgar/data/40730/000119312509105365/0001193125-09-105365-index.htm).

[143] GMAC Form 10–K for 2009, *supra* note 12, at 4, 21.

[144] Residential Capital, LLC, *Form 10–Q for the Quarter Ended March 31, 2009*, at 63 (May 11, 2009) (online at www.sec.gov/Archives/edgar/data/1332815/000119312509105708/d10q.htm) (hereinafter "ResCap Form 10–Q for Q2 2009").

[145] GMAC Form 10–K for 2008, *supra* note 10, at 53.

[146] GMAC Form 10–K for 2009, *supra* note 12, at 4.

[147] ResCap's sales of prime conforming mortgage loans take the form of securitizations guaranteed by Fannie Mae or Freddie Mac, and its sales of government mortgage loans take the form of securitizations guaranteed by Ginnie Mae. GMAC Form 10–K for 2009, *supra* note 12, at 4.

[148] GMAC Form 10–K for 2009, *supra* note 12, at 4.

[149] GMAC Form 10–K for 2009, *supra* note 12, at 4; GMAC Form 10–K for 2008, *supra* note 10, at 56.

ability to securitize many nonconforming loan products" and the "lack of liquidity also reduced the level of whole-loan transactions of certain nonconforming mortgages." [150]

ResCap has been most adversely affected by rising numbers of mark-to-market write-downs,[151] the disappearance of practically all secondary securitization markets (with the exception of government-sponsored or insured markets), increased loan delinquencies, and reduced originations. "Market demand for asset-backed securities, and those backed by mortgage assets in particular * * * significantly contracted and in many markets * * * virtually disappeared," ResCap states. "Further, market demand by whole-loan purchasers * * * also contracted. These unprecedented market conditions have adversely impacted [ResCap], as well as [its] competitors." [152] Cerberus' January 22, 2008 letter to investors about (among other things) GMAC emphasized the significance of the weakening economy, noting that the mortgage markets were "hardest hit" as "mortgage securities have taken an unprecedented beating" (making it "very difficult to find buyers for any mortgage-backed security, other than paper eligible to be sold to Fannie Mae or Freddie Mac") and housing prices continued to fall.[153] The housing price depreciation and increased number of delinquencies and defaults contributed to declines in the fair market valuations of ResCap mortgage loans held for sale (HFS) and of securitized interests that it continues to hold, reducing the value of the collateral underlying ResCap's portfolio and leading to higher provisions for loan losses.[154] GMAC states that "many of ResCap's nonprime [155] assets were liquidated at a loss or marked substantially lower to reflect the severe illiquidity and depressed valuations in the pre-

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[150] GMAC Form 10–K for 2008, *supra* note 10, at 56.

[151] ResCap wrote down its whole loans and mortgage-related securities according to Financial Accounting Standard (FAS) 157, implemented in September 2006, which provided a hierarchy of valuation techniques for determining the fair value of assets, based on assets' observable and unobservable valuation factors. The Financial Accounting Standards Board (FASB) amended its mark-to-market guidance in April 2009. FASB Staff Position (FSP) FAS 157–4 provided eight factors for determining whether a market is not active enough to require mark-to-market accounting. Another April 2009 change, FSP FAS 115–2, provided that permanent impairment attributable to market forces does not reduce earnings or regulatory capital. For further discussion concerning the impact of the new mark-to-market accounting rules, *see* Congressional Oversight Panel, *August Oversight Report: The Continued Risks of Troubled Assets*, at 24–25, nn. 48–49 (Aug. 11, 2009) (online at cop.senate.gov/documents/cop-081109-report.pdf) (hereinafter "August Oversight Report").

[152] ResCap Form 10–Q for Q2 2009, *supra* note 144, at 65.

[153] Cerberus Institutional Partners, L.P., *Letter to Investors*, at 1 (Jan. 22, 2008) (online at online.wsj.com/public/resources/documents/WSJ-LB-cerberus080214.pdf) (hereinafter "Letter to Investors").

[154] ResCap Form 10–Q for Q2 2009, *supra* note 144, at 71. ResCap's liquidity has also been adversely affected by margin calls under certain of its secured credit facilities that are dependent in part on the lenders' valuation of the collateral securing the relevant financing. See Residential Capital, LLC, *Form 10–K for the Fiscal Year Ended December 31, 2008*, at 33 (Feb. 27, 2009) (online at www.sec.gov/Archives/edgar/data/1332815/000119312509039301/d10k.htm) (hereinafter "ResCap Form 10–K for 2009"). Each of these credit facilities allows the lender, to varying degrees, to revalue the collateral to values that the lender considers to reflect market values. If a lender determines that the value of the collateral has decreased, it may initiate a margin call requiring ResCap to post additional collateral to cover the decrease. When ResCap is subject to such a margin call, it must provide the lender with additional collateral or repay a portion of the outstanding borrowings with minimal notice. Any such margin calls harm ResCap's liquidity, results of operation, financial condition and business prospects. *See id*.

[155] In response to the market downturn, ResCap has "substantially eliminated production of loans that do not conform to the underwriting guidelines of Fannie Mae, Freddie Mac, and Ginnie Mae." GMAC Form 10–Q for Q3 2009, *supra* note 22, at 67.

vailing market environment."[156] As the housing bubble burst, many mortgage loans (including a substantial number of subprime loans) became delinquent, entered into default, or were foreclosed. ResCap stated that its results were negatively impacted "by domestic economic conditions, including increases in delinquencies on our mortgage loans held for investment portfolio and a significant deterioration in the securitization and residential housing markets."[157] GMAC management indicated that the majority of ResCap's losses stem from both domestic and international mortgage loans on its balance sheet.[158] The mortgage segment reported a net loss from continuing operations of $7.1 billion in 2009, versus losses of $4.0 billion in 2008 and $4.1 billion in 2007.[159] The decline in the rate of growth in mortgage debt outstanding also reduced the number of mortgage loans available for ResCap to originate or securitize, which led to a reduction in ResCap's revenue, profits and business prospects.

In addition, the decline in ResCap's profitability and financial condition has been exacerbated by repurchase agreements associated with mortgage loans. Beginning in 2007, ResCap was no longer able to issue certain nonprime securitizations in the absence of various representations for early payment defaults.[160] As a result, ResCap agreed that its sales of mortgage loans through whole-loan sales or securitizations would require it to make representations and warranties about the mortgage loans to the purchaser or securitization trust, and it "may be required to repurchase mortgage loans as a result of borrower fraud or if a payment default occurs on a mortgage loan shortly after its origination."[161] Upon the finding of a breach of a representation, ResCap "will either correct the loans in a manner conforming to the provisions of the sale agreement, replace the loans with similar loans that conform to the provisions, or purchase the loans at a price determined by the related transaction documents, consistent with industry practice."[162] According to Mr. Carpenter, "the way this works is if a Fannie Mae or a Freddie Mac reaches the conclusion that they believe there was inadequate underwriting on loans, they have the right to put back those loans to us, or claim a credit from us."[163] ResCap purchased $1.3 billion in mortgage loans under these provisions in 2007 and $988 million in 2008.[164] ResCap's mortgage repurchase reserve expense for 2009 was $1.5 billion, and, "like others in the mortgage industry," it continues to experience "a material increase in repurchase requests."[165] Since repurchases only happen if there was something wrong with the origination, ResCap's continued ex-

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[156] GMAC, LLC, *GMAC Financial Services Reports Preliminary First Quarter Results* (May 2, 2007) (online at media.gmacfs.com/index.php?s=43&item=217).
[157] ResCap Form 10–K for 2009, *supra* note 154, at 68.
[158] GMAC conversations with Panel staff (Feb. 2, 2010).
[159] GMAC Form 10–K for 2009, *supra* note 12, at 51, 139. These figures exclude net losses from discontinued mortgage operations of $1.2 billion in 2009, $1.5 billion in 2008 and $250 million in 2007.
[160] GMAC Form 10–K for 2008, *supra* note 10, at 87.
[161] GMAC Form 10–K for 2009, *supra* note 12, at 19.
[162] GMAC Form 10–K for 2008, *supra* note 10, at 189.
[163] Transcript of COP Hearing on GMAC, *supra* note 12 (Testimony of Michael Carpenter).
[164] GMAC Form 10–K for 2008, *supra* note 10, at 189.
[165] GMAC Form 10–K for 2008, *supra* note 10, at 19–20.

posure to repurchases clearly indicates the imperfections and deficiencies in its model of loan pricing and origination.

In response to the economic downturn and an analysis of the nature and performance history of the collateral, credit rating agencies downgraded asset-backed and mortgage-backed securities, which significantly reduced the liquidity available to finance ResCap's operations.[166] Despite GM's disentanglement from GMAC in 2006, several credit rating agencies, including S&P and Moody's Investors Service, continued to rate GMAC below investment grade while maintaining ResCap at only one step above investment grade. "The challenging market environment—including pressure on home prices and weakening consumer credit—severely depressed the value of ResCap's large nonprime asset portfolio, resulting in significant operating losses at its U.S. Residential Finance Group," ResCap stated.[167] ResCap incurred a total of $7.2 billion in losses between the beginning of 2007 and the middle of 2008, which caused Moody's to downgrade ResCap by seven notches (S&P also made a downgrade), dramatically weakening ResCap's capital base.

While ResCap was a notable competitor in subprime and nonconforming mortgage lending and was widely known for its involvement in subprime lending, the company is a "broad-based market participant" in the mortgage industry and serves a broader spectrum of borrowers, according to GMAC.[168] GMAC made more than $50 billion in subprime mortgage loans over the three-year period ending in 2007, according to data compiled by Inside Mortgage Finance. In each of those years, GMAC ranked among the 25 largest subprime lenders (including being ranked 12th among subprime lenders in 2006), but it has retained a substantial mortgage loan origination business involving prime conforming and government mortgage loans. One of ResCap's main issues with respect to its subprime exposure is that while it started moving away from and reduced its exposure to the subprime market in late 2006 (and has not participated in subprime origination since 2008), it "still held substantial exposure when dislocation occurred in the fourth quarter [of 2006]."[169] As a result, ResCap was forced to sell many of its subprime mortgage-related assets at a substantial loss. In 2007, then-ResCap CEO Bruce Paradis acknowledged that, for its part, ResCap moved too slowly in reducing its subprime exposure in the face of the subprime mortgage downturn, along with being "too slow to reduce infrastructure and modify business processes in the face of new market conditions."[170] Industry analysts have suggested, however, that ResCap's subprime lending and exposure were not unusually bad, but very comparable to the challenges faced by other major mortgage lenders.[171]

By early 2008, ResCap's net worth had dropped from $7.6 billion on December 31, 2006 to $5.8 billion, just $400 million above the

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[166] ResCap Form 10–Q for Q2 2009, *supra* note 144, at 64.
[167] GMAC Q4 2006 Earnings, *supra* note 32.
[168] Industry analyst conversations with Panel staff.
[169] GMAC, LLC and Residential Capital, LLC, *2007 Investor Forum* (online at www.slideshare.net/finance8/rescap-chief-executive-officer-bruce-paradis-gmac-llc-and-residential-capital-llc-2007-investor-forum) (hereinafter "2007 Investor Forum") (accessed Mar. 8, 2010).
[170] 2007 Investor Forum, *supra* note 169.
[171] Industry analyst conversations with Panel staff.

minimum amount it needed to maintain in order to comply with debt covenants. From net income of $705.1 million in 2006, ResCap recorded a net loss of $4.3 billion in 2007 and a net loss of $5.6 billion in 2008.

GMAC has been forced to reorganize its operations and its capital structure on several different occasions to respond to deteriorating economic conditions and the collapse of ResCap's portfolio. As severe weakness in the housing market and mortgage industry persisted, GMAC announced a major restructuring of ResCap operations in October 2007. This plan included a streamlining of operations, a revised cost structure, and a 25 percent reduction in ResCap's workforce (in addition to the elimination of 2,000 positions undertaken in the first half of 2007). In June 2008, as ResCap faced approximately $4 billion of maturing debt obligations, GMAC refinanced more than $60 billion in debt (involving more than 50 institutions from around the world). This refinancing included several key steps designed to increase the amount of available funding and to enhance liquidity, such as GMAC obtaining a new $11.4 billion secured credit facility with a three-year maturity, GMAC renewing a one-year $10 billion commercial paper facility, ResCap extending the maturity on virtually all of its bank facilities equaling approximately $11.6 billion, and ResCap obtaining a new $2.5 billion repurchase facility. GMAC also increased its own capital reserves with a new three-year credit line, in addition to providing ResCap with a two-year $3.5 billion credit line, $750 million of which Cerberus and GM guaranteed.

On September 3, 2008, ResCap announced another restructuring plan to streamline its operations, reduce costs, and refocus its lending and servicing activities. The restructuring plan included closing all GMAC Mortgage retail offices, terminating originations through the wholesale broker channel, curtailing business lending, and selling its GMAC Home Services business. As ResCap Chairman and CEO Tom Marano stated, "[c]onditions in the mortgage and credit markets have not abated and, therefore, we need to respond aggressively by further reducing both operating costs and business risk."[172] These actions reduced ResCap's workforce by approximately 3,300 employees, or 37 percent.[173] In conjunction with the GMAC Home Services business sale, 1,000 employees were transferred effective January 1, 2009, and an additional 500 employees were notified of their termination prior to December 31, 2008, with a termination date in the first quarter of 2009.[174]

Both the industry analysts who talked to Panel staff and the witnesses at the Panel's recent GMAC hearing have asserted that GMAC's major mistake was taking advantage of and leveraging its relatively high credit rating to move away from its core mission of automotive financing and diversify into other areas such as mortgage lending.[175] While other mortgage lenders including New Century Financial and American Home Mortgage Investment have become bankrupt and Bank of America purchased Countrywide Fi-

[172] GMAC, LLC, *GMAC Financial Services and ResCap Announce Further Streamlining of Mortgage Operation* (Sept. 3, 2008) (online at media.gmacfs.com/index.php?s=43&item=273).
[173] ResCap Form 10–K for 2009, *supra* note 154, at 55.
[174] ResCap Form 10–K for 2009, *supra* note 154, at 55.
[175] Panel staff conversations with industry analysts; Transcript of COP Hearing on GMAC, *supra* note 12 (Testimony of Christopher Whalen and Michael Ward).

nancial in early 2008, GMAC kept its mortgage subsidiary alive by channeling much of its capital (as well as liquidity support) into ResCap as its condition worsened.[176] GMAC, unlike other TARP recipients such as Citigroup, does not provide a separate section in its SEC filings devoted to its use of TARP funds. Mr. Hull, however, testified at the Panel's recent GMAC hearing that the company has used its TARP assistance "to create capital, so we could borrow, so we could go to the markets and get more liquidity to give it to that kind of origination," signaling that the TARP funds have "gone to the originations for autos and mortgages over the course of time."[177] The Panel notes that GMAC has supported ResCap with a total of $6.60 billion, including $2.94 billion of cash contributions and $3.66 billion of debt forgiveness since 2007.[178] Given ResCap's limited available capital and liquidity, its ongoing existence and viability have remained highly doubtful without continued contributions from its parent. GMAC's contributions to ResCap would not have been possible, however, had GMAC not received TARP assistance.

Mr. Carpenter calls ResCap "a millstone around the company's neck."[179] ResCap remains heavily dependent on GMAC in order to meet its liquidity and capital requirements, including approximately $2.1 billion in principal amount of bonds slated to mature in 2010.[180] GMAC management has indicated that if ResCap were to need additional support, it "would provide that support so long as it was in the best interests" of its stakeholders.[181] ResCap is also highly leveraged relative to its cash flow and continues to recognize substantial losses resulting in a significant deterioration in capital.[182] As of December 31, 2009, ResCap's liquidity portfolio (the cash readily available to cover operating demands) totaled $354 million, with cash and cash equivalents totaling $765 million.[183] Given ResCap's liquidity and capital needs, combined with the volatility in the marketplace, GMAC recently stated that "there is substantial doubt about ResCap's ability to continue as a going concern."[184] Until recently, ResCap's continued operations have substantially impeded GMAC's short- and long-term financial health, including its ability to access the capital markets and raise third-party financing.[185] In its press release detailing its receipt of

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[176] For further discussion of GMAC's articulated justification for not letting ResCap go bankrupt, *see* Section H.2., *infra*.

[177] Transcript of COP Hearing on GMAC, *supra* note 12 (Testimony of Robert Hull).

[178] Residential Capital, LLC, *2007 Annual Report, Form 10–K–A*, at 49 (Feb. 27, 2008) (online at www.sec.gov/Archives/edgar/data/1332815/000095013708002852/c22171e10vk.htm); ResCap Form 10–K for 2009, *supra* note 154, at 55; GMAC Reports Preliminary Q4 and Full-Year 2009 Results, *supra* note 127. GMAC confirmed that these numbers have been previously reported publicly. The Panel's cash calculation does not include $1.44 billion in loans GMAC contributed to ResCap at fair value in 2009. In addition, the Panel's calculations do not reflect other types of internal support that GMAC has provided to ResCap, including preferred membership interests, gains on extinguishment of debt, accounting contributions, and intercompany loans.

[179] GMAC Q4 2009 Earnings Conference Call, *supra* note 111; GMAC conversations with Panel staff (Feb. 16, 2010).

[180] GMAC Form 10–K for 2009, *supra* note 12, at 12.

[181] GMAC Form 10–Q for Q3 2009, *supra* note 22, at 8.

[182] GMAC Form 10–Q for Q3 2009, *supra* note 22, at 7.

[183] GMAC Form 10–K for 2009, *supra* note 12, at 16.

[184] GMAC Form 10–K for 2009, *supra* note 12, at 16.

[185] Treasury conversations with Panel staff (Feb. 2, 2010); Treasury conversations with Panel staff (Jan. 29, 2010). GMAC has recently accessed the capital markets "for the first time since 2007," and in February 2010, was successful in raising $2.0 billion of 5-year unsecured debt funding. Written Statement of Michael Carpenter, *supra* note 140, at 2.

the latest round of TARP assistance, GMAC indicated that it continues to "explore strategic alternatives for ResCap and the mortgage business." [186]

D. History/Timeline of Various Stages of Investment

1. GMAC Before December 24, 2008

In December 2008, the U.S. automotive industry was on the brink of bankruptcy. Declining car sales, coupled with high costs, had crippled an industry that once stood at the forefront of global innovation. The Big Three lagged far behind their foreign competitors. The CEOs of GM, Ford, and Chrysler flew to Washington to appeal to lawmakers for $25 billion in public funds. The companies were unable to muster sufficient congressional support to get a bill through the Senate, and on December 19, President Bush announced a government-funded rescue package for the automotive industry: the AIFP.[187] The AIFP called for an investment of $13.4 billion in GM and Chrysler by mid-January 2009 and additional funding for GM up to $4 billion.[188] In announcing the plan, then-Treasury Secretary Henry Paulson stated that EESA provided him with the authority to make the investment, even as he acknowledged that "the purpose of [the TARP] program and the enabling legislation is to stabilize our financial sector." [189]

General economic conditions, including the slowdown in the capital and credit markets, the problems in the automotive industry, and the accelerating crisis in the housing market, dramatically affected GMAC's revenues and operations.[190] GMAC reported a net loss of $2.5 billion for the third quarter of 2008,[191] bringing its losses over five consecutive quarters to $7.9 billion. GMAC's mortgage operations incurred substantial losses due to the depreciation in housing prices, mortgage loan defaults and delinquencies, and write-downs on mortgage loans and mortgage-related assets. For GMAC's principal mortgage business, ResCap, the third quarter of

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[186] GMAC Form 10–K for 2009, *supra* note 12, at 4. For further discussion on GMAC's strategy with respect to ResCap, *see* Section C.5, *infra*.

[187] Then-Secretary Paulson did not use the name "Automotive Industry Financing Plan" at the time of the announcement. *See generally* U.S. Department of the Treasury, *Secretary Paulson Statement on Stabilizing the Automotive Industry* (Dec. 19, 2008) (online at www.financialstability.gov/latest/hp1332.html) (hereinafter "Sec. Paulson Statement on the Automotive Industry"). Nonetheless, the investments to GM and Chrysler were made under this program. *See generally* U.S. Department of the Treasury, *Troubled Asset Relief Program Transactions Report for Period Ending February 1, 2010*, at 15 (Feb. 3, 2010) (online at www.financialstability.gov/docs/
transaction-reports/2-3-10%20Transactions%20Report%20as%20of%202-1-10.pdf).

[188] *See* U.S. Department of the Treasury, *Indicative Summary of Terms for Secured Term Loan Facility [GM]*, Appendix A (Dec. 19, 2008) (online at www.treas.gov/press/releases/reports/gm%20final%20term%20&%20appendix.pdf); *see* U.S. Department of the Treasury, *Indicative Summary of Terms for Secured Term Loan Facility [Chrysler]*, Appendix A (Dec. 19, 2008) (online at www.treas.gov/press/releases/reports/chrysler%20final%20term%20&%20appendix.pdf).

[189] Sec. Paulson Statement on the Automotive Industry, *supra* note 187 ("Treasury will make these loans using authority provided for the Troubled Asset Relief Program. While the purpose of this program and the enabling legislation is to stabilize our financial sector, the authority allows us to take this action. Absent Congressional action, no other authorities existed to stave off a disorderly bankruptcy of one or more auto companies"); Congressional Oversight Panel, *September Oversight Report: The Use of TARP Funds in the Support and Reorganization of the Domestic Auto Industry*, at Section G.1 (Sept. 9, 2009) (online at cop.senate.gov/documents/cop-090909-report.pdf) (hereinafter "September Oversight Report").

[190] For further discussion of GMAC's operations and the reasons for its deteriorating economic condition, *see* Section C, *supra*.

[191] GMAC, LLC, *GMAC Financial Services Reports Preliminary Third Quarter 2008 Financial Results* (Nov. 5, 2008) (online at media.gmacfs.com/index.php?s=43&item=286) (hereinafter "GMAC Reports Preliminary Q3 2008 Results").

2008 marked a period of continued turmoil as it reported a net loss of $1.9 billion for the third quarter of 2008, and its operations only slightly improved for the fourth quarter of 2008, when it reported a net loss of $981 million.[192] At the same time, the fourth quarter of 2008, with dramatic changes to the landscape of the automotive industry, marked the worst period for GMAC's automotive finance operations. Coming off of a net loss of $294 million for the third quarter of 2008, GMAC's automotive finance operations reported a net loss of $1.3 billion in the fourth quarter of 2008.[193]

2. Timeline of TARP Investments: December 2008–December 2009

a. December 2008 Investment

On the same day it submitted its application to become a BHC,[194] GMAC submitted an application to Treasury to participate in the CPP.[195] While GMAC's management believed the BHC application would assist its transition to a stronger long-term business model, management hoped the CPP application would help it to survive the immediate "liquidity crunch."[196]

On December 24, 2008, four days after President Bush announced the AIFP, the Federal Reserve Board approved GMAC's application to become a BHC.[197] As part of this approval, the Federal Reserve required GMAC to raise $7 billion in new equity.[198] The government immediately took two separate steps to help GMAC reach this goal.

First, on December 29, 2008, Treasury announced that it would purchase $5 billion in GMAC Fixed Rate Cumulative Perpetual Preferred stock with an 8 percent dividend (the Senior Preferreds) under the AIFP.[199] It also received warrants for an additional $250

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[192] GMAC Reports Preliminary Q3 2008 Results, *supra* note 191; GMAC Reports Preliminary Q4 and Full-Year 2008 Results, *supra* note 90.

[193] GMAC Reports Preliminary Q3 2008 Results, *supra* note 191; GMAC Reports Preliminary Q4 and Full-Year 2008 Results, *supra* note 90.

[194] For further discussion of GMAC's BHC application and approval, *see* Section C.2, *supra*.

[195] GMAC Files BHC Application, *supra* note 49 (noting that GMAC "submitted an application to the U.S. Treasury to participate in the Capital Purchase Program created under the Emergency Economic Stabilization Act of 2008, conditional upon becoming a bank holding company"). For further discussion of GMAC's BHC application and approval, *see* Section C.2, *supra*.

[196] GMAC conversations with Panel staff (Feb. 16, 2010). Treasury also stated that it is preferable for a company of this size to be subject to more supervision. Treasury conversations with Panel staff (Feb. 2, 2010).

[197] For further information about the Board's approval of GMAC's BHC application, *see* Section C.2, *supra*. *See also* GMAC, LLC, *GMAC Receives $5.0 Billion Investment from the U.S. Treasury* (Dec. 29, 2008) (online at media.gmacfs.com/index.php?s=43&item=299) (hereinafter "GMAC Receives $5 Billion Investment").

[198] Office of the Special Inspector General for the Troubled Asset Relief Program, *Quarterly Report to Congress*, at 84 (Apr. 21, 2009) (online at www.sigtarp.gov/reports/congress/2009/April2009_Quarterly_Report_to_Congress.pdf) (hereinafter "April 2009 SIGTARP Report"). As part of the process of granting approval to GMAC's BHC application, the Federal Reserve imposed a number of additional requirements, considered GMAC's business plans, and evaluated its actions to strengthen its risk-management infrastructure. Under the ongoing supervision of the Federal Reserve after approval of the application, GMAC was required to submit a more detailed business plan that was acceptable to the Federal Reserve. Federal Reserve conversations with Panel staff (Feb. 19, 2010).

[199] U.S. Department of the Treasury, *Treasury Announces TARP Investment in GMAC* (Dec. 29, 2008) (online at www.financialstability.gov/latest/hp1335.html) (hereinafter "Treasury Announces TARP Investment in GMAC"); *see also* U.S. Department of the Treasury, *USG Capital Outstanding in GMAC* (Dec. 30, 2009) (online at treas.gov/images/usg_capital.gif) (hereinafter "USG Capital Outstanding in GMAC"). Specifically, the preferred securities were Fixed Rate Cumulative Perpetual Preferred Membership Interests, Series D-l. U.S. Department of the Treasury, *Contract [GMAC]*, Schedule A (Dec. 29, 2008) (online at www.financialstability.gov/docs/

Continued

million in preferred equity with a 9 percent dividend (the Preferred Warrants).[200] These purchases were completed on December 30, 2008, and Treasury exercised the Preferred Warrants immediately.[201] As a result of this transaction, Treasury held $5.25 billion in Senior Preferreds.

Second, GMAC made an equity rights offering to its existing shareholders to raise the remaining $2 billion. Treasury agreed to provide GM with a secured loan of up to $1 billion to participate in this rights offering. Treasury stated that this loan would "support GMAC's reorganization as a BHC."[202] The rights offering closed on January 16, 2009, with Treasury lending GM $884 million to participate in the offering[203] and FIM Holdings, an investment consortium led by Cerberus, purchasing $366 million in new equity.[204] The terms of the agreement gave Treasury the right to exchange its loan for the shares purchased by GM.[205]

Treasury purchased the Senior Preferreds under the AIFP.[206] Treasury suggested that it provided the investments under the AIFP because GMAC is a "financing company that supports GM."[207] Treasury stated that the investment was "part of an auto industry-focused TARP program that will include the $17.4 billion in assistance for domestic automakers announced earlier this month."[208] Treasury did not indicate why it did not make its investments under the CPP, despite the fact that GMAC had become a BHC by that time.

Given that Treasury had $700 billion in TARP funds at its disposal, it had the power in December 2008 to consider a wide range

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AIFP/Posted%20to%20AIFP%20Website%20-%20GMAC%202008.pdf) (hereinafter "Treasury GMAC Contract"). In contrast, the CPP Preferred pays quarterly dividends at a rate of five percent per year for the first five years, and nine percent thereafter. U.S. Department of the Treasury, *Factsheet on Capital Purchase Program* (Mar. 17, 2009) (online at www.financialstability.gov/roadtostability/CPPfactsheet.htm) (hereinafter "CPP Factsheet").

As a firm that has received exceptional TARP assistance, GMAC is subject to EESA's general corporate governance standards and executive compensation restrictions, as amended by the American Recovery and Reinvestment Act of 2009 (ARRA), as well as the rulings of Special Master Feinberg.

[200] Treasury Announces TARP Investment in GMAC, *supra* note 199; *see also* USG Capital Outstanding in GMAC, *supra* note 199. Specifically, the preferred securities were Fixed Rate Cumulative Perpetual Preferred Membership Interests, Series D–l. Treasury GMAC Contract, *supra* note 199. In contrast, the CPP Preferred pays quarterly dividends at a rate of five percent per year for the first five years, and nine percent thereafter. CPP Factsheet, *supra* note 199.

[201] Treasury conversations with Panel staff (Jan. 7, 2010).

[202] Treasury Announces TARP Investment in GMAC, *supra* note 199; *see* Section C.2, *supra*.

[203] April 2009 SIGTARP Report, *supra* note 198, at 84; September Oversight Report, *supra* note 189, at 54 n.267.

[204] GMAC Form 10–K for 2008, *supra* note 10, at 194; April 2009 SIGTARP Report, *supra* note 198; *see* Office of the Special Inspector General for the Troubled Asset Relief Program, *Additional Insight on Use of Trouble Asset Relief Program Funds*, at Appendix D (Dec. 10, 2009) (online at sigtarp.gov/reports/audit/2009/Additional_Insight_on_Use_of_Troubled_Asset_Relief_Program_Funds.pdf) ("At the time of the initial Treasury investment, the Federal Reserve required GMAC to raise $2 billion of new equity. GMAC raised $1.1 billion through private investments . . . ."); GMAC Receives $5 Billion Investment, *supra* note 197.

[205] April 2009 SIGTARP Report, *supra* note 198, at 84. Treasury exercised that right on May 29, 2009 and received a 35 percent equity stake in GMAC. Government Accountability Office, *Office of Financial Stability (Troubled Asset Relief Program) Fiscal Year 2009 Financial Statements*, GAO–10–301, at 62, 74, (Dec. 2009) (online at www.gao.gov/new.items/d10301.pdf) (hereinafter "OFS FY 2009 Financial Statements"); *see* Section D.2.(b), *infra*.

[206] U.S. Department of the Treasury, *Section 105(a) Trouble Asset Relief Program Report to Congress for the Period December 1, 2008 to December 31, 2008*, at 4 (Jan. 5, 2009) (online at www.financialstability.gov/docs/105CongressionalReports/105Report__010609.pdf) (hereinafter "Section 105(a) TARP Report to Congress for December 2008").

[207] Section 105(a) TARP Report to Congress for December 2008, *supra* note 206, at 1.

[208] Treasury Announces TARP Investment in GMAC, *supra* note 199 (referring to Treasury's investments in GM and Chrysler on Dec. 19, 2008).

of options for addressing GMAC's situation.[209] It is not clear whether Treasury considered alternative options before it made the $5.25 billion equity investment in GMAC.[210] It is certain, however, that once it determined that GMAC would not be forced into bankruptcy and that the company and its shareholders would not be required to bear the full cost of their mistakes, its future options were severely constrained. After Treasury made this initial investment, permitting the company to fail in the future would require wiping out Treasury's stake.[211]

In contrast to the conditions Treasury placed on its support to Chrysler and GM, discussed below,[212] Treasury's GMAC investment was not conditioned on the approval of a specific business plan. It was, however, made on the understanding that the Federal Reserve required GMAC to make two substantial changes in its ownership and management structure as part of its application to become a BHC. First, the Federal Reserve required GM and Cerberus to reduce their stakes in the company.[213] Second, GMAC was required to restructure its board of directors to include seven members; two of these seven would be appointed by a trust approved by Treasury.[214] The board changes were required to occur no later than March 24, 2009.[215]

On December 30, 2008, one day after GMAC received the federal government's investment, GMAC President Bill Muir declared that "the actions of the federal government to support GMAC are having an immediate and meaningful effect on our ability to provide credit to automotive customers."[216] He stated that the government's support would permit GMAC to "relax the [credit] constraints we put in place a few months ago due to the credit crisis."[217]

b. May 2009 Investment

In early 2009, the Federal Reserve conducted "stress tests" of the nation's largest BHCs (also known as the Supervisory Capital Assessment Program, or SCAP) to ensure that they would be adequately capitalized even if economic conditions worsened beyond

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[209] *See* September Oversight Report, *supra* note 189, at 3, 86–87 (discussing Treasury as a "tough negotiator" when it invested taxpayer funds in the automotive companies and describing the imposition of conditions on institutions that receive "exceptional assistance").

[210] Ron Bloom, senior advisor to the Secretary of the Treasury, testified that the administration considered bankruptcy in April and May 2009. He did not state whether bankruptcy was considered before Treasury made the December 2008 investment. *See* Transcript of COP Hearing on GMAC, *supra* note 12 (Testimony of Ron Bloom). GMAC maintains that it considered bankruptcy at this time and that this option was ultimately not chosen because it would have required prohibitively large financing and would have caused severe disruption for GM dealers. GMAC conversations with Panel staff (Mar. 3, 2010); *see* Section G.3, *infra*.

[211] For an extended discussion of the bankruptcy option, *see* Section G.3, *infra*. That GMAC avoided bankruptcy is particularly noteworthy in light of the fact that GM and Chrysler did not. *See* Section G, *infra*.

[212] *See* Section G, *infra*.

[213] *See* Section C.2, *infra*.

[214] April 2009 SIGTARP Report, *supra* note 198, at 84; *see* U.S. Department of the Treasury, *Treasury Announces Restructuring of Commitment To GMAC* (Dec. 30, 2009) (online at ustreas.gov/press/releases/tg501.htm) (hereinafter "December 2009 Restructuring Announcement") (stating that Treasury had the right to appoint two directors prior to the December 2009 investment).

[215] April 2009 SIGTARP Report, *supra* note 198, at 84; *see* December 2009 Restructuring Announcement, *supra* note 214 (stating that Treasury had the right to appoint two directors prior to the December 2009 investment).

[216] GMAC to Expand Retail Auto Financing, *supra* note 138.

[217] GMAC to Expand Retail Auto Financing, *supra* note 138; *see* Section C.2, *supra* (discussing GMAC's decision to restrict financing to consumers with a credit score of 700 or above).

expectations. GMAC's participation in the stress tests is discussed in more detail in Section F below.[218] At the conclusion of the stress tests in May 2009, the Federal Reserve announced that GMAC needed an additional $11.5 billion in capital, $9.1 billion of which had to be in the form of fresh capital.[219] Treasury understood that GMAC, in contrast to the other financial institutions that were found to need capital under the stress tests, would not be able to meet its required capital targets by tapping private markets.[220] GMAC itself acknowledged that there is "uncertainty regarding our ability to raise the additional capital required as a result of the recently completed Supervisory Capital Assessment Program and uncertainty around the ultimate form, amount, and terms of such capital."[221] This uncertainty was due principally to the pending bankruptcies of GM and Chrysler.[222] At the time, it was unclear how much residual values would suffer as a result of the bankruptcy process, how dealers would be treated, and whether GM and Chrysler would experience a "customer backlash" that would impact future car sales.[223]

On May 21, 2009, Treasury made a "down payment" of $3.5 billion of the $9.1 billion fresh capital requirement to support GMAC in meeting its capital target, plus a $4 billion investment to permit GMAC to acquire part of the business of Chrysler Financial,[224] for a total contribution of $7.5 billion.[225] In return for its $7.5 billion, Treasury received Mandatory Convertible Preferred Stock (MCP) with a face value of $7.875 billion.[226] Treasury acknowledged that

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[218] *See* Section F, *infra*.

[219] Treasury conversations with Panel staff (Jan. 8, 2010). The balance of $2.4 billion could be obtained through other methods, such as conversion of preferred stock.

[220] Treasury conversations with Panel staff (Feb. 2, 2010).

[221] GMAC, LLC, *Form 10–Q for the Quarter Ended March 31, 2009*, at 90 (May 11, 2009) (online at www.sec.gov/Archives/edgar/data/40729/000119312509105735/0001193125-09-105735-index.htm).

[222] GMAC conversations with Panel staff (Feb. 1, 2010). GMAC management also stated that private markets wanted to see a return to profitability prior to providing financing to GMAC.

[223] Sell-side analyst conversations with Panel staff (Feb. 17, 2010); Treasury conversations with Panel staff (Feb. 2, 2010).

[224] Treasury made a $1.5 billion loan to Chrysler Financial on January 16, 2009. U.S. Department of the Treasury, *Chrysler LB Receivables Trust: Summary of Terms* (Jan. 16, 2009) (online at www.treas.gov/press/releases/reports/011608%20term%20sheet%20chrysler%20fin.pdf). Chrysler Financial has repaid the $1.5 billion loan.

[225] U.S. Department of the Treasury, *Treasury Announces Additional Investment in GMAC LLC* (May 21, 2009) (online at www.treas.gov/press/releases/tg154.htm) (hereinafter "Treasury Announces Additional Investment in GMAC"); Treasury conversations with Panel staff (Jan. 8, 2010). At the time, press reports suggested that the administration's decision to provide GMAC with new capital was contingent—at least in part—on GMAC's willingness to take over this business. *See* Mike Ramsey and Jason Kelly, *Cerberus Said to Study Chrysler Financial as Stand-Alone Lender*, Bloomberg (May 19, 2009) (online at www.bloomberg.com/apps/news?sid=aMkCt0PgMVLI&pid=20601087). Treasury looked at a variety of different alternatives for Chrysler Financial, including merging it with GMAC. It decided against this approach because it would have involved GMAC taking over all of Chrysler Financial's legacy assets. Treasury stated that its ultimate solution—financing GMAC's acquisition of only part of Chrysler Financial's business—was preferable because it gave GMAC control over the credit quality of future originations, but not responsibility for losses on legacy assets. Treasury conversations with Panel staff (Feb. 2, 2010).

[226] Treasury received $7.5 billion face value in Fixed Rate Cumulative MCP together with warrants for a further $375 million, which it exercised immediately. U.S. Department of the Treasury, *Contract [GMAC]*, at 173 (May 21, 2009) (online at www.financialstability.gov/docs/AIFP/Posted%20to%20AIFP%20Website%20-%20GMAC%202009.pdf) (hereinafter "Treasury GMAC Contract"). Treasury conversations with Panel staff (Jan. 7, 2010). The May Securities Purchase Agreement and Treasury's accompanying press release refer to the preferred interests as "*mandatorily* convertible preferred interests." Treasury Announces Additional Investment in GMAC, *supra* note 225 (emphasis added). However, Treasury's December 2009 press release refers to the stock as "Mandatory Convertible Preferred Stock." December 2009 Restructuring Announcement, *supra* note 214. The contract for the December 2009 investment also refers to the stock as "mandatorily convertible preferred stock." *Id.*, at 482. In May 2009, the terms of the

GMAC would need additional capital support—the term sheet for this investment (the May Term Sheet) provided that Treasury would invest "up to $5.6 billion" at a later date.[227]

Additionally, on May 29, 2009, Treasury exercised its option to exchange the $884 million loan it had made to GM to participate in the December 2008 rights offering for GMAC common stock; this amounted to about 35 percent of GMAC's common stock.[228] After these transactions closed, Treasury owned $13.1 billion in preferred stock ($5.25 billion in Senior Preferreds acquired in the December 2008 investment and $7.875 billion in MCP acquired in May 2009) and 35 percent of GMAC's common stock.

Although Treasury had initially created the Capital Assistance Program (CAP) to provide capital to financial institutions in connection with the stress tests,[229] Treasury attributed its May 2009 investment—an investment made pursuant to the stress test results—to the AIFP.[230] Treasury subsequently stated that it used the AIFP because its previous capital injections in GMAC had been under the AIFP, because GMAC was closely tied to the automotive industry, and because it did not view the CAP to have advantages to the terms it has under the existing investment.[231] Further, Treasury noted that no other banks were being funded via the CAP.[232] The terms of the MCP received under the AIFP are also more advantageous to Treasury than the terms of the MCP that would have been received under the CAP: while the CAP MCP was convertible at GMAC's option at any time, GMAC may not convert the AIFP MCP without receiving written approval from Treasury or, unless conversion is required by the Federal Reserve Board.[233]

Some of the terms of the CAP were more onerous for recipients, however, than the terms of the AIFP. A white paper on the CAP indicated that any investments under the program were required to be placed in a trust, and the trustees would be obligated to aim to "protect and create value for the taxpayer as a shareholder over

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MCP specified that GMAC could convert the stock at any time, except that if the conversion would result in Treasury owning more than 49 percent of the company, then GMAC would need Treasury's approval or an order from the Federal Reserve. The terms of this MCP were revised in exchange for Treasury's additional investment in December 2009. After the December 2009 investment, GMAC could only convert the MCP if it received prior written approval from Treasury or an order from the Federal Reserve. Additional terms of the December 2009 investment are discussed in more detail in Section D.2.(c), *infra*.

[227] Treasury GMAC Contract, *supra* note 226, at 60.

[228] OFS FY 2009 Financial Statements, *supra* note 205, at 62, 74. Treasury has stated that one of the concerns it had about taking GMAC into bankruptcy was "execution risk"—that three complex bankruptcies would be much harder to execute successfully than two. In this context, it is worth noting that when it converted the loan into GMAC common shares on the eve of the GM bankruptcy, Treasury took an action that reinforced GMAC's support while reducing its exposure to GM. These actions may or may not have heightened execution risk, but they put Treasury into a position where its interests as an equity holder might have increased its reluctance to put GMAC into bankruptcy. *See* Section G.3, *infra*.

[229] U.S. Department of the Treasury, *Capital Assistance Program* (March 3, 2009) (online at www.financialstability.gov/roadtostability/capitalassistance.html) (hereinafter "Capital Assistance Program").

[230] Treasury Announces Additional Investment in GMAC, *supra* note 225.

[231] Treasury conversations with Panel staff (Jan. 8, 2010 and Feb. 2, 2010).

[232] Treasury conversations with Panel staff (Jan. 8, 2010 and Feb. 2, 2010); *see* Section F, *infra*.

[233] Treasury GMAC Contract, *supra* note 226, at 485 with U.S. Department of the Treasury, *Capital Assistance Program: Summary of Mandatorily Convertible Preferred Stock ("Convertible Preferred") Terms* (online at www.treas.gov/press/releases/reports/tg40__captermsheet.pdf) (accessed Mar. 8, 2010).

time."[234] The CAP also imposed conditions on recipient institutions that were not imposed on institutions that received funding under the AIFP. Every institution applying for funds under the CAP was required to submit a plan to Treasury indicating how it intended to use the funds to "preserve and strengthen their lending capacity."[235] The institution was required to detail how it would use the funds to "increase lending above levels relative to what would have been possible without government support."[236] After submitting this initial plan as part of the application process, a recipient institution would then need to submit monthly reports to Treasury on its lending "broken out by category."[237] Treasury would make all documentation—the initial plan, as well as the monthly reports—available to the public.[238]

In addition, the CAP included a deadline of November 9, 2009, and each institution that was included in the stress tests was required to raise the required capital buffer by that date. According to Treasury's guidelines for the CAP program, if the stress tests should "indicate the need for a bank to establish an additional capital buffer to withstand more stressful conditions, the bank will have a six month window to raise that capital privately or to access the capital made available by the Treasury under the CAP."[239] On November 9, Treasury announced that it would close the CAP without making any investments and that GMAC—the sole institution that depended upon Treasury's assistance to meets its SCAP target—was "expected to access" TARP funds through the AIFP.[240] Treasury provided no additional funding to GMAC on that date.

c. December 2009 Investment

Nine of the 10 BHCs that were identified as needing to raise additional capital as a result of the stress tests met or exceeded their capital raising requirements without government assistance.[241] GMAC was the lone BHC that could not meet the required capital target on its own. As Treasury Secretary Timothy Geithner stated in his December testimony before the Panel, raising money in the private markets "was never going to be possible for GMAC. They

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[234] U.S. Department of the Treasury, *Treasury White Paper: The Capital Assistance Program and its Role in the Financial Stability Plan*, at 3 (online at www.treas.gov/press/releases/reports/tg40_capwhitepaper.pdf) (hereinafter "CAP White Paper") (accessed Mar. 8, 2010) ("In addition, any capital investments made by Treasury under this plan will be placed in a separate trust set up to manage the government's investments in US financial institutions"). In subsequent conversations with Panel staff, Treasury stated that it considered a trust structure as a possibility, but that the decision to place CAP investments in a trust was never finalized. Treasury conversations with Panel staff (Feb. 2, 2010). Mr. Bloom testified that Treasury concluded that a trust "does not enhance our position." Transcript of COP Hearing on GMAC, *supra* note 12 (Testimony of Ron Bloom).

[235] *See* Capital Assistance Program, *supra* note 229.

[236] Capital Assistance Program, *supra* note 229 (accessed Mar. 8, 2010). According to Treasury, GMAC has been providing these reports to Treasury, even though it received funding under the AIFP. *See* Transcript of COP Hearing on GMAC, *supra* note 12 (Testimony of Jim Millstein). The terms of the May and December 2009 investments stipulate that GMAC "shall use its reasonable best efforts to account for the lending and financing activities it undertakes through the use of its available capital." *See* Treasury GMAC Contract, *supra* note 226, at 46, 159. Treasury does not make these reports public. Treasury conversations with Panel staff (Mar. 2, 2010).

[237] Capital Assistance Program, *supra* note 229.

[238] Capital Assistance Program, *supra* note 229.

[239] CAP White Paper, *supra* note 234, at 2.

[240] *See* U.S. Department of the Treasury, *Treasury Announcement Regarding the Capital Assistance Program* (Nov. 9, 2009) (online at www.financialstability.gov/latest/tg_11092009.html) (hereinafter "Treasury Announcement Regarding the CAP").

[241] OFS FY 2009 Financial Statements, *supra* note 205, at 47.

are in a unique and difficult situation."[242] GMAC's initial inability to raise additional money from the capital markets stemmed largely from the uncertainty surrounding GM's bankruptcy. Treasury maintains that after the GM bankruptcy, GMAC continued to struggle to raise money from the private markets because it was the only private BHC in the stress tests—the other 18 banks had an existing shareholder base—and because its debt holders would have demanded a majority of the company's equity in exchange for their conversion.[243] As a result, GMAC was the only participant that sought additional TARP funds from Treasury to meet the capital buffer needs identified in the stress tests.

On December 30, 2009, Treasury provided GMAC with $3.8 billion in new capital.[244] This amount was $1.8 billion less than the remaining $5.6 billion shortfall on the capital buffer calculated in May by the Federal Reserve.[245] The additional funds were provided in the form of $2.54 billion in Trust Preferred Securities (TruPs) and $1.25 billion in MCP.[246] Treasury also received warrants to purchase $127 million of TruPs and $63 million of MCP, which it exercised upon closing.[247] At the same time, Treasury converted $5.25 billion of its Senior Preferreds to MCP, which have a more advantageous conversion rate. It also converted $3 billion of its MCP to common stock, increasing its ownership stake from 35 percent to 56 percent.[248] Treasury also took the opportunity to recut the conversion terms of its existing securities.[249] With its enlarged

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[242] Congressional Oversight Panel, *Transcript: COP Hearing with Treasury Secretary Timothy Geithner* (Dec. 10, 2009) (publication forthcoming) (online at cop.senate.gov/hearings/library/hearing-121009-geithner.cfm) (Testimony of Timothy Geithner).

[243] Treasury stated that without its assistance, GMAC could have raised some of the required capital through conversions; the principal challenge was satisfying the SCAP requirement that GMAC raise $3.8 billion in fresh capital—for GMAC to do this, it would have essentially needed to "give the company to bondholders," which would have wiped out Treasury's prior investment. Treasury conversations with Panel staff (Feb. 2, 2010).

[244] December 2009 Restructuring Announcement, *supra* note 214. The transaction closed and was funded on December 30, 2009. Treasury conversations with Panel staff (Jan. 6, 2010). Treasury stated that it timed the transaction to close in fiscal year 2009 in order to help the company become SCAP compliant before year end. Treasury conversations with Panel staff (Jan. 8, 2010).

[245] December 2009 Restructuring Announcement, *supra* note 214; Treasury Announcement Regarding the CAP, *supra* note 240 ("[GMAC's] capital need is expected to be lower than anticipated at the time the SCAP results were announced"); U.S. Department of the Treasury, *Questions for the Record for U.S. Department of the Treasury Assistant Secretary Herbert M. Allison Jr.*, at 9 (Oct. 22, 2009) (online at cop.senate.gov/documents/testimony-102209-allison-qfr.pdf) (hereinafter "QFRs for Assistant Secretary Herbert M. Allison"); OFS FY 2009 Financial Statements, *supra* note 205, at 62 ("GMAC is in discussions with the Treasury-OFS regarding additional financing to complete GMAC's post-SCAP capital needs up to the amount of $5.6 billion, as previously discussed in May").

[246] December 2009 Restructuring Announcement, *supra* note 214.

[247] December 2009 Restructuring Announcement, *supra* note 214.

[248] December 2009 Restructuring Announcement, *supra* note 214. Cerberus holds a 14.9 percent stake of the company, third-party investors hold 12.2 percent, a trust "managed . . . for the benefit of General Motors" holds 9.9 percent, and an "affiliate of General Motors LLC" holds 6.7 percent. GMAC, Inc., *GMAC Financial Services Announces Key Capital and Strategic Actions* (Dec. 30, 2009) (online at media.gmacfs.com/index.php?s=43&item=377) (hereinafter "GMAC Announces Capital and Strategic Actions").

[249] *See* December 2009 Restructuring Announcement, *supra* note 214 ("Treasury will acquire a 'reset' feature on the entirety of its MCP holdings such that the conversion price under which its MCP can be converted into common equity will be adjusted in 2011, if beneficial to Treasury, based on the market price of private capital transactions occurring in 2010"); *see also* Treasury GMAC Contract, *supra* note 226, at 478 ("The Series F–2 shall be convertible to common stock, in whole or in part, at the applicable Conversion Rate at the option of the holder upon specified corporate events, including any public offering of GMAC's common stock, certain sales, mergers or changes of control at GMAC"). This feature preserves Treasury's ability to assess whether it is advantageous to Treasury to convert considering all the facts and circumstances available at the time.

ownership stake, Treasury has the right to appoint four of the nine seats on GMAC's board of directors.[250] In total, Treasury now holds $2.67 billion in TruPs and $11.4 billion in MCP. As with the December 2008 and May 2009 investments, this investment was made under the AIFP.[251]

When GMAC announced this investment in a press release on December 30, 2009, it also announced that it was making a $2.7 billion capital contribution to ResCap and a $1.3 billion capital contribution to Ally Bank.[252] For ResCap, the capital contribution permitted the "reclassification of certain international mortgage assets and businesses from held for investment (HFI) to held for sale (HFS)," which resulted in a pre-tax charge of $1.3 billion.[253] Its reclassification of domestic assets and businesses incurred a pre-tax charge of $700 million.[254] With the capital contribution in Ally Bank, GMAC purchased high-risk mortgage assets at "fair value" of $1.4 billion, resulting in a pre-tax charge of $1.3 billion.[255] GMAC then contributed these high-risk assets to ResCap.[256] In total, GMAC recognized a pre-tax charge of $3.8 billion: $3.3 billion from the mortgage-related charges at ResCap and Ally Bank and $500 million from increasing ResCap's repurchase reserve liability.[257]

Treasury stated that the investment honored its "commitments made in May to GMAC in a manner which protects taxpayers to the greatest extent possible. These actions offer the best chance for GMAC to complete its overall restructuring plan and return to the private capital markets for its debt financing and capital needs in 2010."[258] Treasury also noted that the investment would help to "provide stability to the American auto industry"[259] and would demonstrate the government's commitment to honoring its promises.[260]

Treasury used a "staged" investment strategy—providing one investment in May 2009 and a second investment in December 2009—as a means of tying future assistance to a satisfactory review of certain of GMAC's plans.[261] The May Term Sheet states that any additional Treasury investment would be contingent upon

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[250] December 2009 Restructuring Announcement, *supra* note 214. The increase in ownership stake from 35 percent to 56 percent gave Treasury the right to appoint two additional directors.

[251] December 2009 Restructuring Announcement, *supra* note 214.

[252] GMAC, Inc., *Form 8–K for the Period Ending December 31, 2009*, at Ex. 99.2 (Jan. 5, 2010) (online at www.sec.gov/Archives/edgar/data/40729/000119312510001220/dex992.htm) (hereinafter "Form 8–K for Q4 2009"); GMAC Announces Capital and Strategic Actions, *supra* note 248.

[253] GMAC Announces Capital and Strategic Actions, *supra* note 248. *See also* Form 8–K for Q4 2009, *supra* note 252, at Ex. 99.2.

[254] GMAC Announces Capital and Strategic Actions, *supra* note 248. *See also* Form 8–K for Q4 2009, *supra* note 252, at Ex. 99.2.

[255] GMAC Announces Capital and Strategic Actions, *supra* note 248. Prior to GMAC's purchase of these assets, Ally Bank reclassified them from HFI to HFS. *See* Form 8–K for Q4 2009, *supra* note 252, at Ex. 99.2.

[256] GMAC Announces Capital and Strategic Actions, *supra* note 248. *See also* Form 8–K for Q4 2009, *supra* note 252, at Ex. 99.2; GMAC conversations with Panel staff (Feb. 1, 2010) (discussing its efforts to "ringfence" ResCap).

[257] Form 8–K for Q4 2009, *supra* note 252, at Ex. 99.2.

[258] December 2009 Restructuring Announcement, *supra* note 214.

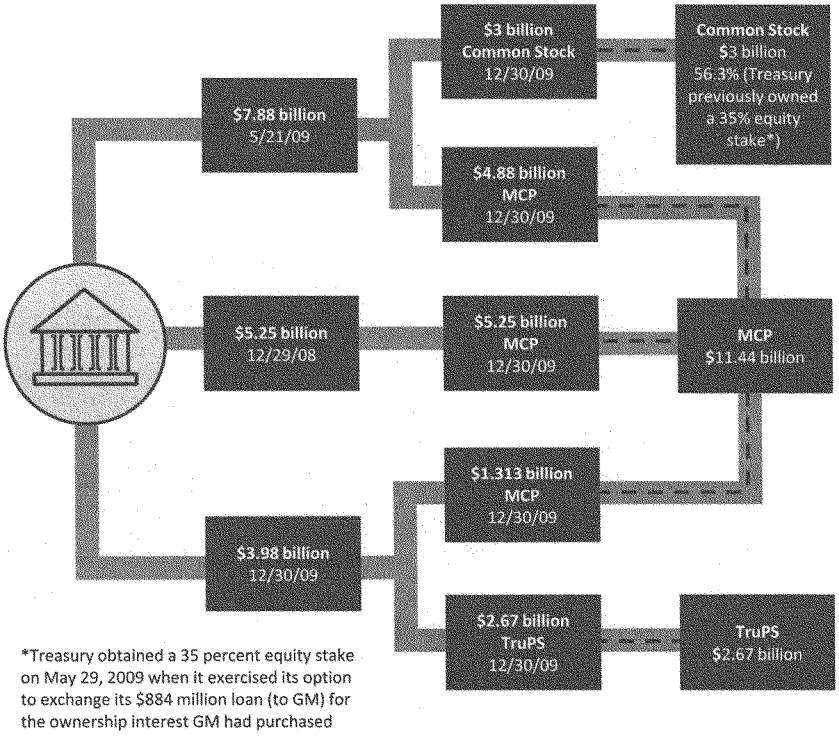
[259] *See* December 2009 Restructuring Announcement, *supra* note 214; Treasury conversations with Panel staff (Jan. 8, 2010).

[260] Treasury conversations with Panel staff (Jan. 8, 2010).

[261] These conditions were similar, though not identical, to the conditions Treasury imposed on GM and Chrysler when it first provided the automotive industry with assistance in December 2008. *See* Section H, *infra*.

its approval of GMAC's capital plan.[262] GMAC submitted the capital plan to the Federal Reserve Bank of Chicago on June 8, 2009, and the plan was approved after input from both the Federal Reserve and Treasury.[263]

FIGURE 7: FLOWCHART OF INVESTMENTS [264]



[262] The Term Sheet also specified that if liquidity was "separately addressed," then GMAC would also need Treasury's approval of its "Liquidity Plan." Treasury GMAC Contract, *supra* note 226, at 60. In addition, Treasury's announcement of its May 2009 investment states that "[a]s a participant in the SCAP program, GMAC will announce an approved Capital Plan on June 8. This plan will outline how GMAC will meet the full $9.1 billion in new capital need identified in the SCAP program." Treasury Announces Additional Investment in GMAC, *supra* note 225.

[263] GMAC, Inc., *Form 10–Q for the Quarter Ended June 30, 2009*, at 110 (Aug. 7, 2009) (online at www.sec.gov/Archives/edgar/data/40729/000119312509169238/0001193125-09-169238-index.htm); GMAC conversations with Panel staff (Feb. 16, 2010). In addition, Treasury used the December 2009 investment as an opportunity to acquire some control over the future conversion of its MCP stock. Because converting Treasury's sizeable MCP stock would substantially dilute any existing shareholders, the right to determine the timing of this conversion provided Treasury with additional control over GMAC's capital decisions. In a decision not characteristically taken in an arm's length capital infusion situation, Treasury determined that it did not need to review GMAC's business plan prior to making the December 2009 investment, giving the new CEO and Board of Directors time to formulate GMAC's go-forward business plan. Treasury conversations with Panel staff (Feb. 2, 2010).

[264] These figures reflect the corresponding warrants that were exercised immediately. U.S. Department of the Treasury, *Troubled Asset Relief Program Transactions Report for Period Ending February 25, 2010* (Mar. 4, 2010) (online at www.financialstability.gov/docs/transaction-reports/3-1-10%20Transactions%20Report%20as%20of%202-25-10.pdf) (hereinafter "Treasury Transactions Report").

3. Government Support from Programs Other Than the TARP

a. The FDIC's Temporary Liquidity Guarantee Program

In the second quarter of 2009, GMAC received approval to issue debt up to $7.4 billion under the FDIC's TLGP.[265] Pursuant to the program, it issued $4.5 billion of unsecured long-term debt during the second quarter, which included $3.5 billion of senior fixed-rate notes and $1.0 billion of senior floating rate notes. Both types of notes are due in December 2012.[266] On October 30, 2009, GMAC issued an additional $2.9 billion of unsecured debt in the form of senior fixed-rate notes. These notes are due in October 2012.[267]

b. The Federal Reserve's Discount Window and Term Auction Facility

Ally Bank was eligible to borrow at the Federal Reserve's discount window, and becoming a BHC made GMAC eligible to participate in the Term Auction Facility (TAF), a Federal Reserve program that auctions funds to depository institutions.[268] The program aims to "ensure that liquidity provisions can be disseminated efficiently even when the unsecured interbank markets are under stress" by providing funds "against a broader range of collateral than open market operations," according to the Federal Reserve.[269] On December 31, 2009, according to GMAC, "Ally Bank had pledged collateral in an amount sufficient to generate total capacity of $7.8 billion of which $5.0 billion was outstanding and $2.8 billion was unused capacity."[270]

c. The Federal Reserve's Term Asset-Backed Securities Loan Facility

The Federal Reserve launched the Term Asset-Backed Securities Loan Facility (TALF) on November 25, 2008. The program intends to support lending by financing credit through ABS.[271]

GMAC made two offerings of TALF-eligible securities in 2009,[272] the first in September and the second in November.[273] Backed by retail automotive loans, the transactions totaled $2.2 billion. GMAC stated that it expected to "continue pursuing the execution of TALF-eligible transactions during the first quarter of 2010,"[274] and in February 2010 made a $1.4 billion offering of securities, of

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[265] GMAC Form 10–Q for Q3 2009, *supra* note 22, at 64.
[266] GMAC Form 10–K for 2009, *supra* note 12, at 83.
[267] GMAC Form 10–Q for Q3 2009, *supra* note 22, at 64.
[268] *See* Federal Reserve Bank of New York, *Term Auction Facility Questions and Answers* (Jan. 12, 2009) (online at www.federalreserve.gov/monetarypolicy/taffaq.htm#q3).
[269] Federal Reserve Bank of New York, *Term Auction Facility Questions and Answers* (Jan. 12, 2009) (online at www.federalreserve.gov/monetarypolicy/taffaq.htm#q1).
[270] GMAC Form 10–K for 2009, *supra* note 12, at 83.
[271] A more extensive discussion of the TALF and its impact on lending can be found in the Panel's May report. Congressional Oversight Panel, *May Oversight Report: Reviving Lending to Small Businesses and Families and the Impact of the TALF* (May 7, 2009) (online at cop.senate.gov/documents/cop-050709-report.pdf).
[272] GMAC Form 10–K for 2009, *supra* note 12, at 83.
[273] GMAC, Inc., *GMAC Financial Services Reports Preliminary Third Quarter 2009 Financial Results* (Nov. 4, 2009) (online at media.gmacfs.com/index.php?s=43&item=371) (hereinafter "GMAC Reports Preliminary Q3 2009 Results").
[274] GMAC Form 10–K for 2009, *supra* note 12, at 83.

which $900 million of were TALF-eligible, backed by wholesale automotive loans.[275]

d. The Federal Reserve's Commercial Paper Funding Facility

GMAC has participated in the Federal Reserve's Commercial Paper Funding Facility (CPFF) since the program became operational on October 27, 2008. As a participant, GMAC has sold asset-backed commercial paper to the Federal Reserve through its New Center Asset Trust (NCAT). By December 31, 2008, GMAC had approximately $8 billion of outstanding asset-backed commercial paper, 95 percent ($7.6 billion) of which was financed by the CPFF.[276]

On November 25, 2008, Moody's and S&P downgraded some of the ABS owned by NCAT.[277] On January 23, 2009, after NCAT was unable to secure a ratings upgrade, GMAC began a wind-down of NCAT's operations. As a consequence of entering this wind-down process, NCAT could no longer issue commercial paper.[278] The downgrade also prevented NCAT from participating in the CPFF.[279] As of December 31, 2009, GMAC had approximately $2.9 billion outstanding under NCAT.[280]

4. Impact of the TARP on Executive Compensation

Mr. Carpenter was appointed CEO of GMAC in November 2009. Subsequently, a pay package was developed by the GMAC Compensation Committee and submitted to Special Master for TARP Executive Compensation Kenneth Feinberg for approval.[281] The Special Master set the compensation for Mr. Carpenter in a determination letter dated December 20, 2009 as follows in Figure 8:

FIGURE 8: COMPENSATION OF MR. CARPENTER [282]

Base salary		Restricted stock units	Target total compensation
Cash	Deferred stock units		
$950,000	$5,415,000	$3,135,000	$9,500,000

[282] U.S. Department of the Treasury, *Supplemental Determination Regarding 2009 Compensation Payments for the Chief Executive Officer* (Dec. 23, 2009) (online at www.financialstability.gov/docs/20091223%20GMAC%20Supplemental%20Determination%20Letter.pdf).

A portion of Mr. Carpenter's salary comprises deferred stock units (DSUs), which vest immediately, but are subject to restrictions on the timing of payout: "DSUs cannot be paid out until at least two years after the date of grant. After the two-year time restriction has passed, the DSUs will be paid out in installments beginning immediately and continuing over the next three years." Another portion of Mr. Carpenter's salary comprises restricted stock

[275] Data provided to the Panel by GMAC.
[276] GMAC Form 10–K for 2008, *supra* note 10, at 80.
[277] GMAC Form 10–K for 2008, *supra* note 10, at 80. The commercial paper was downgraded below A–1/P–1. GMAC, Inc., *Form 10–Q for the Quarter Ended June 30, 2009*, at 101 (Aug. 7, 2009) (online at www.sec.gov/Archives/edgar/data/40729/000119312509169238/d10q.htm) (hereinafter "GMAC Form 10–Q for the Q3 2009").
[278] GMAC Form 10–K for 2008, *supra* note 10, at 80.
[279] GMAC Form 10–Q for the Q3 2009, *supra* note 277, at 101.
[280] GMAC Form 10–K for 2009, *supra* note 12, at 88.
[281] GMAC is subject to executive compensation levels set by Treasury's Special Master Feinberg because the company is classed by Treasury regulations as one of a group of companies that has received "exceptional assistance" under the TARP.

units (RSUs), which "vest in full three years after they are granted." After the vesting requirement is met, payouts will be made only "when the Company starts to repay its TARP obligations. Payouts will be made on an incremental basis."[283]

The Panel believes that the levels of compensation set for the CEO of GMAC (and of other companies classed as receiving "exceptional assistance" under the TARP) raise significant questions, which the Panel will continue to study. These include whether particular levels of compensation are either necessary or appropriate, the nature of the incentives the compensation creates, and the manner in which Treasury is exercising its authority under the EESA compensation restrictions as amended by the American Recovery and Reinvestment Act of 2009 (ARRA).

E. Justification for the Rescue of GMAC

Treasury presents a twofold justification for its intervention in GMAC: first, GMAC's significance to the automotive industry and to GM and Chrysler in particular; and second, GMAC's inclusion in the stress tests, pursuant to which Treasury committed to provide funds for BHCs that could not raise funds privately. Treasury has declined to say whether either one of these factors in the absence of the other would have led to the same result, explaining that it was dealing with the facts as they existed at the time of the intervention and that Treasury staff cannot speculate on the outcome of hypothetical events.[284]

1. GMAC's Significance to the Financing of the Automotive Industry

a. Automobile Companies' Reliance on GMAC

Treasury's first justification for support of GMAC is the role played by GMAC in automotive industry financing.[285] In answers to questions posed by the Panel, Assistant Secretary of the Treasury for Financial Stability Herb Allison stated that Treasury's assistance to GMAC has provided a "reliable source of financing to both auto dealers and customers seeking to buy cars," helped "stabilize our auto financing market," and contributed "to the overall economic recovery."[286] As discussed in more detail below, GMAC is a primary source of retail and wholesale financing for both GM and Chrysler. In conversations with Panel staff, Treasury stated that if Treasury had refused to support GMAC after providing assistance to GM and Chrysler, it would have undermined the government's investments in the automotive companies.[287]

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[283] GMAC Form 10–K for 2009, *supra* note 12, at 224–225.

[284] Treasury conversations with Panel staff (Jan. 8, 2010); Treasury conversations with Panel staff (Jan. 29, 2010).

[285] Treasury stated that its desire to ensure that GMAC's non-automobile operations, including ResCap, continue operation played a "minimal, at most" role in its decision to support GMAC. Treasury conversations with Panel staff (Jan. 29, 2010).

[286] QFRs for Assistant Secretary Herbert M. Allison, *supra* note 245. *See also* July 2009 SIGTARP Report, *supra* note 133, at 112 ("Treasury has stated that it believes its investment in GMAC will help provide a reliable source of financing to both auto dealers and customers seeking to buy cars, and that a recapitalized GMAC will offer strong credit opportunities, help stabilize the auto financing market, and contribute to the overall economic recovery").

[287] Treasury conversations with Panel staff (Jan. 8, 2010); Treasury conversations with Panel staff (Jan. 29, 2010).

According to Treasury, it is almost certain that GMAC and Chrysler Financial would have failed without Treasury's intervention.[288] Relying on outside industry estimates, Treasury stated that the impact of letting GMAC and Chrysler Financial fail (together with credit conditions) would likely have been a further immediate decline of 1.5 to 2.5 million domestic automobile sales, primarily because of these companies' roles in providing floorplan financing to GM and Chrysler dealers.[289] Treasury believes that such a decline in sales would, in turn, have immediately threatened the economic viability of GM and Chrysler.[290]

GM similarly has taken the position that the continued solvency of GMAC was crucial for GM's ability to continue operating, especially in the context of the financial crisis. In December 2008, GM Chief Executive Rick Wagoner stated that "GMAC's difficulties were 'hammering' the carmaker's ability to sell automobiles."[291] The importance of GMAC for GM's sales is underscored in GM's public filings and discussions with the Panel staff, in which GM explained that GMAC's severe financial difficulties in late 2008 and the first quarter of 2009 were an important independent contributing factor in its ability to sell automobiles. GM emphasized its historical and continued reliance on GMAC for financing and explained that when GMAC tightened its floorplan financing to GM dealers and radically rolled back its retail lending (including a complete cessation of lease finance by the end of 2008), vehicle sales declined.[292] In discussions between the Panel staff and GM, the company repeated its contention that the continuation of financing from GMAC, especially floorplan financing, was essential for GM's continued ability to operate in 2008 and 2009 and that a complete disruption of floorplan financing—as opposed to the relatively minor credit contraction that actually occurred—would have crippled the company.[293]

Treasury provides a similar rationale for the additional support it provided GMAC in order to assume the wholesale and retail financing of Chrysler dealers and customers from Chrysler Financial. On April 30, 2009, when Chrysler filed for bankruptcy, GMAC entered into an agreement with Chrysler that made GMAC the "preferred provider of new wholesale financing for Chrysler dealer

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[288] Treasury conversations with Panel staff (Jan. 8, 2010).

[289] Treasury conversations with Panel staff (Feb. 2, 2010).

[290] Treasury conversations with Panel staff (Feb. 2, 2010); Written Testimony of Ron Bloom and Jim Millstein, *supra* note 73, at 3 ("Without government assistance, GMAC would have been forced to suspend financing lines to creditworthy dealerships, leaving them unable to purchase automobile inventory for their lots. Without orders for cars, GM would have been forced to slow or shut down its factories indefinitely to match the drop in demand. Given its significant overhead, a slow-down or stoppage in production of this magnitude would have toppled GM").

[291] Soyoung Kim and Karen Brettell, *GM Shares Up, GMAC May be Eyeing $6 Billion Loans*, Reuters (Dec. 26, 2008) (online at www.reuters.com/article/idUSTRE4BP27120081227).

[292] Motors Liquidation Co., *Form 10–Q for the Quarter Ended March 31, 2009*, Part II, Item 1, at 108 (May 8, 2009) (online at www.sec.gov/Archives/edgar/data/40730/000119312509105365/d10q.htm) (hereinafter "Motors Liquidation Form 10–Q for Q2 2009") (explaining that "[a]s a result" of reduced consumer finance by GMAC in this period, "the number of vehicles sold with a subsidized financing rate or under a lease contract declined rapidly in the second half of the year, with lease contract volume dropping to zero by the end of 2008. This had a significant effect on our vehicles sales overall, since many of our competitors have captive finance subsidiaries that were better capitalized than GMAC and thus were able to offer consumers subsidized financing and leasing offers"). In addition, GM stated that the declining availability of GMAC wholesale financing to GM dealers "caused and will likely continue to cause dealers to modify their plans to purchase vehicles from us." *Id*.

[293] GM conversations with Panel staff (Feb. 12, 2010).

inventory."[294] In its announcement of this agreement, GMAC stated that the government "indicated that it intends to support GMAC in promoting the availability of credit for dealers and customers by making liquidity and capital available and by providing the capitalization that GMAC requires to support the Chrysler business."[295] With GMAC moving quickly into the business of providing Chrysler financing, Chrysler Financial has begun to wind down the minimal portion of its operations not assumed by GMAC and aims to complete the process by December 31, 2011.[296] GMAC's relatively rapid assumption of most of Chrysler Financial's floorplan lending business provides the justification for support of GMAC to encompass the credit needs of Chrysler dealers and car purchasers.

Industry analysts and market participants who were consulted by the Panel overwhelmingly agreed that GM and Chrysler were heavily reliant on GMAC and Chrysler Financial—and, after May 2009, on GMAC alone—for the provision of floorplan financing for dealers who held their franchises.[297] They underscored the considerable aggregate credit needs of GM's and Chrysler's vast network of dealers, the need for floorplan credit to be renewed continually to ensure that dealers would have funds to take inventory, and the considerable infrastructure and historical ties that GMAC had developed to meet these needs.[298] Industry sources also generally agreed that while GMAC had historically been crucial in providing some consumer financing for GM, particularly subvented financing, GM was considerably less dependent overall on GMAC for consumer financing than for floorplan financing.[299]

In addition to speaking to Treasury, GMAC, GM, and industry sources, the Panel reviewed data on automotive financing. The Panel's review of this data supports the automobile manufacturers' and Treasury's contentions that GMAC and Chrysler Financial provided important financing for the wholesale and consumer customers of GM and Chrysler. In general, GMAC and Chrysler Financial provided financing almost exclusively to dealers affiliated with GM and Chrysler, respectively, and to purchasers of automobiles manufactured by these companies; their role in financing

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[294] GMAC LLC, *GMAC Financial Services Enters Agreement to Provide Financing for Chrysler Dealers and Customers* (Apr. 30, 2009) (online at gmacfs.mediaroom.com/index.php?s=43&item=324) (hereinafter "GMAC to Provide Financing for Chrysler Dealers and Customers").

[295] GMAC to Provide Financing for Chrysler Dealers and Customers, *supra* note 294.

[296] *See* letter from Kenneth R. Feinberg, special master for TARP executive compensation, to Tracy Hackman, vice president, general counsel and secretary, Chrysler Financial, *Proposed Compensation Payments and Structures for Senior Executive Officers and Most Highly Compensated Employees*, Annex A, at A5 (Oct. 22, 2009) (online at treas.gov/press/releases/docs/20091022%20Chrysler%20Financial%20Letter.pdf). Treasury explained that it began to orchestrate the transfer of most of Chrysler Financial's business into GMAC because it realized in the Spring 2009 that by July 2009, Chrysler Financial would be unable to meet its financing requirements. Treasury indicated that while parties explored merging Chrysler Financial with GMAC, such a solution would have been impractical because GMAC would assume all of Chrysler's debt obligations (and problems within its legacy portfolio). Instead, Treasury decided that it would allow the legacy portfolio to be placed in run-off and then capitalize the GMAC system that it believes has been shown to work. Treasury conversations with Panel staff (Feb. 2, 2010).

[297] National Automobile Dealers Association conversations with Panel staff (Feb. 2, 2010); industry analyst conversations with Panel staff; market participants conversations with Panel staff.

[298] National Automobile Dealers Association conversations with Panel staff (Feb. 2, 2010); industry analyst conversations with Panel staff; market participants conversations with Panel staff.

[299] National Automobile Dealers Association conversations with Panel staff (Feb. 2, 2010); industry analyst conversations with Panel staff; market participants conversations with Panel staff.

GM's and Chrysler's competitors was negligible. GMAC and Chrysler Financial were, however, a significant source of GM's and Chrysler's financing needs—especially for floorplan financing but also in some segments of the consumer financing market.

GMAC's financial statements demonstrate that it derives significant revenues from automotive financing. Before the financial crisis, around a third of GMAC's revenue came from its GAF operations, with net revenue of nearly $5 billion in 2007.[300] Those revenues are primarily derived from GM customers and dealers, as demonstrated in more detail by the charts below.

From the point of view of GM dealers, GMAC has provided the vast majority of floorplan financing received—typically between 80 and 85 percent of total GM international and North American sales[301]—and this percentage has remained relatively stable through both GMAC's transition to non-captive status and the stresses caused by the financial crisis and other recent shocks to the automotive industry and market. The balance of the floorplan financing needs of GM dealers was provided by national and regional banks.[302] In contrast, GMAC's role in financing non-GM dealers was negligible, typically amounting to only three percent of GMAC's floorplan business and not a substantial proportion of floorplan financing for any other OEM's dealers.

FIGURE 9: GMAC FLOORPLAN FINANCING TO GM AND NON-GM DEALERS[303]

	2005	2006	2007	2008	2009
Total GM Units	6,260,000	6,122,000	6,093,000	5,404,000	3,876,000
Total GM Units NA	3,798,000	3,464,000	3,161,000	2,540,000	1,374,000
Total GM Units Int'l	2,462,000	2,658,000	2,932,000	2,864,000	2,502,000
Non GM Units	180,000	145,000	199,000	196,000	[304] 249,000
Percent of GM Sales	82%	80%	82%	81%	78%
Percent of GM NA	80%	76%	77%	76%	77%
Percent of GM Int'l	84%	86%	88%	85%	79%

[303] *See* GMAC LLC and GMAC, Inc., *Forms 10–K for the Fiscal Years Ended December 31, 2003–2009* (online at www.sec.gov/cgi-bin/browse-edgar?action=getcompany&CIK=0000040729&type=10–K&dateb=&owner=exclude&count=40) (hereinafter "GMAC Forms 10–K for FY 2003–2009").

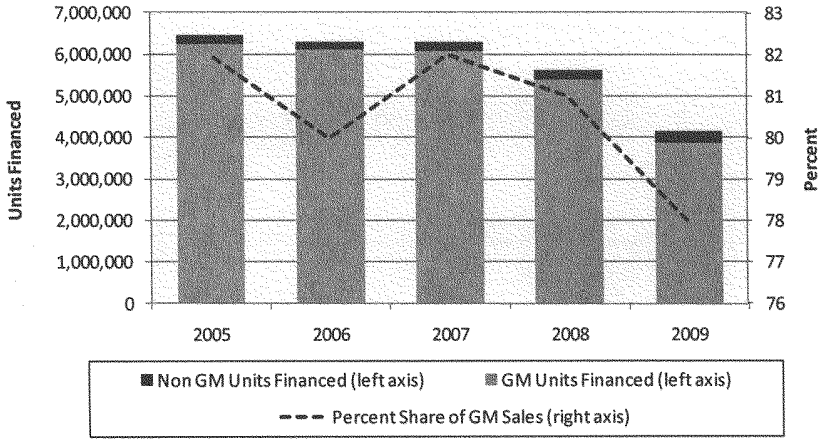
[304] Of the 249,000 non-GM units GMAC financed through its wholesale financing, 131,000 were financings of Chrysler units compared to only 7,000 Chrysler units in 2008. See GMAC Form 10–K for 2009, *supra* note 12, at 47.

[300] GMAC Form 10–K for 2008, *supra* note 10, at 35.

[301] The proportion of GM U.S. sales supported by GMAC floorplan financing has historically been slightly higher: approximately 85 percent at year-end 2008 and 91 percent at year-end 2009. *See* Written Statement of Robert Hull, *supra* note 141, at 3.

[302] *See* Written Testimony of Ron Bloom and Jim Millstein, *supra* note 73, at 4 ("For example, in December 2008, 75% of GM dealers received their financing from GMAC while the next five lenders made up only 8%. The remaining dealers were serviced by 200 banks, most of which provided financing for only a single dealer").

FIGURE 10: GMAC FLOORPLAN FINANCING TO GM AND NON-GM DEALERS [305]



The heavy reliance of GM dealers on GMAC for floorplan financing is typical of the industry; the majority of floorplan financing for dealers of a particular OEM has historically been provided by the OEM's captive (or former captive) finance company.[306] A similar pattern is apparent with respect to Chrysler, where Chrysler Financial has historically provided between 70 and 75 percent of Chrysler dealers' floorplan financing.[307] GMAC has rapidly replaced Chrysler Financial as the prime supplier of floorplan financing for Chrysler dealers, and by the end of 2009, it provided wholesale financing for 77 percent of Chrysler dealership inventory in the United States, which is substantially the same proportion of floorplan financing that it provided before the financial crisis.[308]

[305] *See* GMAC Forms 10–K for FY 2003–2009, *supra* note 303. This chart includes North American and international sales.

[306] For example, Ford Motor Credit provided a roughly equivalent proportion of floorplan financing to Ford North American dealerships that GMAC provided to GM North American dealers. In 2006, Ford Motor Credit supplied 80 percent of floorplan credit; in 2007, 78 percent of floorplan credit; and in 2008, 77 percent of floorplan credit. *See* Ford Motor Company, *Form 10–K for the Fiscal Year Ended December 31, 2008,* at 10, 49, 52 (Feb. 26, 2009) (online at www.sec.gov/Archives/edgar/data/37996/000114036109005071/form10k.htm); Ford Motor Company, *Form 10–K for the Fiscal Year Ended December 31, 2007,* at 10, 46–50 (Feb. 27, 2008) (online at www.sec.gov/Archives/edgar/data/37996/000114036108005181/form10k.htm).

[307] *See* Figure 11, *infra.* Compared to GMAC, Chrysler Financial historically did a higher proportion of its floorplan financing business with dealers associated with its OEM, with average monthly non-Chrysler units financed generally constituting 20–25 percent of Chrysler Financial's floorplan business. *See id.*

[308] *See* Figure 11, *infra. See also* GMAC, Inc., *GMAC Statement on Financing of Chrysler Dealers, Customers* (Nov. 5, 2009) (online at media.gmacfs.com/index.php?s=43&item=372) (hereinafter "GMAC Statement on Financing of Chrysler Dealers, Customers") (reporting that as of November 2009, GMAC was providing wholesale financing for 85 percent of dealer inventory in Canada). Based on other metrics, such as floorplan loans outstanding and number of units financed, however, the transfer of Chrysler dealers' floorplan financing from Chrysler Financial to GMAC has been more gradual. *See* Note 341, *infra.*

FIGURE 11: CHRYSLER FINANCIAL (SUBSEQUENTLY GMAC) FLOORPLAN FINANCING TO CHRYSLER AND NON-CHRYSLER DEALERS [309]

	2005	2006	2007	2008	Q1 2009	Q2 2009	Q3 2009 [310]	Q4 2009
Share of Chrysler U.S. Sales	70%	73%	75%	75%	74%	Not Available	67%	77%.
Average Monthly Chrysler Units Financed [311] ..	407,000	406,000	355,000	308,000	262,000	Not Available [312]	Not Available	Not Available.
Average Monthly Non-Chrysler Units Financed	90,000	71,000	69,000	60,000	44,000	Not Available	Not Available	Not Available.

[309] Unless otherwise noted, the table is based on data provided to the Panel from Chrysler Financial. All data contained in the table reflects financing of U.S. Chrysler dealers. Unit numbers have been rounded to the nearest thousand.
[310] Third and fourth quarter 2009 figures represent GMAC's provision of floorplan financing to Chrysler dealers. *See* Written Statement of Robert Hull, *supra* note 141, at 3.
[311] Unlike GMAC, Chrysler Financial did not track total units financed, but instead tracked average monthly units in dealer inventories that were supported by Chrysler Financial floorplan lending. An estimate of units financed per year cannot be derived from the monthly figures because vehicles often remain on dealer lots for more than one month and are thus reflected in more than one month's numbers.
[312] Chrysler Financial stopped financing new floorplan loans in April 2009 with the transition of its floorplan financing business to GMAC. GMAC does not disclose comparable data.

In contrast to floorplan financing, automobile credit companies face greater competition in the consumer finance market from national and regional banks and credit unions.[313] Despite the relatively competitive environment, however, both GM and Chrysler relied on their credit companies for a substantial portion of their consumer financing.

In 2006, despite its spin-off from its parent, GMAC still provided 38 percent of GM's consumer financing, a figure that included 48 percent of financing for its North American sales.[314] GM relied on GMAC even more heavily, however, for particular types of consumer financing; as GM stated in its public filings, GMAC "finances a significant percentage of our global vehicle sales and virtually all of our U.S. sales involving subsidized financing such as below-market interest rates."[315] In fact, approximately 80 percent of GMAC's consumer financing has historically been subvented financing.[316]

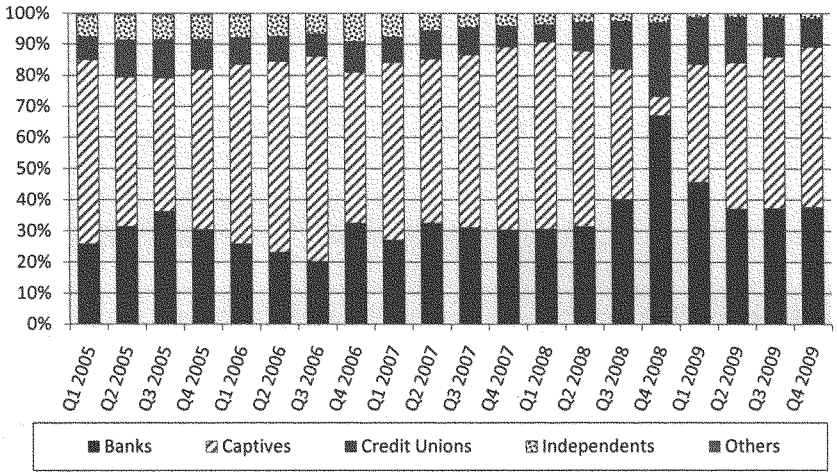
[313] *See* Figure 2, *supra*.
[314] *See* Figure 12.
[315] Motors Liquidation Form 10–Q for Q2 2009, *supra* note 292, at 108.
[316] GMAC Form 10–K for 2008, *supra* note 10, at 163.

FIGURE 12: GMAC CONSUMER AUTOMOBILE FINANCING [317]

	2005	2006	2007	2008	2009
Total Units	2,157,000	2,198,000	2,092,000	1,564,000	1,115,000
GM Units	2,085,000	2,130,000	1,984,00	1,468,000	840,000
Non GM Units	72,000	68,000	108,000	96,000	111,000
Percent of GM Sales/Leases	36%	38%	35%	32%	20
Percent of GM NA	42%	48%	45%	38%	27
Percent of GM Int'l	26%	24%	23%	25%	14

[317] *See* GMAC Forms 10–K for FY 2003–2009, *supra* note 303.

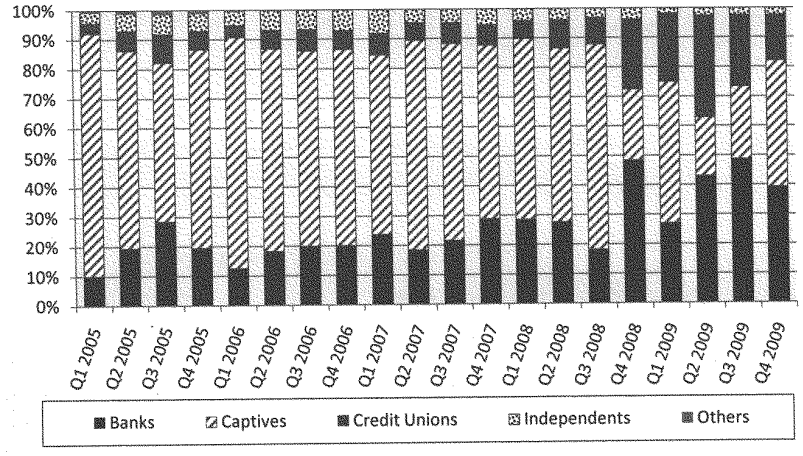
FIGURE 13: GM RETAIL SALES BY FINANCING SOURCE [318]



[318] Data provided to the Panel by J.D. Power and Associates.

With respect to Chrysler, before the crisis, approximately 70 percent of the consumer purchases at Chrysler dealers were provided by Chrysler Financial, with the rest coming from local banks and credit unions.[319] Although GMAC rapidly assumed most of Chrysler Financial's floorplan financing of Chrysler dealers, GMAC's assumption of Chrysler Financial's consumer financing has been neither as swift nor as complete. During the fourth quarter of 2009, GMAC was the leading provider of consumer financing for Chrysler vehicles in the United States, providing financing for 25.5 percent of retail sales.[320] While GMAC's share is increasing, it is still substantially below the pre-transition figure, and it is not clear whether Chrysler consumers have permanently shifted a portion of their financing business to GMAC's competitors.

FIGURE 14: CHRYSLER RETAIL SALES BY FINANCING SOURCE [321]



[319] *See* Chrysler Bankruptcy Filing (April 30, 2009) *In re Chrysler LLC, et al.,* Bankr. S.D.N.Y. (No. 09–50002–ajg) (online at graphics8.nytimes.com/packages/images/nytint/docs/chrysler-bankruptcy-filing/original.pdf).

[320] Data provided to the Panel by J.D. Power and Associates (reporting 35 percent by fourth quarter 2009); Written Statement of Michael Carpenter, *supra* note 140, at 1 (reporting that GMAC financed 25.5 percent of Chrysler retail sales in the United States); GMAC Reports Preliminary Q4 and Full-Year 2009 Results, *supra* note 127 (reporting that GMAC financed 25.5 percent of Chrysler's U.S. retail sales in the fourth quarter of 2009 in October 2009, compared to 13.3 percent in the third quarter of 2009).

Chrysler Financial no longer engages in new dealer financing. *See* Chrysler Financial, *Chrysler Financial Restructures Its Business Operations* (June 30, 2009) (online at corp.chryslerfinancial.com/news_business_restructure.html). Instead, it provides "dealership insurance and consumer retail financing products." *Id.* During the wind-down process, it will also continue to "service and collect on its on-going loan portfolio of about $45 billion." *Id.*

[321] Data provided to the Panel by J.D. Power and Associates.

These data support the position that both GMAC and Chrysler Financial were important suppliers of credit for GM's and Chrysler's operations, especially with respect to floorplan financing. In line with the historical relationship between OEM's and their captive financing arms, GMAC and Chrysler Financial provided the vast majority of floorplan financing for their respective OEMs' dealers even after GMAC and Chrysler Financial lost their subsidiary status, while the provision of retail financing was much less consolidated.

b. Could Financing Have Been Provided by Other Market Participants?

The financial crisis disrupted the automotive financing market in several different ways, constraining the ability of all market participants to provide wholesale or retail financing.

In December 2008 and January of 2009, the credit ratings of GMAC and Chrysler Financial were each downgraded,[322] which, in turn, raised their borrowing costs. The securitization market, GMAC's primary source of funds for its automobile finance operations, dried up. While GMAC had a bank with access to the Federal Reserve's discount window and the TLGP beginning at the end of 2008, it was unable to use bank funds to finance loans to GM dealers until May 2009 because of restrictions on related-party transactions.[323] The result was that GMAC rolled back its consumer lending in order to focus on providing floorplan lending, which GMAC believed was key to the survival of both itself and GM, and where it believed it could not easily be replaced.[324] Thus, despite the challenging financial climate, GMAC slightly expanded, and Chrysler Financial maintained, their respective market shares in floorplan financing. GMAC did, however, respond to its difficulties in raising funds by raising interest rates on floorplan loans and tightening its floorplan financing standards[325]—actions that theoretically presented an opportunity for some dealers to seek third-party lending from other market participants.

Few bank competitors, however, stepped up as the captive finance companies struggled. The Panel staff's discussions with numerous market participants, market analysts, and experts in finance and economics suggest that if GMAC's floorplan lending were significantly disrupted in the end of 2008 and the first half of 2009, it was highly unlikely that, absent significant government

[322] *See* Bloomberg Data (Fitch downgraded GMAC's Senior Unsecured Debt to "RD" from "CCC" on January 9, 2009); Standard and Poor's, *DaimlerChrysler Financial Services Americas LLC Rating Lowered to 'CCC-'; on Watch Dev.,* at 2 (Dec. 23, 2008).

[323] GMAC conversations with Panel staff (Feb. 1, 2010); industry analysts conversations with Panel staff. In late December 2008, GMAC received an exemption from the related-party restrictions for its retail loans, but it did not receive an exemption for its dealer loans until May 2009. *See* Section C.2, *supra*. Representatives of the credit union industry, while conceding the need to bail out GMAC to avoid a GM bankruptcy, object to the GMAC's continuing receipt of bailout-related subsidies and liquidity and, most significantly, its open-ended ability to fund its automobile lending with deposits from Ally Bank. Panel discussions with credit industry representatives. They believe that these measures provide GMAC with an unfair competitive advantage in making retail loans to purchasers of GM automobiles. *Id.* This complaint raises the question of whether GMAC's access to federally-insured deposits through Ally Bank, the "covered transactions" exemptions it has received under Section 23A of the Federal Reserve Act, *see* Section C.2, *supra*, and its status as a hybrid BHC/quasi-captive automobile finance company are appropriate going forward in a non-emergency context, *see* Section H.2., *infra*.

[324] GMAC conversations with Panel staff (Feb. 1, 2010); industry analysts conversations with Panel staff.

[325] GMAC conversations with Panel staff (Feb. 16, 2010).

backing, other market participants could have compensated for the loss of floorplan lending to preserve GM's operations absent significant government backing.

The primary obstacle facing national and regional banks was that the industry had entered a risk-reduction mode, with depository banks curtailing their lending during the financial crisis because of their large and uncertain exposures to real estate-related assets; the dramatic slowdown in the economy; and their needs to write down assets and to boost capital ratios.[326] In addition, banks were subject to some of the same pressures in funding their floorplan lending as the finance companies. Nine out of the top ten non-captive providers of floorplan financing were depository institutions.[327] While financing companies, including GMAC, traditionally funded their operations through access to wholesale finance markets and funded their floorplan lending through the securitization markets, banks supported their floorplan lending by adding assets to their balance sheets, financed by funds raised in the wholesale finance market and consumer deposits from their affiliated banks.[328] During the financial crisis, banks faced a significant disruption in their access to the wholesale finance market. Moreover, if banks lacked the appetite to increase substantially the amount of floorplan loans in their portfolios, they could not reduce their exposure by securitizing these loans. In 2008 and the first part of 2009, floorplan securitization almost completely evaporated until the TALF slowly began to revive the moribund floorplan securitization market.[329] Another indication of banks' low appetite for forging new floorplan financing relationships with GM dealers is the fact that GMAC's share of floorplan financing actually increased from 80 percent to 85 percent of GM-affiliated dealers even as GMAC was tightening its credit standards.[330] This shift can be attributed to the fact that non-GMAC floorplan lenders were remaining at least as cautious as they were before, if not being more diligent or tightening their standards.[331]

Banks feared that floorplan lenders were at risk of being saddled with loan collateral comprised of vehicles that were rapidly depreciating in value because the manufacturers were at risk of bankruptcy.[332] These were the same factors that credit rating agencies used to justify downgrading the ratings of the existing securitizations of GMAC and Chrysler Financial and to refuse to

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[326] Written Testimony of Ron Bloom and Jim Millstein, *supra* note 73, at 4 ("It is also important to remember that when the initial investment decision was being made, many large national banks faced significant threats to their own financial health (e.g., deteriorating legacy asset values, diminished access to capital, mounting losses). Finally, most banks lack the capacity to aggressively grow their automotive lending portfolios, given internal and regulatory limits on borrower and industry concentrations").

[327] Treasury conversations with Panel staff (Feb. 2, 2010).

[328] Market participants discussions with Panel staff; industry analysts conversations with Panel staff.

[329] Floorplan securitizations declined from $12.3 billion in 2006 to $5.6 billion in 2007 and $0 in 2008 before slightly recovering to $2.5 billion in 2009. Data provided to the Panel by the Securities Industry and Financial Markets Association (relying on data from Thomson Reuters).

[330] GMAC conversations with Panel staff (Feb. 1, 2010).

[331] Industry analysts conversations with Panel staff; market participants conversations with Panel staff.

[332] Industry analysts conversations with Panel staff; market participants conversations with Panel staff.

grant AAA ratings to new securitizations.[333] While industry groups believe that these fears were misplaced,[334] banks feared that the vehicles branded by a bankrupt GM and Chrysler would remain unsold and depreciate because demand for vehicles would dry up and the warranties would not be honored.[335] Banks also had additional fears. Because they were less familiar with the auto dealers, they were unsure which dealers would survive the downturn, and lacking the strong relationships with GM and Chrysler that GMAC and Chrysler Financial had, they were less certain about the impact of a GM and Chrysler bankruptcy.[336]

In fact, by the time of the financial crisis, the wholesale financing market was substantially bifurcated, with the captives financing the vast majority of dealers, including relatively higher-risk dealers, and banks typically funding the lower-risk dealers.[337] GMAC retained some of the incentives of a captive and was willing to provide less profitable floorplan financing—impacted by its increased costs of funds relative to banks—in order to ensure that GM continued to produce and market its cars.[338]

Banks and other financial institutions that did not previously have floorplan lending operations did not enter the segment significantly, and those banks that were already in the market did not expand their operations.[339] There were also structural barriers to entry or further penetration of this segment of the market. Some market observers have stressed what they believed were GMAC's substantial advantages of human and institutional capital over their bank competitors as important barriers to entry.[340] GMAC stressed that it had developed a substantial amount of operational and management expertise to support its proprietary floorplan finance operations, including sophisticated inventory control sys-

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[333] The rating agencies were also concerned that if either GM or Chrysler entered bankruptcy or was severely disabled, it would be unable to honor the buyback obligations that would be triggered upon default of the dealer. National Automobile Dealers Association conversations with Panel staff (Mar. 5, 2010).

[334] National Automobile Dealers Association conversations with Panel staff (Feb. 2, 2010 and Mar. 5, 2010) (explaining that there was typically sufficient collateral and credit protections for providers of floorplan financing, including the dealership's unsecured promise to pay, the dealer's personal guarantee, the intrinsic value of the collateral, and various enhancements and haircuts in the securitizations).

[335] In fact, some market participants have noted that they were reluctant to provide floorplan financing to any GM or Chrysler dealers at times in late 2008 and early 2009. Market participants conversations with Panel staff.

[336] Treasury conversations with Panel staff (Feb. 2, 2010); industry analysts conversations with Panel staff. For its part, GMAC denied that it had inside knowledge of dealer closings. GMAC conversations with Panel staff. GM had already contracted its dealership network from 7,367 in 2004 to 6,246 in 2008. *See* General Motors Corp., *2009–2014 Restructuring Plan,* at 17 (Feb. 17, 2009) (online at www.financialstability.gov/docs/AIFP/GMRestructuringPlan.pdf). Additionally, GM announced in May 2009 that it was planning to reduce further its dealer network to 3,600 by the end of 2010. *See* General Motors Corp., *GM Statement Regarding Dealer Network Communications* (May 15, 2009) (online at media.gm.com/content/media/us/en/news/news_detail.brand_gm.html/content/Pages/news/us/en/2009/May/0515_ReducingDealers).

Complicating the picture is the fact that the sources of floorplan financing also often provided dealers with other credit products. While the floorplan financing was collateralized in large part by the dealer's inventory, the collateral for these other products was often based on the value of the dealer's property. Given the large decline and uncertainty in property values, dealers became increased credit risks, which would have been a factor in market participant's decisions whether to provide floorplan and other financing to dealers. Industry analysts conversations with Panel staff.

[337] Market participants conversations with Panel staff.

[388] GMAC conversations with Panel staff (Feb. 1, 2010).

[339] Industry analysts conversations with Panel staff; market participants conversations with Panel staff.

[340] Industry analysts conversations with Panel staff; market participants conversations with Panel staff.

tems, and long-established ties to, knowledge of, and monitoring of dealers.[341] While some market participants and analysts believed that these historical links functioned as a substantial barrier to further penetration of the market by banks, others believed that non-captive companies could have gained the expertise, management systems, and capacity in the medium term and that some of these barriers, like the need to implement new information technology systems, were overstated.[342] However, the prospect of this happening in the context of a dual financial and automotive industry crisis, where many were seeking to reduce their exposure to the industry, was remote.

Market analysts and participants with whom the Panel staff spoke stated that some of the barriers to entry and concerns about credit could have been mitigated if the government had been willing to provide guarantees for financing or related incentives or credit enhancements. Alternatively, GMAC's floorplan financing business could have been transferred to another party voluntarily and in an orderly manner.[343] Yet even these government-sponsored

[341] GMAC conversations with Panel staff (Feb. 16, 2010). *See also* Written Testimony of Ron Bloom and Jim Millstein, *supra* note 73, at 4 ("In addition to size and capital constraints, providing new dealers with financing is complex and requires time that was not available. Moreover, GM estimates that it would have taken a new provider up to six months to create the infrastructure, systems, and human capital necessary to replace GMAC"); Transcript of COP Hearing on GMAC, *supra* note 12 (Testimony of Michael Carpenter) ("And I think the barrier to entry, if you will, is not money and cost of money—it's infrastructure and the knowledge—it's the knowledge of the automobile business, how automobiles are dealt with in the wholesale channel, the retail channel and the systems that are acquired and the relationships that are necessary to manage that business over time—represents a very significant barrier to entry. Now, is it a barrier to entry that a major bank could overcome over many years? Absolutely. It would cost a great deal of money and historically they have not shown the appetite to do it. So, if you look at where the, you know, which of these dealers actually get financing from banks, they fall into two categories. One is the local bank down the street, where the bank is taking a very different risk. We're a secured lender, they're taking a risk on the business, the character of the business person in the community. And the other characteristics are some of the largest—often public—dealerships which are of interest to the larger banks, just like any other major commercial credit").

[342] In fact, one market participant stated that he believed his institution's inventory tracking, and dealer auditing and monitoring capabilities were on par with GMAC's and that transition from GMAC's systems would not have been burdensome. Market participant conversation with Panel staff.

[343] The relatively rapid and successful transition of Chrysler Financial's floorplan financing operations to GMAC beginning in May 2009 would be an encouraging example. This experience, however, does not necessarily suggest that GMAC's floorplan operations could be as easily assumed by other market participants. GMAC's ability to absorb Chrysler Financial's floorplan lending operations was based on a number of important factors. First, GMAC's floorplan operations dwarfed those of Chrysler Financial, and the addition of Chrysler Financial's floorplan lending portfolio represented a significant but not overwhelming expansion of GMAC's business. In December 2008, GMAC managed about $26.5 billion of wholesale automobile loans. *See* Written Testimony of Ron Bloom and Jim Millstein, *supra* note 73, at 3. By comparison, on April 30, 2009—the eve of GMAC's assumption of Chrysler Financial's floorplan financing business—Chrysler Financial's U.S. and Canada floorplan lending portfolio in support of Chrysler dealers was about $8.4 billion. Data provided to the Panel by Chrysler Financial. In addition, there is reason to believe that the aggregate floorplan lending numbers overstate the burden GMAC faced, and, in fact, GMAC had the luxury of a relatively slow ramp up in providing floorplan financing for Chrysler dealers. First, as of September 30, 2009, GMAC's outstanding balance of wholesale financing of Chrysler dealers was approximately $3.3 billion, only a fraction of the $8.4 billion market. *See* GMAC Statement on Financing of Chrysler Dealers, Customers, *supra* note 308. Moreover, while the percentage of Chrysler dealers supported by GMAC approached pre-GMAC levels by end of the third quarter of 2009, *see* Figure 11, *infra* GMAC indicates that it provided floorplan financing for only 131,000 Chrysler units in 2009 out of a total 4.125 million units financed in 2009, *see* Figure 10, *infra* [GMAC Floorplan Financing to GM and Non-GMAC Dealers]. Finally, GMAC was already identified as having a sufficient operational and financial *infra*structure to meet the floorplan financing needs of Chrysler dealers—new market players did not have to step in and provide financing—and the transition was facilitated by Treasury's heavy subsidization of GMAC's effort to assume Chrysler Financial floorplan (and retail) lending operations. Treasury provided GMAC with $4.0 billion in May 2009 designated ex-

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options may not have ensured the continuation of the supply of floorplan credit. Even with guarantees or a government-brokered transfer of existing business, market participants cited the political risk—the fear that the government would later change its policies—as another obstacle to the industry's participation in any such plan. The experience of the government's taking Chrysler into bankruptcy and the rapid shifts in federal financial regulatory policies amidst the financial crisis led to a distrust by Wall Street of federal intervention. Given the need for a rapid takeover, this lack of trust might have undermined any attempts to facilitate an orderly transition of business. To a certain extent Treasury was forced to address a problem of its own making, as government intervention in the automotive and financial services industries added to the existing uncertainty and may have constrained Treasury's ability to allow GMAC to fail and instead facilitate, through guarantees or incentives, a process by which existing and new market participants would have replaced GMAC's floorplan lending operations.[344]

The industry analysts and market participants consulted by the Panel were consistent in stating that the likely result of the disappearance of GMAC from the floorplan lending market in late 2008 or early 2009 would have been an immediate and severe decline in the total availability of floorplan credit. As a result of this decline, credit would have been available at much higher prices, if at all, to already-struggling GM dealers, and less creditworthy, more thinly-capitalized dealers would have been forced into insolvency.[345]

The story for consumer lending was different. The captive automotive finance companies were not as indispensable for consumer lending as for floorplan lending, and there was a wide array of players competing in the market.[346] GMAC's temporary abandon-

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pressly for that purpose. *See* Treasury Announces Additional Investment in GMAC, *supra* note 225.

[344] Industry analysts conversations with Panel staff.

[345] This conclusion is reflected in the opinion of Mr. de Molina, CEO of GMAC from March 1, 2008 to November 18, 2009, who stated: "No one, either by itself or together, could have done it [replaced GMAC's floorplan financing of GM dealers] at the time . . . There was a concentration of risk that no one would take on. I don't know anyone who opposes that view." Panel staff conversation with Alvaro G. de Molina (Feb. 19, 2009). *See also* Transcript of COP Hearing on GMAC, *supra* note 12 (Testimony of Ron Bloom) ("Had Treasury allowed GMAC to fail, no single competitor or group of competitors could have stepped in to absorb GMAC's entire loan portfolio"); Transcript of COP Hearing on GMAC, *supra* note 12 (Testimony of Michael Ward) ("It's gone. I mean, if they didn't rescue GMAC—if GMAC did not exist, GM would have been Chapter 7").

Panel hearing witness Christopher Whalen stated in his written testimony that "[t]here were private alternatives available to GM and Chrysler in the marketplace for floor plan lending" that could have stepped in "[w]ith a little bit of effort and imagination," "albeit at a higher cost level." *See* Congressional Oversight Panel, Written Testimony of Christopher Whalen, senior vice president and managing director, Institutional Risk Analytics, *COP Hearing on GMAC Financial Services,* at 4, 8–9 (Feb. 25, 2010) (online at cop.senate.gov/documents/testimony-022510-whalen.pdf) (hereinafter "Testimony of Christopher Whalen"). During his oral testimony, however, Mr. Whalen, while stating that other market participants have been unable to compete with captives (and former captives) because of the economic advantages the last two enjoy by dint of their relationships with OEMs, agreed that GMAC's floorplan financing was crucial to the survival of GM because of the inability of market participants to step in adequately to fill GMAC's large market share at the time of Treasury's assistance. *See* Transcript of COP Hearing on GMAC, *supra* note 12 (Testimony of Christopher Whalen, Senior Vice President and Managing Director, Institutional Risk Analytics).

[346] *See* General Motors, Corp., Form 10–K for the Fiscal Year Ended December 31, 2008, at 45 (Mar. 5, 2009) (online at www.sec.gov/Archives/edgar/data/40730/000119312509045144/0001193125-09-045144-index.htm) (hereinafter "GM Form 10–K for 2008") (disclosing risks to GMAC's continued ability to operate because it might fare poorly in the "highly competitive" "markets for automotive and mortgage financing, insurance, and reinsurance" and further ex-

ment of the consumer financing market to concentrate on floorplan lending, which led its market share to plummet from over 30 to five to six percent in the fourth quarter of 2008[347]—and its more permanent complete withdrawal from the subprime automobile lending market—had a disruptive but not catastrophic effect on the availability of consumer financing for purchasers of GM automobiles. As discussed above, a much wider range of sources is available for consumer automotive financing.[348] The degree to which the banks and other market participants stepped in (and could have filled the void if GMAC completely exited the market) is mixed. In response to the various stresses in the financial, credit, and automobile markets discussed above, national and regional banks were curtailing their consumer lending, including their lending to consumers to purchase and lease new and used automobiles.[349] Consumer automotive lending was heavily dependent on the ability to securitize auto loans, and consumer automobile securitizations halved in 2008.[350]

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plaining that the "market for automotive financing has grown more competitive as more consumers are financing their vehicle purchases, primarily in North America and Europe").

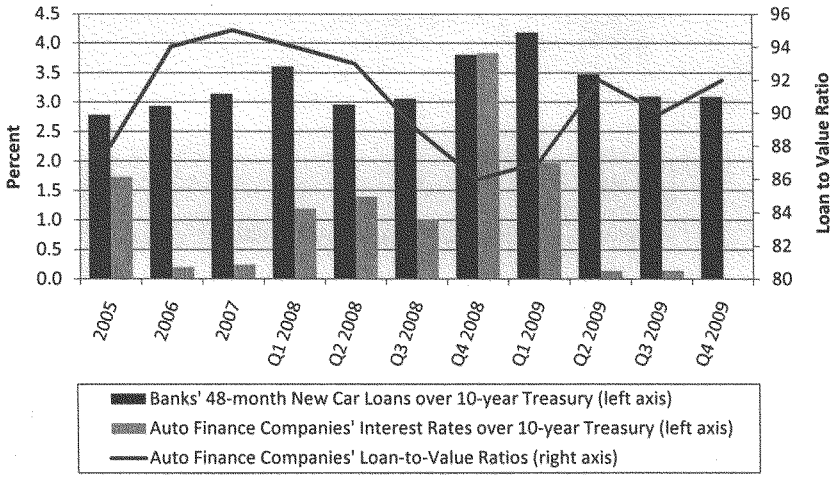
[347] *See* Figure 13, *supra*.

[348] *See* Section E.1(a–b), *infra*.

[349] *See* Board of Governors of the Federal Reserve, *Federal Reserve Statistical Release G.19: Consumer Credit* (Jan. 8, 2010) (online at www.federalreserve.gov/releases/g19/) (hereinafter "Federal Reserve Statistical Release G.19") (showing that nonrevolving consumer credit—a category that includes automobile loans and that had grown at an average annualized rate of 5 percent from 2004–2008—declined at an annualized rate of 1.0 percent in the third quarter of 2008, 0.4 percent in the fourth quarter of 2008, grew at 0.2 percent in the first quarter of 2009, and declined 1.9 percent in the second quarter of 2009).

[350] Consumer auto securitizations declined from $72.7 billion in 2007 to $35.7 billion in 2008 before partially recovering to $52.6 billion in 2009. Data provided to the Panel by Security Industry and Financial Markets Association (relying on data from Thomson Reuters). But reliance on aggregated yearly data understates the depth of reduction in the consumer auto loan securitization market. Total auto securitization (a measure which, while also including wholesale and other types of securitizations, is mostly constituted by consumer securitization) failed to reach $3 billion in either the third or fourth quarters of 2008. *See* Security Industry and Financial Markets Association, *US ABS Issuance 1996–2010* (online at www.sifma.org/uploadedFiles/Research/Statistics/SIFMA_USABSIssuance.pdf) (relying in part on Thomson Reuters data).

FIGURE 15: INTEREST RATE SPREADS AND LOAN-TO-VALUE RATIOS ON NEW CAR LOANS [351]



When GMAC exited the market for several months, credit for subprime consumer borrowers disappeared.[352] Credit unions made a coordinated effort to pick up the slack and assumed some of the market share exited by GMAC.[353] As shown in the charts above, for those who were approved, the terms were less favorable: interest rates—especially those offered by automobile finance companies—climbed, and lower limits on loan-to-value ratios were imposed.[354] While demand for automobiles also decreased, the lack of availability of consumer automotive finance was an independent factor that hurt GM sales.

But even assuming that there were adequate substitutes for consumer credit, the availability of financing for consumers would have been irrelevant if GM and Chrysler dealers had been unable to finance the purchase of their inventories.

The TALF, the federal government's other major effort to support the automotive credit market by restarting the securitization markets, was not timed sufficiently to alter this analysis. The TALF was launched in the beginning of 2009 by the Federal Reserve Bank of New York and backstopped by TARP funds.[355] At that

[351] *See* Federal Reserve Statistical Release G.19, *supra* note 349 (accessed Mar. 8, 2010) (interest rate data adjusted to reflect spreads over 10-year Treasuries).

[352] Market participants conversations with Panel staff; industry analysts conversations with Panel staff.

[353] *See* Figure 13, *supra*; market participants (including credit union representatives) conversations with Panel staff.

[354] Treasury conversations with Panel staff (Jan. 29, 2010); Federal Reserve Statistical Release G.19, *supra* note 349 (accessed Mar. 8, 2010); Written Testimony of Ron Bloom and Jim Millstein, *supra* note 73, at 3 (reporting that loan approval rates to prime borrowers dropped from mid-80 percent to approximately 60 percent, loan-to-value ratios decreased from 95 percent to 85 percent, and interest rates increased from approximately 5 percent to over 8 percent). *See also* Figure 15, *supra*.

[355] Automobile-industry loans eligible for securitization under TALF included floorplan financing for automobile dealers, prime and subprime consumer purchase loans, prime consumer lease loans; and loans supporting government, commercial, and rental fleets. Federal Reserve Bank of New York, *Term Asset-Backed Securities Loan Facility: Frequently Asked Questions* (Feb. 17,

time, Treasury had already made financing decisions with respect to GMAC and Chrysler Financial, including the provision of bridge loans to the companies. The inability of GMAC, Chrysler Financial, and Ford Motor Credit Corporation (FMCC) to obtain AAA ratings on floorplan securitizations effectively closed the TALF to them for floorplan securitizations, and efforts to expand the TALF to lower-rated securitizations were not successful.[356] It was not until August 2009 that TALF become available for any industry floorplan securitizations, and GMAC did not do a floorplan ABS issuance until 2010.[357]

It is clear that disruptions in GMAC's provision of wholesale and consumer credit materially affected GM's business at a particularly crucial time when GM was undergoing bankruptcy and restructuring amidst a severe financial crisis and deep recession. At least at that point, there may have not been adequate substitute market players to step sufficiently into the breach. What is less clear is whether these other market players would eventually have increased their capacity to step into the breach, especially after the credit crunch eased. Treasury has indicated that it was focused on the short and medium term; it did not consider whether there would be adequate substitutes for the traditional roles of GMAC and Chrysler Financial five years down the road.[358]

2. Commitments Made by Treasury

The other primary justification Treasury has provided for its continued support of GMAC is that these transactions, especially the most recent transaction in late December 2009, were not new commitments, but were made in fulfillment of previously made commitments. In its December 30, 2009 press release announcing an additional investment of $3.8 billion of new capital, Treasury stated that it was "acting on its previously announced commitment to provide capital to GMAC as identified in May as a result of the SCAP."[359]

As discussed in more detail in Section F below, a key element of the SCAP or stress tests was the unconditional commitment of Treasury to provide necessary capital to banks that were unable to raise it privately.

2010) (online at www.newyorkfed.org/markets/talf_faq.html) (hereinafter "Term Asset-Backed Securities Loan Facility: FAQs").

[356] Industry analysts conversations with Panel staff; National Automobile Dealers Association conversations with Panel staff (Feb. 2, 2010 and Mar. 5, 2010).

[357] National Automobile Dealers Association conversations with Panel staff (Feb. 2, 2010 and Mar. 5, 2010); GMAC conversations with Panel staff (Feb. 16, 2010). Data provided to the Panel by GMAC (reporting on GMAC's $900 million offering of TALF-eligible securities backed by wholesale automotive loans in February 2010). Similarly, while the Small Business Administration opened up Section 7(a) lending to dealer floorplan lendings, specifics of this program made it impractical to significantly ease the floorplan credit crunch. *See* Section E, *infra*.

[358] In fact, one of the results of the financial crisis and restructuring was to accelerate the weakening of the relationship between GMAC and GM. On December 29, 2008, GMAC and GM agreed to modify the GMAC Services Agreement to provide that "GMAC no longer is subject to contractual wholesale funding commitments or retail underwriting targets." *See* GM Form 10–K for 2008, *supra* note 346.

[359] December 2009 Restructuring Announcement, *supra* note 214. As described in greater detail in Section F, the SCAP was designed to "stress test" the nation's largest bank holding companies—those with $100 billion or more in assets—and provide additional capital to those that were found to be potentially at risk in the case of an even deeper recession. *See* Section F, *infra* (analyzing the inclusion of GMAC in the SCAP and the implications of the funding that was ultimately provided).

There was no specific contractual obligation to GMAC either as a result of the stress tests or as a result of previous injections of capital. At the time of the May 2009 investment, Treasury and GMAC executed the May Stock Purchase Agreement (SPA), which described the terms under which Treasury would provide capital to GMAC should it be unable to obtain additional capital from private sources. The term sheet appended as a schedule to the May SPA, however, only stated that Treasury stood ready to commit "up to $5.6 billion" in additional capital.[360] Treasury clearly retained the legal flexibility to provide less than that amount—even zero—if circumstances warranted.

Over the course of the financial crisis, Treasury has variously argued that its decisions have been influenced by the potentially conflicting needs to change its strategy as the economic environment has shifted[361] and to protect the government's credibility by following through on its promises.[362] The best example of the former justification is the overall shift in emphasis from the original purpose behind the TARP to the TARP in its current form. On September 18, 2008, then-Secretary Paulson issued a statement attributing much of the crisis to an inability to value residential mortgage-backed assets and calling for a program to "remove these illiquid assets that are weighing down our financial institutions and threatening our economy."[363] As implemented, the TARP has only one relatively small program, the Public-Private Investment Program, aimed at buying such assets. In its first report, the Panel asked Treasury to explain this shift in strategy.[364] In response, Treasury explained:

> Given [the existing] market conditions, Secretary Paulson and Chairman Bernanke recognized that Treasury needed to use the authority and flexibility granted under the EESA as aggressively as possible to help stabilize the financial system. They determined the fastest, most direct way was to increase capital in the system by buying equity in healthy banks of all sizes. Illiquid asset purchases, in contrast, require much longer to execute.[365]

Shifting strategy with regard to one transaction with one institution—i.e., deciding not to proceed with the December 30, 2009 transaction—could be argued to be a less drastic shift than Treasury's shift in overall TARP strategy a year earlier.

It might also be argued that conditions have changed significantly since the May 2009 statement regarding future funding, such that revisiting that position might not have such an adverse

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[360] Treasury GMAC Contract, *supra* note 226, at Schedule A.

[361] U.S. Department of the Treasury, *Responses to Questions of the First Report of the Congressional Oversight Panel for Economic Stabilization,* at 4–5 (Dec. 30, 2008) (online at www.treas.gov/press/releases/reports/123108%20cop%20response.pdf) (hereinafter "Treasury Response to December 2008 Oversight Report").

[362] Treasury meeting with Panel staff (Jan. 29, 2010).

[363] U.S. Department of the Treasury, *Statement by Secretary Henry M. Paulson, Jr. on Comprehensive Approach to Market Developments* (Sept. 19, 2008) (online at www.financialstability.gov/latest/hp1149.html).

[364] Congressional Oversight Panel, *December Oversight Report: Questions About the $700 Billion Emergency Economic Stabilization Funds,* at 4 (Dec. 10, 2008) (online at frwebgate.access.gpo.gov/cgi-bin/ getdoc.cgi?dbname=110_cong_senate_committee_prints&docid=f:45840.pdf) (hereinafter "December Oversight Report").

[365] Treasury Response to December 2008 Oversight Report, *supra* note 361, at 5.

impact as it would have earlier. The economic environment had shifted noticeably between December 2008, when Treasury first articulated its intent to support GMAC as a part of the U.S. automotive industry, and December 2009, when it executed its most recent investment in GMAC.[366] It may even be argued that the economic environment underwent a major shift between the completion of the stress tests in May and the December 2009 investment. For example, in November 2009, Secretary Geithner stated that "[t]he U.S. economy and the global economy are growing again" and that "the value of savings around the world has risen" and "[t]he cost of credit has fallen."[367] Later in the month, he stated that "we have stabilized the financial system and brought down the cost of borrowing for business and families. Companies across the country are now able again to raise equity and issue bonds. Credit terms are easing as markets that were once frozen are beginning to open up."[368]

Treasury, however, has approached the issue of GMAC's financing from the position that it must follow through on its commitments, even if the commitments are not legally enforceable, to maintain the credibility of the federal government. Treasury, in coordination with the FDIC and the Federal Reserve, has used guarantees to prevent further destabilization of the markets at the height of the crisis. Treasury has argued that its ability to establish stability might be significantly impaired if it failed to follow through on its statements with respect to funding, although that involvement carries countervailing effects as well.[369] Much of the progress in stabilizing the markets that has been experienced since early 2009 arguably might have crumbled if Treasury had failed to follow through in this way with respect to GMAC. Moreover, Treasury has noted that the impact of other guarantees it has provided throughout this crisis might decline in value and its ability to use

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[366] The TED Spread, which measures the difference between 3-month LIBOR and 3-month Treasury Securities, is a widely used financial metric seen as an indicator of economic stability and market liquidity. By December 31, 2009, the TED Spread decreased 85 percent from its December 2008 level of 135 basis points, signaling a marked increase in overall financial stability (online at www.bloomberg.com/apps/cbuilder?ticker1=.TEDSP:IND).

[367] U.S. Department of the Treasury, *Statement by Secretary Geithner at the G–20 Meeting of Finance Ministers and Central Bank Governors* (Nov. 7, 2009) (online at www.treas.gov/press/releases/tg358.htm).

[368] U.S. Department of the Treasury, *Treasury Secretary Timothy Geithner Opening Remarks—Small Business Conference* (Nov. 18, 2009) (online at www.treas.gov/press/releases/tg412.htm). *See also* Congressional Oversight Panel, *December Oversight Report: Taking Stock: What Has the Troubled Asset Relief Program Achieved,* at 101 (Dec. 9, 2009) (online at cop.senate.gov/documents/cop-120909-09report.pdf) (hereinafter "December 2009 Oversight Report"). In addition, the September Auto Industry Brief authored by Manheim Consulting Chief Economist Tom Webb noted several statistics suggesting targeted improvement in the automotive sector, including the following facts:

- The Manheim Used Vehicle Value Index for August was up for the eighth consecutive month; at 116.4, this represents a year-over-year increase of 5.1%;
- The Cash-for-Clunkers program spurred new vehicle sales in August, significantly depleting inventories. The seasonally adjusted annual rate of new sales reached 14.1 million in August, compared to "10 million in the first half of the year." This means that "there will be virtually no 'carryover' inventory this fall";
- Household net worth increased in the second quarter of 2009 "after six consecutive quarterly declines," "primarily the result of a rising stock market—a trend which continued in the third quarter."

Manheim Consulting, *Auto Industry Brief,* at 3, 5 (Sept. 2009) (provided to the Panel by Thomas Webb).

[369] Treasury conversations with Panel staff (Mar. 2, 2010). A decision by Treasury that GMAC did not require the additional funding in December may not, however, have been interpreted in the market as a decision to let GMAC fail. Given Treasury's previous support for the company, the market may have believed that Treasury had merely changed its strategy with regard to its support for GMAC.

guarantees to alleviate future crises might be limited if the markets doubted the reliability of Treasury's word.[370] As discussed in the Panel's November report, the guarantees that Treasury has used to increase stability during the present crisis have allowed Treasury to leverage a small pool of assets to guarantee a larger pool of assets in the market. Treasury has taken the view that it has been able to obtain guarantees at such a low cost to taxpayers because the value of Treasury's guarantee—which is another way of saying the likelihood that it will honor its commitments—is so high.[371] If the market came to believe that Treasury was less likely to honor commitments, Treasury has stated, it might be obliged to put up a larger fund to guarantee the same pool of market assets. Other Treasury commitments may also have been impaired. Most notably, Treasury argues that the value of other government-supported entities may have deteriorated had its government backing been devalued.

Taking a more limited view, the collapse of GMAC may itself have caused ripple effects. The fact that Treasury intended to provide capital to GMAC may have been a factor in the business decisions of entities that do business with GMAC. These entities would have relied on the expectation of future Treasury funding for GMAC and may have been disadvantaged if GMAC had failed to survive.

3. Systemic Importance of GMAC: Could it Just be Permitted to Fail?

Treasury has never argued that GMAC itself was systemically important, although in 2008 some Treasury staff members believed that GMAC's failure at that time—independent of its effects on the domestic automotive industry—could have thrown an already precarious financial system into further disarray during the depths of the financial crisis.[372]

As discussed above, Treasury defends its assistance to GMAC as crucial to supporting its extensive investments in GM and Chrysler, which, in turn, were made for a variety of reasons, including the fear of shock to the economy—perhaps rising to the level of systemic risk if the domestic auto industry were to fail.[373] The Panel's previous review of statements of the last two administrations concluded:

> Treasury's intervention in the automotive industry could be attributed to one of (or a combination of) three broad policy objectives: (1) the prevention of a systemic threat to the U.S. financial markets and broader economy; (2) the advancement of social policy (such as tempering the impact of unemployment, environmental improvement, or provision of retirement benefits); or (3) the maintenance of

[370] Treasury conversations with Panel staff (Mar. 2, 2010).
[371] Treasury conversations with Panel staff (Jan. 29, 2010).
[372] Treasury conversations with Panel staff (Feb. 2, 2010) (reporting on a review of internal Treasury Department memoranda from October and November 2008 considering support for GMAC based on systemic risk caused by failure of GM and Chrysler and on fear of financial contagion of possible default of GMAC's debt).
[373] *See* September Oversight Report, *supra* note 189, at Section D.

a viable American automotive presence in the United States.[374]

Apart from the role it plays with respect to automotive financing, GMAC's operations do not appear to have any systemic significance. Until revenues from ResCap plummeted upon the implosion of the housing market in 2007, GMAC's revenue over the last five years was roughly equally distributed among automobile finance, mortgage finance, and insurance operations.[375] In fact, insurance has been the most consistent source of GMAC revenue recently, accounting for almost double GMAC's automobile finance revenue in 2008, a year where both the mortgage and automobile sales industries were severely depressed. Loss of GMAC's operations in this sector would not seem to pose a systemic threat. Finally, while ResCap was once a profitable venture for GMAC, and ResCap holds significant market shares in both the mortgage origination and mortgage servicing sectors,[376] there has been no suggestion that the disruption of these businesses caused by a bankruptcy would have any direct systemic effect. Treasury has stated that while it has some interest in ResCap's holdings in the mortgage market,[377] it regarded ResCap as "marginal, at best" as a factor in the decision to support GMAC.[378]

It is the automotive finance operations of GMAC, then, that would have the most impact on the U.S. economy if GMAC were to be allowed to fail. Treasury has cited estimates of automobile sales declines solely attributable to diminished availability of credit ranging from 1.5 to 2.5 million vehicle sales per year.[379] Treasury estimated that a further reduction of between 2 and 2.5 million in yearly automobile sales could have been expected if GMAC were allowed to fail—a number that Treasury believed might affect the overall viability of the domestic automotive industry.[380]

Treasury's support of GMAC can be contrasted to its treatment of CIT Group, Inc., a finance company that received initial support from Treasury, in part because of its perceived systemic significance, only later to be allowed to go into bankruptcy, resulting in over $2 billion of losses to Treasury.

CIT Group was a hundred-year-old company that provided a variety of commercial financing and leasing products and services, including factoring, and was an important source of lending for small businesses nationwide.[381] The financial crisis deeply affected CIT Group's business, and the company's losses accelerated in the second quarter of 2007 because of its heavy exposure to underper-

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[374] September Oversight Report, *supra* note 189, at 103 (citing various sources).

[375] *See* Section C.1, *supra.*

[376] ResCap is the sixth largest mortgage originator and fifth largest mortgage servicers in the United States. GMAC Form 10–K for 2008, *supra* note 10, at 53.

[377] GMAC and one other institution have 50 percent of their HAMP-eligible mortgages in active trial or permanent modifications. U.S. Department of the Treasury, *Making Home Affordable Program Servicer Performance Report Through January 2010,* at 7 (Feb. 18, 2010) (online at www.financialstability.gov/docs/press/January%20Report%20FINAL%2002%2016%2010.pdf).

[378] Treasury conversations with Panel staff (Jan. 29, 2010).

[379] *See* Written Testimony of Ron Bloom and Jim Millstein, *supra* note 73, at 3 (citing estimates of the effect of diminished credit on the Seasonally Adjusted Annualized Rate (SAAR) of auto sales, including: 2.6 million units (Barclays), 1 to 1.5 million units (the Federal Reserve), and 1.6 million units in 2009 and 3.1 million units in 2010 (AutoNation)).

[380] Treasury conversations with Panel staff (Feb. 2, 2010).

[381] Factoring is a financial transaction whereby a business sells its accounts receivable (i.e., invoices) to a third party (called a factor, here, CIT Group) at a discount in exchange for immediate money with which to finance continued business.

forming assets, including subprime mortgages and student loans. As its losses mounted and CIT expended over $7 billion in emergency bank credit, CIT Group's credit was downgraded, and it had difficulty accessing credit in short-term debt markets, on which its business model was heavily reliant.[382]

In December 2008, the Federal Reserve, citing "unusual and exigent circumstances affecting the financial markets" and "emergency conditions," approved the conversion of CIT Group, Inc. from an ILC to a BHC upon conversion of its subsidiary CIT Bank from a limited purpose bank to a state bank for the purposes of the Bank Holding Act.[383] In making that determination, the Federal Reserve found that CIT was "adequately capitalized and as a result of its successful efforts to raise additional capital, will be well capitalized prior to consummation."[384] The Federal Reserve's action allowed the company to become eligible for TARP funds. One day after the conversion, Treasury preliminarily approved what became a $2.33 billion investment in CIT Group under the CPP, and the capital injection was complete on December 31, 2008.[385]

Up to this point, there are significant parallels between the two companies' appeals for government support. The Federal Reserve's reference to "emergency conditions" in the financial markets when issuing an expedited approval of CIT Group's BHC application underscores the concern in late 2008 that the failure of CIT Group could be harmful to an already fragile economy because of CIT Group's specialized provision of certain financial services—small business lending and factoring services. Similarly, the Federal Reserve's expedited approval of GMAC's BHC application (and Treasury's subsequent support under the AIFP) both relied on Treasury's belief that GMAC played a critical role in its specialized provision of financial services—automobile finance.[386] Both suffered heavy credit losses in large part because of their exposures to the subprime mortgage market, and their inability to access capital markets further imperiled their abilities to function in their market niches.[387] Moreover, like GMAC, CIT Group was denied access to capital markets, suffered a damaging downgrade in its credit rating, and successfully petitioned the Federal Reserve for an emergency conversion of its ILC to a BHC to gain access to the deposit

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[382] In June, CIT entered into a 20-year secured lending facility with Goldman Sachs, Inc. with the intention of reducing its reliance on unsecured credit markets. CIT Group, Inc., *Form 8–K for the Period Ending June 6, 2008* (June 9, 2008) (online at www.sec.gov/Archives/edgar/data/1171825/000089109208002979/e31893_8k.htm).

[383] *See* Board of Governors of the Federal Reserve System, *CIT Group Inc.: Order Approving Formation of a Bank Holding Company and Notice to Engage in Certain Nonbanking Activities,* Federal Reserve Bulletin Volume 95: Legal Developments: Fourth Quarter, 2008 (May 29, 2009) (online at www.federalreserve.gov/pubs/bulletin/2009/legal/q408/order5.htm).

[384] *See Id.* The Federal Reserve also approved CIT Group's bid to continue to engage in nonbanking activities through its subsidiaries based on the Board's belief that the public benefits of CIT Group strengthening its position as a "leading provider of factoring services in the United States and a leading lender in the Small Business Administration's 7a programs" would "outweigh any likely adverse effects." *Id.*

[385] U.S. Department of the Treasury, *Troubled Asset Relief Program Transactions Report for Period Ending November 18, 2009,* at 5 (Nov. 20, 2009) (online at www.financialstability.gov/docs/transaction-reports/11-20-09%20Transactions%20Report%20as%20of%2011-18-09.pdf).

[386] *See* section C.2(b) (discussion of Federal Reserve's approval of GMAC's BHC application), *supra.*

[387] GMAC's consumer automobile finance shriveled in 2008, *see* section E.1, *supra*; CIT Group's consumer small business declined precipitously (from $4.46 billion in the first quarter of 2007 to $127 million in the second quarter of 2008). *See* CIT Group, Inc., *Form 10–Q for the Quarter Ending Sept. 30, 2008* (Nov. 10, 2008) (online at www.sec.gov/Archives/edgar/data/1171825/000089109208005502/e33450_10q.htm).

market and government financial assistance programs. Both institutions received emergency injections of TARP funds, promptly sought access from the FDIC to the TLGP, and eventually applied for additional TARP assistance.

But there were significant differences in the respective treatment and fates of the companies. Unlike GMAC, CIT Group's TLGP application with the FDIC was pending for several months as its capital needs became even more pressing. CIT Group aggressively sought to increase deposits in CIT Bank, but that was not sufficient to offset a lack of short-term financing and capital deficiencies. In mid-July 2009, the Federal Reserve Bank of New York completed a stress test of CIT Group and concluded that the same institution that it had found "adequately capitalized" four months earlier would need to raise $4 billion.

But Treasury, the Federal Reserve, and the FDIC did not coordinate to rescue CIT Group and preserve Treasury's investment; instead, the federal government allowed CIT Group to continue on the path toward bankruptcy. After months of delay, the FDIC denied CIT Group's TLGP application and issued a cease-and-desist order prohibiting CIT Bank from increasing its deposits.[388] Treasury was unwilling to prop up CIT Group alone and withheld additional CPP funds, finding that CIT did not qualify for receipt of "exceptional assistance" under the TARP, based in part on Treasury's view of the importance (or, in this case, relative unimportance) of CIT's role in the financial system and the existence of alternate sources of credit for CIT's customers.[389]

Unable to raise sufficient private capital, CIT had to either restructure or enter bankruptcy. In October 2009, CIT Group's bondholders and creditors rejected a restructuring plan, which would have at least partially preserved Treasury's CPP investment, in favor of a prepackaged bankruptcy.[390] CIT filed for bankruptcy on November 1, 2009.[391] CIT emerged from bankruptcy on December 10, 2009.[392] As part of CIT's reorganization plan, Treasury's invest-

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[388] *See* Federal Deposit Insurance Corporation, *In the Matter of CIT Bank, Salt Lake City, Utah, Order to Cease and Desist* (July 16, 2009) (online at www.fdic.gov/bank/individual/enforcement/2009-07-18.pdf).

[389] Congressional Oversight Panel, *February Oversight Report: Commercial Real Estate Losses and the Risk to Financial Stability,* at 184 (Feb. 10, 2010) (online at cop.senate.gov/documents/cop-021110-report.pdf) (hereinafter "February Oversight Report") (citing Letter from Timothy F. Geithner, secretary of the Treasury, to Elizabeth Warren, chair, Congressional Oversight Panel (Jan. 13, 2010)) (responding to Panel's question whether it deemed CIT to be "systemically significant", that Treasury considered CIT's role in the financial system; the availability of alternative sources of liquidity to CIT; the likelihood that CIT would continue as a going concern in the absence of exceptional assistance; the existence of alternative credit channels for CIT's customers; the condition of the financial system at the time of the determination; and CIT's size and funding structure).

[390] CIT Group, Inc., *CIT Board of Directors Approves Proceeding with Prepackaged Plan with Overwhelming Support of Debtholders* (Nov. 1, 2009) (online at cit.com/media-room/press-releases/index.htm). Under the rejected restructuring plan, bondholders would have received 70 cents on the dollar and equity in a newly restructured company and Treasury would have converted its preferred shares into 3.5 and 5 percent of CIT's common equity. *See* CIT Group, Inc., *Form 8–K for the Period Ending October 1, 2009,* at 5 (Oct. 1, 2009) (online at www.sec.gov/Archives/edgar/data/1171825/000095012309047816/y02330exv99w2.htm).

[391] *See* Voluntary Petition for CIT Group Inc. (Nov. 1, 2009), *In re* CIT Group Inc., No. 09–16565, 2009 WL 4824498 (Bankr. S.D.N.Y. Dec. 8, 2009) (online at www.kccllc.net/documents/8803600/88036000911010000000000002.pdf).

[392] *See* Notice of Filing of Confirmed Modified Second Amended Prepackaged Reorganization Plan of CIT Group Inc. and CIT Group Funding Company of Delaware LLA (Dec. 10, 2009), *In re* CIT Group Inc., No. 09–16565, 2009 WL 4824498 (Bankr. S.D.N.Y. Dec. 8, 2009) (online

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ment, valued at $2.3 billion, was deemed an "old preferred interest" and subordinated to the interests of CIT's senior creditors.[393] As a byproduct of CIT's bankruptcy, taxpayers have lost the entirety of their TARP investment in CIT Group.[394] Perhaps equally notable, the original fear that the failure of CIT Group would further weaken the already anemic small business lending sector has not materialized. CIT Group was forced to reduce its lending well before its eventual bankruptcy,[395] and while small business lending is still weak nationally, market observers have not pointed to CIT Group's demise as a major factor in this continued weakness.

There are several differences in the economic and regulatory landscape that may account for the differential treatment. The primary difference is that GMAC was a stress-tested bank, and CIT Group was not. Treasury had made a commitment by including GMAC as one of the 19 financial institutions included in the SCAP, and pledging TARP funds to make up for capital deficiency if the institution could not raise capital in the private market. Because CIT Group had not been formally designated as crucial to the stability of the financial system, Treasury made no similar commitment to address any future capital deficiencies, and therefore its credibility or commitment was not on the line when it decided to cut its losses. Second, Treasury deemed GMAC to be essential to the continuing operation of another recipient of TARP assistance, GM, which, in turn, Treasury deemed systemically important. CIT Group did not have a similar role as the primary provider of credit to any recipient of TARP funds.

Treasury's support of CIT Group may suggest that half-hearted attempts at saving an institution from insolvency that lack coordination among regulators—particularly when there are questions about its long-term business model and capital structure—may end up to be more costly than a decision to support an institution fully or allow it to enter bankruptcy. On the other hand, the GMAC experience underscores the double-edged nature of regulatory flexibility. By designating GMAC as crucial for economic stability—and backing such a view with a commitment to provide support—the federal government believed that it foreclosed the option to stop funding the institution, even if the commitment to back GMAC arguably outlasted the economic justification for maintaining its solvency.

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at www.kccllc.net/documents/0916565/091656509121000000000003.pdf) (hereinafter "Notice of Filing of CIT Reorganization Plan").

[393] Notice of Filing of CIT Reorganization Plan, *supra* note 392, at 12.

[394] February Oversight Report, *supra* note 389, at 184 (citing Letter from Timothy F. Geithner, secretary of the Treasury, to Elizabeth Warren, chair, Congressional Oversight Panel (Jan. 13, 2010)).

[395] CIT Group's Loan Originations declined from $39.6 billion in 2007 to $18.6 billion in 2008. SNL Financial data provided to Panel staff. Additionally, CIT Group's consumer and small business lending declined from $4.46 billion in the first quarter of 2007, to $1.99 billion in the third quarter of 2007, to only $127 million in the second quarter of 2008, and almost zero thereafter. *See* CIT Group, Inc., *Form 10–Q for the Quarter Ended March 31, 2007,* at 30 (May 7, 2007) (online at www.sec.gov/Archives/edgar/data/1171825/000089109207001797/0000891092-07-001797-index.htm); CIT Group, Inc., *Form 10–Q for the Quarter Ended September 30, 2007,* at 36 (Nov. 6, 2007) (online at www.sec.gov/Archives/edgar/data/1171825/000089109207004826/0000891092-07-004826-index.htm); CIT Group, Inc., *Form 10–Q for the Quarter Ended June 30, 2008,* at 45 (Aug. 11, 2008) (online at www.sec.gov/Archives/edgar/data/1171825/000089109208004007/0000891092-08-004007-index.htm).

4. Treasury's Explanations for Why Bankruptcy Law Could Not be Used and Why ResCap Could Not be Abandoned in a Restructuring

GMAC and Treasury maintain that a traditional Chapter 11 filing or a Section 363[396] sale was an unrealistic option for GMAC. In response to Panel questions about the possibility of placing GMAC into bankruptcy, Treasury provided four reasons for its belief that bankruptcy was not a viable policy option:

- Treasury believed that GM was so dependent on GMAC that if GMAC could not continue financing its dealers, GM would collapse,[397] and the amount of debtor-in-possession (DIP) financing that Treasury would have needed to provide during a bankruptcy would have been prohibitively large;
- Treasury believed that Chrysler needed a source of financing in order to emerge from bankruptcy, and in the wake of the collapse of Chrysler Financial, Treasury staff believed that GMAC was essential for providing financing to Chrysler;
- Any prior Treasury investments would have been wiped out by a bankruptcy filing; and
- Treasury believed that having promised in May to support GMAC in fulfilling its SCAP requirements if it was unable to meet its capital targets through private financing, Treasury staff believed that it could not renege on this promise.[398]

Treasury staff stated that the combination of these four factors—rather than any single one—made bankruptcy virtually impossible.[399]

Each of the first three of the reasons that Treasury has offered appears, on its own, not to be totally persuasive. That GMAC was critical to GM means only that financing would have needed to continue, not that GMAC could not restructure. Treasury has provided a range for the DIP financing: $6 billion per month for the floorplan financing and a total of $10–18 billion, assuming a 60–90 day bankruptcy process,[400] but up to $50 billion for both floorplan and consumer financing, and assuming a bankruptcy process that took closer to six months.[401] Even assuming that Treasury's numbers are correct[402]—and given the range of num-

[396] Under Section 363 of the bankruptcy code, a debtor may sell certain assets from the bankruptcy estate. *See* September Oversight Report, *supra* note 189, at 46–48.

[397] As noted above in Section E.1(a), *infra,* Treasury maintains that GMAC's collapse or bankruptcy would have crippled dealer financing and with it GM and Chrysler. Treasury also maintains that a GMAC bankruptcy would have harmed Chrysler's efforts to partner with Fiat.

GMAC also maintains that a quick workout in bankruptcy would have so disrupted its access to the credit markets that, as a finance company, it would have been unable to either continue to obtain financing or to refinance its debt, and that the hardship to the automotive industry and GM's dealers would have been too great. GMAC and Treasury both stated that bankruptcy is not currently an option worth considering for the future, as GMAC's $2 billion bond issue on February 9, 2010, marks it as a company that is not in distress. GMAC conversations with Panel staff (Feb. 16, 2010); Treasury conversations with Panel staff (Feb. 18, 2010) (bankruptcy is unnecessary because it is "out of line with existing market conditions and the perception of the company"). Of course, it is also conceivable that the market perception of GMAC is that Treasury will provide additional funds if necessary, which undercuts the argument that the market is becoming more comfortable with GMAC as an independent entity.

[398] Treasury conversations with Panel staff (Feb. 18, 2010).

[399] Treasury conversations with Panel staff (Feb. 18, 2010).

[400] Treasury conversations with Panel staff (Feb. 22, 2010).

[401] Transcript of COP Hearing on GMAC, *supra* note 12 (Testimony of Ron Bloom); Treasury conversations with Panel staff (Mar. 2, 2010).

[402] Treasury bases these numbers on the amounts that would have gone into run-off under GMAC's then current credit lines. After a bankruptcy filing, GMAC would have been unable to

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bers that Treasury has offered, this may be a generous assumption—the question is not just one of size, but also one of risk. A DIP investment might have been low-risk because floorplan financing is low-risk, so Treasury might have recouped its DIP investment. Particularly if the company had been broken up, automotive finance is a profitable business, and any auto-specific DIP financing could have been serviced by the floorplan loans and ultimately refinanced. It is not clear that such loans would have been likely to be lost. Treasury asserts that the tremendous uncertainty in the markets at the end of 2008 and the beginning of 2009 might have rendered ordinarily low-risk loans much higher-risk once GMAC entered a bankruptcy proceeding. In this context, Treasury maintains that even if it had provided the required DIP investment, there is no guarantee that GMAC would have emerged from the restructuring process.[403] While the size of the DIP financing is less important than the riskiness of the investment, it is impossible to determine with any certainty whether DIP financing would have been more risky than Treasury's current investment.

As for the Chrysler financing, Treasury had a variety of options for ensuring that Chrysler had access to financing, including using DIP financing to keep GMAC's floorplan operations afloat during a bankruptcy and then using these operations to finance Chrysler dealers.

With respect to Treasury's concerns about the loss of the original $6 billion equity investment, unless wiping out Treasury's prior investments would have been more expensive over the long-run than the strategy that Treasury actually pursued, this concern may prove misplaced. Ultimately, bankruptcy in April 2009 would have wiped out the $6 billion equity investment, but it also would have significantly reduced the likelihood that Treasury would have needed to make the $7.5 billion May 2009 investment and, in particular, the $3.8 billion December 2009 investment, the latter of which was completed largely to deal with the home mortgage lending portfolio, not the automotive finance operations.[404] Moreover, such a move even as late as April 2009 might have resolved the GMAC difficulties and increased the likelihood that Treasury would have had a clean exit and not continue to face the risks associated with GMAC's ongoing weakness.

As for a separate ResCap bankruptcy, in the third-quarter 2009 Form 10–Q and the 2009 Form 10–K, GMAC offered a particular reason for avoiding the proceeding. GMAC is the parent of and has financing and hedging arrangements with ResCap. In the 10–K and the 10–Q, GMAC expressed concern that in the event of a ResCap bankruptcy, other ResCap creditors might seek to recharacterize loans from GMAC to ResCap as equity contributions or otherwise seek equitable subordination of GMAC's claims against ResCap. Further, GMAC noted that in a bankruptcy proceeding, ResCap might not be able to repay its obligations to GMAC, while any GMAC equity in ResCap would likely be lost.

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draw upon its existing credit lines and would have required new originations, which (according to Treasury) would have had to come from the government. Transcript of COP Hearing on GMAC, *supra* note 12 (Testimony of Ron Bloom).

[403] Treasury conversations with Panel staff (Feb. 22, 2010).

[404] The May 2009 investment, in part, underpinned GMAC's absorption of the Chrysler Finance business.

GMAC therefore has concerns that a ResCap bankruptcy could significantly harm it as ResCap's parent.[405] In conversations with Panel staff, GMAC also stated that in evaluating bankruptcy, it consulted with advisors and weighed ResCap's involvement with GMAC Financial Services; the disruption a decision to discontinue support would cause for GMAC's access to the capital markets; interparty agreements; and the significant volume of servicing ResCap provides for residential loans and modification assistance.[406] After evaluating these factors, GMAC concluded that a separate ResCap bankruptcy was not in GMAC's best interests, and Treasury representatives have stated that they view this conclusion as reasonable.[407] But ResCap's continued existence threatens GMAC (as described in greater detail in Section H, below) and it is difficult to determine whether the choice to keep ResCap will end up doing more harm in the long run than a choice to put ResCap through bankruptcy.

Treasury has also expressed concern that adding GMAC's bankruptcy to the landscape in which GM's and Chrysler's bankruptcies were already in the offing would have magnified the risks from the GM and Chrysler workouts. According to Treasury, not only would those complex bankruptcies need to be successfully prosecuted, but the financing arm would also have had to be successfully brought through the process, and bankruptcies of financial institutions are more complex than those of industrial companies.[408] Again, however, this line of argument implies that there was only one way to prosecute a GMAC bankruptcy and maintain systemic stability. If the floorplan financing was the key, there might have been ways to save floorplan financing without saving GMAC. For example, Treasury could have provided a variety of guarantees to private parties—perhaps even including GM—to take over the floorplan financing.[409] One of the most troubling aspects of Treasury's discussion of a GMAC bankruptcy is the way in which it elides the distinction between a need to save the automotive financing services of GMAC and a need to save GMAC. Even assuming that the automotive financing was critical, the Panel is not convinced that GMAC itself needed to survive. Further, saving GMAC saved ResCap, which has no apparent relevance to automotive financing and continues to destabilize GMAC. The Panel remains unconvinced that saving GMAC whole, without attempting (for example) a Section 363 sale of the automotive financing business or a sepa-

[405] GMAC Form 10–Q for Q3 2009, *supra* note 22, at 8; *see also* GMAC Form 10–K for 2009, *supra* note 12, at 17 ("We have secured financing arrangements and secured hedging agreements in place with ResCap. Amounts outstanding under the secured financing and hedging arrangements fluctuate. If ResCap were to file for bankruptcy, ResCap's repayments of its financing facilities, including those with us, will be subject to bankruptcy proceedings and regulations, or ResCap may be unable to repay its financing facilities. In addition, we could be an unsecured creditor of ResCap to the extent that the proceeds from the sale of our collateral are insufficient to repay ResCap's obligations to us. In addition, it is possible that other ResCap creditors would seek to recharacterize our loans to ResCap as equity contributions or to seek equitable subordination of our claims so that the claims of other creditors would have priority over our claims").

[406] GMAC conversations with Panel staff (Mar. 3, 2010).

[407] Transcript of COP Hearing on GMAC, *supra* note 12 (Testimony of Jim Millstein).

[408] Transcript of COP Hearing on GMAC, *supra* note 12 (Testimony of Jim Millstein).

[409] While in his hearing, Mr. Bloom noted that a 363 sale of the auto platform would still have required DIP financing, he did not disagree with the premise that the action would have created a stronger company, rather stating that keeping GMAC whole was viewed as the most prudent decision at the time. Transcript of COP Hearing on GMAC, *supra* note 12 (Testimony of Ron Bloom).

rate liquidation of ResCap, will prove to have been the better decision in the long run.

Of all of the reasons proffered by Treasury, GMAC's inclusion in the stress tests would appear to be the stronger reason that Treasury has offered for keeping GMAC out of bankruptcy early in the process. After setting up stress tests for the largest BHCs and establishing them with the explicit promise that the government would serve as a backstop for tested institutions that could not raise the necessary capital from private sources, Treasury and the Federal Reserve asserted that they believed that they could not have allowed a large BHC to file for bankruptcy.[410] The Federal Reserve, for its part, has maintained that the tests were designed to restore confidence to the nation's banking system through assessing the capital and capital needs of the largest banks during a period of great uncertainty, that the banks' safety and soundness was perceived to be of importance to the broader economy, and that GMAC was properly included among the stress-tested banks.[411] Treasury and the Federal Reserve might reasonably have believed that conducting the assessment and then withholding the promised support could have cast an ominous shadow over the government's efforts to combat the financial crisis, especially initially.

Beyond these reasons, it is possible that any bankruptcy requiring substantial agreement on the part of the stakeholders might have been unlikely, and that attempts at a Section 363 sale would have encountered similar difficulties to those that dogged GMAC's 2008 bond exchange offer.[412] GMAC's bondholders were resistant to the exchange, which was instituted to raise capital for the BHC application, and did not initially tender the principal amount of bonds necessary for the BHC conversion.[413] Ultimately, however, the Federal Reserve approved GMAC's BHC application despite the shortfall in the amount of tendered bonds on the grounds that GMAC's capital ratio was nonetheless adequate.[414] It is impossible, in retrospect, to determine what would have happened if GMAC had continued to press its bondholders in the absence of the Federal Reserve's intervening BHC application approval. Although a Section 363 sale might have met with similar obstacles, it is not clear that this would have been the case.

For its part, GMAC stated that it was concerned that any disruption in its ability to obtain capital at reasonable cost or any perception of distress would have created a funding void that, it states, would have been between $50 billion and $60 billion. According to GMAC, it would then have needed DIP financing at these levels, which only Treasury could have provided. GMAC also asserts that there are few successful finance company bankruptcies, and that its advisors estimated that a bankruptcy process—either Chapter 11 or Section 363—would have created major disruption for GM's dealers and retail customers.[415]

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[410] *See* Section F, *infra,* for further discussion of the stress tests. Of course, many entities sought to raise private capital as a means of repaying the government and exiting TARP.

[411] Federal Reserve conversations with Panel staff (Feb. 19, 2010).

[412] *See* Section C.2, *infra,* for further discussion of the bond exchange.

[413] GMAC Announces Results of Exchange Offers, *supra* note 67.

[414] Federal Reserve conversations with Panel staff (Feb. 19, 2010).

[415] GMAC conversations with Panel staff (Mar. 3, 2010).

From the vantage point of Treasury's two most recent investments—May and December 2009—bankruptcy might not have been a prudent option, although that determination requires a careful analysis of the anticipated recovery before and after bankruptcy, as well as of returns on any additional capital required. Before 2009, however, the landscape was fundamentally different. A taxpayer who picked up a newspaper and sat down to breakfast on December 20, 2008 would have read headlines about the government's decision to provide substantial support to GM and Chrysler. But as of that date, GMAC had not yet received approval to become a BHC, the stress tests were two months away, and Treasury had invested no money in GMAC. Even two weeks later, bankruptcy should reasonably have remained an option. Treasury, after all, was already providing GMAC with liquidity, and could presumably have underpinned a GMAC workout. Another possibility might have been a U.S. government-supported sale, such as that which aided JP Morgan in its purchase of Bear Stearns.[416] The Panel remains unconvinced that at that point bankruptcy of either GMAC or ResCap or a similar restructuring was not a real possibility. It is unclear whether either was seriously considered at the time.

What is clear is that policymakers now believe that the decisions made in December 2008 constrained the options in 2009. For reasons described in greater detail in Section H, below, this may prove unfortunate. GMAC, and ResCap, are still struggling with many of the issues that hampered them prior to Treasury's first intervention, and a bankruptcy restructuring could have alleviated or perhaps solved some of the problems facing the entities. Further, a bankruptcy would have solved a current problem of particular matter to the taxpayers: the continued claims that GMAC's pre-bailout shareholders can still make on the company. Treasury and GMAC have provided a variety of reasons for rejecting bankruptcy and Section 363 sales of various of GMAC or GMAC assets, but the Panel remains unconvinced that the consequences of those decisions will not prove more harmful to the taxpayers in the long run.

F. GMAC and the Stress Tests

The supervisory action, or SCAP, Treasury announced on February 10, 2009 was intended to address the ongoing economic crisis by stressing the country's major financial institutions.[417] The results of the test were intended to show either that a BHC was sufficiently capitalized, thus presumably reassuring the market regarding its stability, or that a BHC required additional capital. Any BHC requiring additional capital that could not raise funds privately was promised the necessary funds from Treasury, assuring that these BHCs would also be sufficiently capitalized and stable. The SCAP was thus designed to ensure that the nation's largest financial institutions would be fully capitalized and that the market would view them as stable.

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[416] JPMorgan Chase, *JPMorgan Chase and Bear Stearns Announce Amended Agreement* (Mar. 24, 2008) (online at www.jpmorgan.com/cm/cs?pagename=JPM_redesign/JPM_Content_C/Generic_Detail_Page_Template&cid=1159339104093&c=JPM_Content_C).

[417] The Government Accountability Office (GAO) has begun an audit of the SCAP as part of its ongoing oversight of TARP.

Secretary Geithner described the SCAP in a statement issued on the day the program was announced:

> First, we're going to require banking institutions to go through a carefully designed comprehensive stress test, to use the medical term. We want their balance sheets cleaner, and stronger. And we are going to help this process by providing a new program of capital support for those institutions which need it.
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> * * * * * * *
>
> Those institutions that need additional capital will be able to access a new funding mechanism that uses funds from the Treasury as a bridge to private capital. The capital will come with conditions to help ensure that every dollar of assistance is used to generate a level of lending greater than what would have been possible in the absence of government support. And this assistance will come with terms that should encourage the institutions to replace public assistance with private capital as soon as that is possible.[418]

A term sheet setting out the conditions upon which funds would be available from Treasury was published on February 25.[419]

The Federal Reserve paper that detailed the design and implementation of the stress tests also referred to the availability of funds from Treasury:

> The United States Treasury has committed to make capital available to eligible BHCs through the Capital Assistance Program as described in the Term Sheet released on February 25.[420]

The Federal Reserve performed these "stress tests" under the SCAP on the 19 BHCs with assets above $100 billion, including GMAC.[421]

On May 7, 2009, the Federal Reserve released the results of the stress tests, which showed that ten of the tested banks, including GMAC, had insufficient tier 1 capital to withstand the so-called "more adverse scenario."[422] The more adverse scenario was de-

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[418] U.S. Department of the Treasury, *Secretary Geithner Introduces Financial Stability Plan* (Feb. 10, 2009) (online at *www.financialstability.gov/latest/tg18.html*). This announcement was made in coordination with the Federal Reserve and the FDIC.

[419] U.S. Department of the Treasury, *U.S. Treasury Releases Terms of Capital Assistance Program* (Feb. 25, 2009) (online at *www.financialstability.gov/latest/tg40.html*).

[420] Board of Governors of the Federal Reserve System, *The Supervisory Capital Assessment Program: Design and Implementation*, at 2 (Apr. 24, 2009) (online at *www.federalreserve.gov/newsevents/press/bcreg/bcreg20090424a1.pdf*) (hereinafter "SCAP Design and Implementation").

[421] GMAC converted to a BHC in December 2008. See Section C.2, *infra*, describing the timeline of events related to GMAC. According to the Federal Reserve, the decision to use the category of all BHCs with assets above $100 billion as the basis for inclusion in the SCAP was made after GMAC's application for conversion to a BHC was approved. The decision, however, was based on the fact that the SCAP was intended to target the financial sector and so using a category that would encompass the largest BHCs was the most logical choice to the Federal Reserve. Conference call with Panel staff (Feb. 19, 2010).

[422] Board of Governors of the Federal Reserve System, *The Supervisory Capital Assessment Program: Overview of Results* (May 7, 2009) (online at www.federalreserve.gov/newsevents/press/bcreg/bcreg20090507a1.pdf). Specifically, the results showed that GMAC required an additional $11.5 billion in tier 1 capital, $9.1 billion of which was to be provided in fresh capital. *Id.* at

signed to model the effects of an even greater downturn than was being forecast at the time.[423] These ten BHCs were given until June to devise a plan for raising the necessary capital from private sources. If any BHC was not able to raise this capital by November, TARP funds would be made available via the CAP. An institution that received funding under the CAP would be subject to several restrictions, including restrictions on executive compensation, increased disclosure requirements, and a requirement that the institution provide information regarding how it would use the CAP funds to increase lending.

As of November 9, 2009, nine of the ten BHCs identified as needing additional tier 1 capital had met the requirements through private investment. GMAC was the only BHC that failed to raise the necessary capital. In a press release issued that day, Treasury announced that it would not use the CAP to provide GMAC with additional capital, but would use the AIFP instead. While the AIFP places many of the same restrictions on recipient institutions as the CAP would have placed, noticeably absent from the AIFP is a requirement that a recipient institution provide information on how it would use the funds to increase lending above the levels that would have been possible absent government support.[424] GMAC is, however, required to provide Treasury with monthly reports on its overall lending activities,[425] although it is not clear whether these reports include specific information about how much lending has increased as a direct result of Treasury's investments. Moreover, these reports are not publicly available, despite a provision in the CAP that would have required such disclosure.[426] Also absent from the AIFP, but not from the CAP, is a plan to place all assets into a trust.[427]

The decision not to include the increased lending plan makes sense to the extent that the AIFP's target is the automotive industry and not, as with the CAP, the financial industry. But to the extent that the SCAP was aimed at stabilizing the financial industry, it is unclear why GMAC should have been allowed to receive tier 1 capital free of the strictures that were envisioned as a core component of the SCAP/CAP process. Each of Treasury's statements about the SCAP has included a reference to the importance of increasing lending. Furthermore, while GMAC started as the financial arm of an automotive company, it has expanded beyond that role to provide a greater array of financial services, as described in detail in Section C above. Recent statements by the company suggest that it intends to continue this expansion into the future.[428]

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26. As discussed in Section D.2(b), *infra*, Treasury provided $3.5 billion of this amount to GMAC in May.

[423] As noted in the Panel's June 2009 report, the nation's unemployment figures have already exceeded the assumptions used for the "more adverse" scenario. Congressional Oversight Panel, *June Oversight Report: Stress Testing and Shoring Up Bank Capital*, at 18 (Jun. 9, 2009) (online at cop.senate.gov/documents/cop-060909-report.pdf) (hereinafter "June Oversight Report").

[424] Capital Assistance Program, *supra* note 229.

[425] Transcript of COP Hearing on GMAC, *supra* note 12 (Testimony of Jim Millstein).

[426] CAP White Paper, *supra* note 234, at 3.

[427] CAP White Paper, *supra* note 234, at 3.

[428] GMAC, Inc., *Preliminary 2009 Third Quarter Results*, at 22 (Nov. 4, 2009) (online at phx.corporate-ir.net/External.File?item=UGFyZW50SUQ9MTk0MDJ8Q2hp bGRJRD0tMXxUeXBlPTM=&t=1) (noting that "Ally Bank continues to build brand awareness and retail deposit base" and identifying goal of "expand[ing] and diversify[ing]" revenue opportunities in auto and mortgage, driving originations").

Ultimately, GMAC's original and most important purpose is to provide financing to the automotive sector. In late 2008 and early 2009, the automotive wholesale and consumer credit markets, like all credit markets, nearly froze. Interest rates shot up and approval rates plummeted as lenders became increasingly cautious and unwilling to part with cash. To the extent that the SCAP was intended to loosen up the credit markets, requiring GMAC to provide a plan for increasing lending would have made sense.

In meetings with Panel staff, Treasury staff have stated that they used the AIFP instead of the CAP because GMAC was already part of the AIFP and because it did not make sense to open the CAP for only one institution when that institution could receive funding elsewhere (i.e., through the AIFP).[429] According to Treasury, the CAP's requirement regarding a lending program was unnecessary for GMAC because GMAC is already a lending institution. This explanation, however, does not adequately address the question. In late 2008 and early 2009, the credit markets were all but frozen and nearly all lending institutions stopped lending. GMAC was and is a part of those markets and there are no indications that it was not at least as severely affected by the crisis as other lenders. It is therefore unclear why GMAC should not be required to provide a lending plan just as any other BHC that received funding following the SCAP would have been required to provide.

More importantly, the lack of public disclosure of GMAC's lending reports is troubling. This Panel has consistently requested that Treasury provide more transparency in its administration of the TARP. In this instance, Treasury appears to have chosen the program with lower disclosure requirements in a situation where the more transparent program had been established as the default selection.

The CAP also contemplated the creation of a trust to hold the assets purchased through the program while the AIFP does not. Because GMAC's assets were purchased through the AIFP, they have not been placed in a trust. Treasury staff, in a meeting with Panel staff, stated that there was no requirement under the CAP to place assets in a trust despite the language in the CAP documents that states: "any capital investments made by Treasury under this plan will be placed in a separate trust set up to manage the government's investments in US financial institutions."[430]

Additionally, Treasury did not provide the full amount to GMAC that the SCAP indicated that the company would require. Although the SCAP found that GMAC would require $11.5 billion in total additional capital, including $9.1 billion in fresh capital, the total provided by Treasury increased GMAC's tier 1 capital by only $7.3 billion.[431] Treasury and the Federal Reserve have both stated that the shift in the size of the capital buffer required for GMAC occurred because the impact of the GM bankruptcy on GMAC's operations was less adverse to GMAC than the assumptions used by

[429] Treasury meeting with Panel staff (Feb. 2, 2010).
[430] CAP White Paper, *supra* note 234, at 3.
[431] Treasury also provided $4 billion to GMAC related to GMAC's acquisition of Chrysler Financial, as described in Section D above, for a total in fresh capital of $13.1 billion.

the Federal Reserve in the SCAP.[432] At the time the stress tests were conducted, the GM bankruptcy process was not yet complete and, according to Treasury, three items remained unknown: (1) what the residual values for GM's assets would be; (2) how GM dealers who had been rejected would be treated; and (3) what preference GMAC would receive in the bankruptcy process. When the Federal Reserve conducted the SCAP, it used very conservative assumptions for the outcome of these three unknowns. Ultimately, the real values were less adverse than the Federal Reserve's assumptions and, in December 2009, GMAC presented Treasury with a proposed revised plan that would require a smaller amount of additional tier 1 capital than the May stress test results required.[433] Treasury discussed the revised plan with the Federal Reserve, and the Federal Reserve judged that the capital buffer requirement for GMAC could be adjusted downward, although not as far as GMAC had proposed.[434] Instead of reducing the additional capital needed to the figure proposed by GMAC, it was reduced to $3.8 billion.

None of the other 18 BHCs that participated in the SCAP had their capital buffer requirements revised after the May 6, 2009 announcement. According to both Treasury and the Federal Reserve, this is because GMAC was uniquely situated; the outcome of the GM bankruptcy would have considerable impact on GMAC's operations and, given the size of GM and the state of the economy at the time, that outcome was exceedingly difficult to predict.[435] Although every BHC that was tested had some uncertainties for which the Federal Reserve was obliged to devise assumptions, only for GMAC did the actual numbers diverge from the assumptions enough to warrant a revision to the capital buffer.[436] GMAC's unique position, however, was never publicly mentioned by Treasury or the Federal Reserve.

Although the SCAP was unique in its size, scope, and visibility, bank supervisors regularly conduct such exercises on a smaller scale to ensure that BHCs remain healthy and viable. It is not surprising that, over the course of seven or more months, the amount of additional capital a BHC requires might change. Nor does the Panel have an opinion as to whether GMAC's current capital buffer is sufficient. What is notable to the Panel, however, is the fact that there appears to have been a degree of conditionality in the results of the SCAP that was not communicated to the public. While, for example, the document issued by the Federal Reserve noted that "[i]f the economy recovers more quickly than specified in the more adverse scenario, firms could find their capital buffers at the end of 2010 more than sufficient to support their critical intermediation role and could take actions to reverse their capital build-up[,]"[437] there was no suggestion that the capital levels might be revised

[432] Treasury conversations with Panel staff (Feb. 2, 2010); Federal Reserve conversations with Panel staff (Feb. 19, 2010).

[433] Treasury conversations with Panel staff (Jan. 29, 2010); GMAC conversation with Panel staff (Feb. 1, 2010).

[434] It does not appear that any similar adjustments were made for any other BHCs tested under the SCAP.

[435] Treasury conversations with Panel staff (Feb. 2, 2010); Federal Reserve conversations with Panel staff (Feb. 19, 2010).

[436] Treasury conversations with Panel staff (Feb. 2, 2010); Federal Reserve conversations with Panel staff (Feb. 19, 2010).

[437] SCAP Design and Implementation, *supra* note 420, at 5.

downward at any earlier point. Announcements regarding the results of the SCAP likewise included no indication that the results might be subject to revision at any point or, in particular, that the level required for one company might be adjusted based solely on factors relevant to that BHC. It is therefore surprising that such a revision was apparently available.

G. GMAC and the AIFP: A More Lenient Approach

As discussed earlier, Treasury maintains that the aid provided to GMAC was inextricable from the aid provided to the automotive companies. Like the automotive companies, which received bridge financing before long-term investment, GMAC also received successive infusions, the last of which was paid in December 2009. It is there that the similarities end. For most other points of comparison, GMAC received very different treatment from the automotive companies it supports.

1. Due Diligence and Demonstrations of Viability

The first point upon which GMAC's treatment differs from that of the automotive companies is in the due diligence Treasury performed, and the requirements it imposed on GMAC. Unlike the automotive companies, GMAC does not appear to have been required to demonstrate or disclose anything particularly rigorous regarding its future plans, viability, or current stability in order to receive later sums. Given that Treasury's investment in GMAC is currently larger than its investment in Chrysler, this omission is, at best, puzzling. GMAC has explained that prior to the December 2009 infusion, it provided Treasury and the Federal Reserve with pro forma financial statements.[438] The pro-forma financials were, however, a work in progress, and while GMAC and Treasury discussed and reviewed the pro-forma financials, Treasury did not otherwise require a rigorous determination of GMAC's viability prior to delivering the funds in late December 2009.[439] Instead, GMAC received the funds and continued to develop the details of its strategy over the following quarter. Treasury takes the position that a diligence process would have added little, given that the funds were already committed, and that renegotiating the consent provisions for the entire MCP holdings would permit it to evaluate GMAC's strategy and viability at any time that GMAC approached it for a conversion. Whether this substitute for due diligence will prove relevant to the taxpayer is yet to be seen; the difference from Treasury's treatment of the automotive companies is, however, marked.

The automotive companies were given bridge financing and funds for current operations, but were required to demonstrate their continued viability before they could receive longer-term help. More specifically, the initial loans to the automotive companies were extended with a requirement that each company demonstrate the capacity to stabilize and achieve long-term health.[440] In announcing

[438] GMAC conversations with Panel staff (Feb. 1, 2010).
[439] GMAC conversations with Panel staff (Feb. 1, 2010).
[440] White House, *Fact Sheet: Financing Assistance to Facilitate the Restructuring of Auto Manufacturers to Attain Financial Viability* (Dec. 19, 2008) (online at georgewbush-

the program, then-Secretary Paulson emphasized the conditionality of the loans, stating that assistance came with the "requirement that [the companies] move quickly to develop and adopt acceptable plans for long term [sic] viability."[441] Moreover, then-Secretary Paulson emphasized that the assistance was not intended solely as a means of preventing "significant disruption to our economy," but was also a critical step toward "the significant restructuring necessary to achieve long-term viability."[442] In response to the conditions, in February 2009, both companies submitted financial viability plans, which the Obama Administration reviewed critically, requiring Chrysler to develop a partnership with another automotive company, and describing GM's forecasts as overly optimistic.[443] GMAC is currently at work on a viability plan: this plan, however, was not a precondition to the government's investments. If any evaluation of GMAC's viability occurred prior to the commitment of TARP funds, it has not been disclosed to the public.

2. Consequences to Shareholders

Yet another distinction between Treasury's treatment of GMAC and Treasury's approach to the automotive companies lies in the consequences visited upon the various entities' owners. Prior to Treasury's intervention, Daimler and Cerberus were the primary owners of Old Chrysler, with 19.9 percent and 80.1 percent equity, respectively. In the Old Chrysler[444] liquidation, both were wiped out. Old Chrysler's first-lien secured lenders, who had $6.9 billion in secured claims from Old Chrysler, received $2 billion cash in the liquidation. Other stakeholders similarly found their claims upon Old Chrysler substantially impaired after the bankruptcy proceeding. The Old GM shareholders were also wiped out, while other stakeholders saw substantial obligations owed by Old GM converted into more uncertain shares in the new GM. The automotive companies, accordingly, had vastly different ownership structures after Treasury's intervention than they did before, and many if not most of the parties involved were asked to make significant sacrifices in the bankruptcy proceedings.[445]

By contrast, GMAC's shareholders have been diluted by Treasury's entry, but have not been wiped out.[446] In reviewing GMAC's BHC application, the Federal Reserve required GM and Cerberus to reduce their ownership interest in GMAC: neither GM nor Cerberus could comply with the nonbanking activities restrictions in the BHCA, and therefore neither could retain a controlling interest

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whitehouse.archives.gov/news/releases/2008/12/20081219-6.html). The loans also imposed conditions related to operations, expenditures, and reporting.

[441] Sec. Paulson Statement on the Automotive Industry, *supra* note 187.

[442] Sec. Paulson Statement on the Automotive Industry, *supra* note 187.

[443] U.S. Department of the Treasury, *Chrysler February 17 Plan: Determination of Viability*, at 1 (Mar. 30, 2009) (online at www.financialstability.gov/docs/AIFP/Chrysler-Viability-Assessment.pdf); U.S. Department of the Treasury, *GM February 17 Plan: Determination of Viability*, at 2 (Mar. 30, 2009) (online at www.financialstability.gov/docs/AIFP/GM-Viability-Assessment.pdf).

[444] For purposes of consistency, Chrysler, in its incarnation before it entered bankruptcy, is referred to as Old Chrysler, while the new entity that emerged from the bankruptcy process is referred to as Chrysler.

[445] *See* September Oversight Report, *supra* note 189, at 23–31.

[446] *See* Sections C.2 and D.2, *supra*, for a discussion of the consequences visited upon GMAC's bondholders, board, and management. The board has turned over completely since before the BHC application, and the bondholders were required to take a haircut. Management experienced some, but not overwhelming, turnover.

in GMAC once it became a BHC. The Federal Reserve required GM to reduce its ownership interest to less than 10 percent of the voting equity in GMAC and required Cerberus to reduce its aggregate direct and indirect investments to no greater than 14.9 percent of the voting and 33 percent of the total equity in GMAC.[447] Although GM and Cerberus lost control, neither GM nor Cerberus sacrificed all economic value in the investment. Rather, GM transferred its remaining equity interest in GMAC to a trust,[448] while each Cerberus fund that held interests in GMAC distributed its excess equity interest in the company to its respective investors.[449] While the value of these investments to either the GM Trust or to the Cerberus investors is, of course, subject to the vagaries of the market, the original investors had something to distribute. Neither original investor was therefore wiped out in the sense that the Old GM or Old Chrysler shareholders were wiped out in the bankruptcies. Finally, both GM and Cerberus retained a residual equity voting interest in GMAC. To the extent that the GMAC bailout is part of the AIFP, the disparate treatment of the stakeholders in the process appears to be without any particular justification. In his speech on the GM restructuring, President Obama emphasized the principle of sacrifice: in particular, he observed that the UAW was receiving cuts in employee compensation and retiree health care benefits, while shareholders were sacrificing any remaining value in their shares.[450] If GMAC is properly part of the AIFP, it is unclear why no such sacrifices were required of the GMAC shareholders.

3. Bankruptcy

Another glaring difference between GMAC and the automotive companies, and the reason that GMAC's shareholders retain whatever value is left in their shares, is, of course, that GMAC never went through bankruptcy. In the abstract, bankruptcy would have been possible for GMAC. In the absence of market-specific concerns, the structure and business of GMAC—either before or after the BHC conversion—would not have presented any particular obstacles to either a bankruptcy proceeding or, more likely, a Section 363 sale. The nonbank portions of the business would have been segregated and placed into the bankruptcy process, while the bank portions of the business could either have been kept solvent or placed into receivership by the FDIC according to its customary processes. The profitable automotive financing business could have been sold, perhaps with a government guarantee. In testimony be-

[447] Order Approving GMAC's BHC Formation, *supra* note 58.

[448] Order Approving GMAC's BHC Formation, *supra* note 58. The Trustee of the trust had to be acceptable to the Federal Reserve and the Treasury, entirely independent of GM, and have sole discretion to vote and dispose of the GMAC equity interests. As part of the process, GM was also required to sign a passivity agreement whereby its representative on the board is only an observer, and does not vote. March 24 Letter to B. Robbins Kiessling, Esq., *supra* note 65.

[449] The Federal Reserve imposed additional requirements on Cerberus and GM's ability to effect control over GMAC. Among other things, Cerberus employees and consultants were to cease providing services to or otherwise functioning as dual employees of GMAC, and Cerberus was also required to abjure any advisory relationships with GMAC or any investor regarding the sale of shares or management or policies of GMAC. Order Approving GMAC's BHC Formation, *supra* note 58.

[450] See White House, *Remarks by the President on General Motors Restructuring* (June 1, 2009) (online at www.whitehouse.gov/the__press__office/Remarks-by-the-President-on-General-Motors-Restructuring/).

fore the Panel, Treasury representatives cited a variety of concerns underpinning the decision to keep GMAC out of bankruptcy, from their belief that adding a GMAC bankruptcy to the GM and Chrysler bankruptcies would have further destabilized a precarious situation, to their assertion that the workout would have required enormous DIP financing, to, ultimately, their fear that GMAC, as a financial services company, could have failed to emerge from bankruptcy.[451] But Treasury and GMAC's objections, further discussed in Section E.4, could as easily have applied to the automobile company bankruptcies. After all, fear that the company would emerge from liquidation crippled, if at all; substantial need for assistance; and fear of significant disruption all describe the concerns surrounding GM's bankruptcy as well. A bankruptcy could have solved a variety of the problems that face GMAC now, which are discussed in greater detail in Section H, below: its debt burden, its exposure to deteriorating mortgages through ResCap, and its high preferred share ratio and attendant high cost of capital, among others. In fact, a bankruptcy could have addressed many of GMAC's problems: it could have wiped out the old equity, limited losses on housing, haircut the outstanding debt, and overall put the company on a better path towards the future. A bankruptcy might have preserved an independent GMAC or sold off its parts, including the automotive financing business, for more value. And yet, GMAC and its shareholders were never subjected to the same risk of total loss, because Treasury deemed bankruptcy imprudent for GMAC. The Panel has discussed its objections to Treasury's concerns in Section E, above, and continues to question whether Treasury was indeed powerless in the face of the hurdles it described: as the Panel noted in its September report, a $700 billion fund gives the holder many options.[452]

Fundamentally, these decisions matter not only because they affect the manner of the taxpayers' investment, but also, and more importantly, because they affect the taxpayers' potential for recovery. When the prior shareholders were preserved, with them were preserved their claims upon GMAC, although it is Treasury, and not the prior investors, that has kept GMAC afloat. Treasury has assured the Panel that it would be highly unlikely for the third-party shareholders to receive a return if the taxpayers suffered a loss, because Treasury has multiple mechanisms for protecting the priority of its investment. First, Treasury has substantial preferred share holdings, which would be paid before any distributions on the equity of the other investors. Second, if Treasury converted its preferred shares, the other shareholders would be diluted beyond their already substantial dilution. Treasury's MCP have conversion rights that allow Treasury to convert—and substantially dilute—other shareholders in the event of certain corporate actions, and therefore permit Treasury to intervene in GMAC's efforts to raise

[451] Transcript of COP Hearing on GMAC, *supra* note 12 (Testimony of Jim Millstein). For a more detailed discussion of Treasury's reasons for determining that a bankruptcy proceeding was not appropriate for GMAC, *see* Section E.4, *supra*.

[452] *See* September Oversight Report, *supra* note 189, at 3, 86–87 (discussing Treasury as a "tough negotiator" when it invested taxpayer funds in the automotive companies and describing the imposition of conditions on institutions that receive "exceptional assistance").

capital.[453] But Treasury has also stated that the only way to legally wipe out the other shareholders was through bankruptcy, and this option was rejected: Treasury may have the power to dilute the other shareholders, but unless it takes GMAC into bankruptcy, it does not have the power to eliminate them.[454] Ultimately, the Panel urges Treasury to make every effort to bring to fruition its assertion that no third-party shareholder is likely to receive a return unless the taxpayers are paid in full.[455] It would be the height of impropriety for these shareholders to recover any value in their investment if the taxpayers were not previously or simultaneously made whole.

H. Exit Strategy and Expected Returns from the GMAC Investment

1. Treasury's Options for Divesting the GMAC Stake

Treasury currently owns $11.4 billion in MCP, $2.67 billion in TruPs and 56.3 percent of the common equity of GMAC. For the purpose of comparison, this is a larger investment than the $12.8 billion acquisition cost of Treasury's Chrysler holdings.[456] In fact, if Treasury converted its preferred position, it would hold more than 70 percent of the common equity of GMAC.[457] And yet, in sharp contrast to its discussion of the investment in Chrysler, Treasury has provided the public virtually no information about its intentions with respect to its future strategy or exit for GMAC. This deprives the taxpayers of the means to understand the current state of and future plans for their not insubstantial investment in GMAC. The Panel has repeatedly called for Treasury to manage the TARP in a transparent and open fashion.[458] In its

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[453] Treasury GMAC Contract, *supra* note 226, at Schedule A.

[454] Transcript of COP Hearing on GMAC, *supra* note 12 (Testimony of Ron Bloom).

[455] It would be theoretically possible for a third-party investor to sell its shares in a private sale. Given Treasury's ability to dilute the shareholdings, the large number of outstanding preferred shares, and GMAC's pending debt maturities, however, it is unlikely that this hypothetical private sale would net very much. Treasury conversations with Panel staff (Mar. 2, 2010).

[456] This figure represents the total amount of funds provided to Chrysler through the AIFP. *See* Congressional Oversight Panel, *January Oversight Report: Exiting TARP and Unwinding Its Impact on the Financial Markets*, at 85, 87 (Jan. 13, 2009) (online at cop.senate.gov/documents/cop-011410-report.pdf) (hereinafter "January Oversight Report"). These comparisons should not imply that there is any special significance that rests upon the size of an investment. Rather, this report hopes to draw a contrast between the professed rigor and transparency associated with the investment in the automotive companies with the more opaque circumstances of the GMAC investment. Chrysler, as an AIFP participant with a Treasury stake of roughly the same size as GMAC, is a useful point of comparison. *See* Congressional Oversight Panel, *January Oversight Report: Exiting TARP and Unwinding Its Impact on the Financial Markets*, at 87 (Jan. 13, 2009) (online at cop.senate.gov/documents/cop-011410-report.pdf).

[457] GMAC, Inc., *Investor Call to Discuss Key Capital and Strategic Actions*, at 10 (Jan. 5, 2010) (online at www.gmacfs.com/us/en/about/investor/upcoming__events.html) (hereinafter "Investor Call to Discuss Capital and Strategic Actions").

[458] The Panel has been consistent in its calls for transparency in the administration of the TARP, recommending or discussing the need for transparency in nearly all of its reports. See Congressional Oversight Panel, *April Oversight Report: Assessing Treasury's Strategy: Six Months of TARP*, at 5 (Apr. 7, 2009) (online at cop.senate.gov/documents/cop-040709-report.pdf); August Oversight Report, *supra* note 151, at 60; December 2009 Oversight Report, *supra* note 368, at 95–97; December Oversight Report, *supra* note 364, at 5, 16, 19; Congressional Oversight Panel, *February Oversight Report: Valuing Treasury's Acquisitions*, at 3, 12 (Feb. 6, 2009) (online at cop.senate.gov/documents/cop-020609-report.pdf); Congressional Oversight Panel, *January Oversight Report: Accountability for the Troubled Asset Relief Program*, at 3–4 (Jan. 9, 2009) (online at cop.senate.gov/documents/cop-010909-report.pdf); January Oversight Report, *supra* note 456, at 45; Congressional Oversight Panel, *July Oversight Report: TARP Repayments, Including the Repurchase of Stock Warrants*, at 39 (July 10, 2009) (online at cop.senate.gov/documents/cop-071009-report.pdf); June Oversight Report, *supra* note 423, at 5, 49; Congressional Oversight Panel, *November Oversight Report: Guarantees and Contingent Payments in TARP*

treatment of GMAC, Treasury has, however, failed to provide the public with much information.

As with the automotive companies, Treasury's stake in GMAC—common, TruPs, and MCP[459]—is fundamentally illiquid.[460] Accordingly, Treasury's large common stock position in GMAC, a non-public company, can be sold only in private sales unless and until GMAC makes an initial public offering (IPO). Divesting Treasury's preferred share position depends on whether Treasury converts the MCP into common stock. If Treasury converted the MCP, it could sell the resulting common stock in the market after the eventual IPO, or, less likely, in a private sale.[461] Even then, Treasury will be hampered by the ownership restrictions imposed on holders of bank stock. As any entity holding 25 percent or more of the voting stock of a bank or BHC is itself a BHC, Treasury could transfer its interests in GMAC stock only consistent with the BHCA, which could further limit its ability to sell its position.[462] In any event, consistent with its approach overall, Treasury's goal is to "dispose of the government's interests as soon as practicable consistent with EESA goals."[463]

Treasury has stated that it intends to sell its interests in a timely and orderly manner that "minimizes financial market and economic impact," under what it determines to be appropriate market conditions.[464] At the Panel's hearing, Treasury representatives set forth the steps GMAC would need to follow in order for Treasury to divest the GMAC investment. First, GMAC must address its looming maturing debt. Until GMAC's debt has been refinanced, Treasury does not expect GMAC to be able to access the equity markets. Once the debt is refinanced and the GMAC balance sheet has a better liquidity profile, then an IPO should be possible. Treasury would likely convert its MCP to common in whole or in part and sell its shares after the company becomes public.[465]

An IPO strategy hinges on the ability of GMAC to become profitable. Since a public offering is the primary method for recovery of

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and Related Programs, at 79, 86 (online at cop.senate.gov/documents/cop-110609-report.pdf) (hereinafter "November Oversight Report"); Congressional Oversight Panel, *October Oversight Report: An Assessment of Foreclosure Mitigation Efforts After Six Months*, at 93 (Oct. 9, 2009) (online at cop.senate.gov/documents/cop-100909-report.pdf); September Oversight Report, *supra* note 189, at 104–105.

[459] TruPs have elements of both common equity and debt, are senior to all other common equity of GMAC, and have no contractual restrictions on transfer (other than requirements that certificates bear certain legends and other similar restrictions set forth in the Declaration of Trust for the Trust), while MCP, which are convertible at the Federal Reserve's option, would require conversion before they can be marketed. See December 2009 Restructuring Announcement, *supra* note 214; U.S. Department of the Treasury, *Decoder* (online at www.financialstability.gov/roadtostability/decoder.htm) (accessed Mar. 8, 2010); U.S. Department of the Treasury, *The Treasury Capital Assistance Program and the Supervisory Capital Assessment Program*, Joint Statement by Secretary of the Treasury Timothy F. Geithner, Chairman of the Board of Governors of the Federal Reserve System Ben S. Bernanke, Chairman of the Federal Deposit Insurance Corporation Sheila Bair, and Comptroller of the Currency John C. Dugan (May 6, 2009) (online at www.financialstability.gov/latest/tg91.html); GMAC Inc., *Summary of Trust Preferred Securities and Warrant Terms* (May 21, 2009) (online at financialstability.gov/docs/AIFP/Posted%20to%20AIFP%20Website%20-%20GMAC%202009.pdf).

[460] *See* GMAC to Expand Retail Auto Financing, *supra* note 138.

[461] Transcript of COP Hearing on GMAC, *supra* note 12 (Testimony of Ron Bloom and Jim Millstein).

[462] 12 U.S.C. § 1842(a).

[463] U.S. Department of the Treasury, *Office of Financial Stability Agency Financial Report: Fiscal Year* 2009, at 44 (Dec. 10, 2009) (online at www.treas.gov/press/releases/OSF%20AFR%2009.pdf) (hereinafter "OFS Financial Report: Fiscal Year 2009").

[464] OFS Financial Report: Fiscal Year 2009, *supra* note 463, at 40.

[465] Transcript of COP Hearing on GMAC, *supra* note 12 (Testimony of Ron Bloom and Jim Millstein).

taxpayers' money, delays in or hindrances to accessing the equity capital markets will prolong Treasury's involvement as a shareholder. This therefore places substantial weight on GMAC's strategy for becoming profitable, which is presently a work in progress. At base, GMAC is dependent on maintaining liquidity in order to sustain the lending flows to the automotive industry. In this context, GMAC has two primary obstacles between its current position and the profitability that would support a potential IPO, both of which relate to liquidity: it must have unfettered and non-government-sponsored access to the third-party credit markets, and it must be able to reduce its cost of capital.[466] In order to overcome both roadblocks, it must address its maturing debt; hire good staff,[467] support and expand a retail bank, contain a deeply troubled mortgage subsidiary, convince the credit markets that its debt is a worthwhile investment and the equity markets that it has a future as a non-captive finance arm of GM, and engage in asset securitizations in a tight market. Any one of these could prove a substantial impediment to a return to profitability, but to succeed, GMAC must accomplish all of these goals simultaneously.

2. GMAC's Current Strategy

The overall likelihood of success of GMAC's current operations is, like the future of the U.S. automotive industry generally, uncertain. At a high level, GMAC has stated that it intends to focus on fulfilling the regulatory requirements of a BHC, address the issues posed by ResCap, repay the U.S. government,[468] and become a multi-brand source of automotive financing.[469] Further, in a recent press release, GMAC stated that it believes that the best way for

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[466] The GMAC preferred stock that Treasury holds pays 9 percent interest. U.S. Department of the Treasury, *Treasury Announces Restructuring of Commitment to GMAC* (Dec. 30, 2009) (online at www.financialstability.gov/latest/pr_1052010.html).

[467] GMAC is subject to Special Master Feinberg's jurisdiction and may pay compensation only if it is consistent with the restrictions imposed on entities that received exceptional financial assistance under TARP. Among other things, these entities may only pay covered employees compensation that will not encourage them to take unnecessary or excessive risks, appropriately allocates its components between short- and long-term incentives, is comparable to the compensation at similar entities, and is sufficiently competitive to attract talented staff. 31 CFR Part 30; *see also* U.S. Department of the Treasury, TARP Standards for Compensation and Corporate Governance (June 6, 2010) (online at www.treas.gov/press/releases/reports/ec%20ifr%20fr%20web%206.9.09tg164.pdf).

Special Master Feinberg rejected aspects of GMAC's initial compensation proposal, finding them inconsistent with the regulatory standards. GMAC was also directed to institute corporate governance reforms consistent with the Special Master's direction, including clawbacks, disclosure, and prohibitions on luxury expenditures and tax gross-ups. See Letter from Kenneth R. Feinberg, special master for TARP executive compensation, to Al de Molina, chief executive officer, GMAC, *Proposed Compensation Structures for Senior Executive Officers and Most Highly Compensated Employees* (Oct. 22, 2009) (online at www.treas.gov/press/releases/docs/20091022%20GMAC%20Letter.pdf); Letter from Kenneth R. Feinberg, special master for TARP executive compensation, to Drema M. Kalajian, attorney, GMAC, *Proposed Compensation Structures for Certain Executive Officers and Most Highly Compensated Employees* (Dec. 11, 2009) (online at www.financialstability.gov/docs/20091210%20GMAC%20Determination.pdf).

Some entities subject to the compensation restrictions have argued that they cannot attract or retain the talented and dedicated staff necessary to help untangle the mess. Bank of America, Corp., *Form 10–K for the Fiscal Year Ended December 31, 2008*, at 6 (Feb. 27, 2009) (online at www.sec.gov/Archives/edgar/data/70858/000119312509041126/d10k.htm); Citigroup, *Form 10–K for the Fiscal Year Ended December 31, 2008*, at 49 (Feb, 27, 2009) (online at www.citi.com/citi/fin/data/k08c.pdf?ieNocache=865).

As long as it is subject to the restrictions, GMAC may believe that it is similarly hampered. If GMAC cannot assemble the team it needs to address its many problems, it may also delay its return to solvency.

[468] GMAC, Inc., *GMAC Names Michael A. Carpenter Chief Executive Officer; Will Lead Next Phase Of Renewal* (Nov. 16, 2009) (online at media.gmacfs.com/index.php?s=43&item=374).

[469] GMAC conversations with Panel staff (Feb. 1, 2010).

it to return to profitability is to focus on its core automotive financing business.[470] GMAC is expanding in both the wholesale and the retail market to obtain funds for its automotive financing. Underlying any and all discussions of specific strategy, however, lies GMAC's need to keep access to credit. Whether it achieves liquidity through taking deposits, access to the credit markets, or asset securitizations, it must be able to keep the funds flowing in order to maintain the automotive finance core.

As noted above, GMAC has multiple impediments to overcoming its two core obstacles to profitability. At a high level, GMAC suffers from significant amounts of maturing debt and an uncertain ability to access the credit markets. In October 2009, GMAC issued $2.9 billion in senior fixed rate notes pursuant to the TLGP,[471] but this facility has effectively expired and is unlikely to be readily available for GMAC for additional offerings in the future.[472] GMAC recently offered $2 billion principal amount of five-year corporate-guaranteed debt at 8.3 percent in a Rule 144A offering. This offering was not supported either by the Federal Reserve or the TLGP, and may therefore represent renewed access to the credit markets.[473] The interest rate paid, however, is high and may prove a significant drag on future profitability. It is also not clear whether or on what terms this access will continue, particularly given that GMAC has $24 billion worth of debt coming due in 2010, $22 billion in 2011, and $13 billion in 2012.[474] If GMAC is unable to refinance at affordable rates or has insufficient cash to cover its maturing obligations, it may face even higher borrowing costs, possibly resulting in renewed liquidity problems.

Another of GMAC's impediments to becoming an attractive borrower or equity investment is the uncertainty surrounding the losses at ResCap. Consistent with a focus on its core automotive business, GMAC has announced its intention to seek strategic disposition of ResCap, and to that end has reclassified most of the ResCap assets as "held for sale" rather than "held for investment."[475] According to Treasury, the losses at ResCap have weighed on GMAC's balance sheet: not only did ResCap have significant amounts of debt coming due, but the boundaries of the ResCap losses were extremely difficult to quantify. To address this problem, as part of the December capital infusion, GMAC contributed cash to its banking subsidiary, Ally Bank, in exchange for impaired subprime assets, which were then contributed to ResCap.[476] This benefitted Ally Bank while having little functional effect on ResCap. Ally Bank received more cash and shed impaired as-

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[470] GMAC Announces Capital and Strategic Actions, *supra* note 248.

[471] GMAC Reports Preliminary Q3 2009 Results, *supra* note 273.

[472] Temporary Liquidity Guarantee Program FAQs, *supra* note 49.

[473] It is, however, roughly comparable to other offerings: Ford Motor Credit recently issued $1 billion of five-year senior unsecured notes at 8.7 percent. Ford Motor Credit, *Prospectus Supplement Filed Pursuant to Rule 424(b)(2)* (Sept. 16, 2009) (online at www.sec.gov/Archives/edgar/data/38009/000095012309043842/k48318b2e424b2.htm).

[474] GMAC, Inc., *Preliminary 2009 Second Quarter Results* (Aug. 4, 2009) (online at phx.corporate-ir.net/External.File?item=UGFyZW50SUQ9MTIwMjN8Q2hpbGRJRD0tMXxUeXBlPTM=&t=1) (hereinafter "GMAC Preliminary 2Q 2009 Results").

[475] GMAC Announces Capital and Strategic Actions, *supra* note 248.

[476] GMAC Announces Capital and Strategic Actions, *supra* note 248; *see also* GMAC, Inc., *Form 8–K for the Period Ending December 30, 2009*, at Ex. 99.2 (Jan. 5, 2010) (online at www.sec.gov/Archives/edgar/data/40729/000119312510001220/0001193125-10-001220-index.htm).

sets,[477] while ResCap merely added to an already substantial portfolio of impaired subprime mortgages.[478] According to Treasury and GMAC, these transactions also had the effect of signaling the general extent of the ResCap losses to the market, making the market more willing to lend to GMAC. In setting clearer bounds to the potential ResCap downside, Treasury and GMAC also believe that ResCap itself has become a more attractive acquisition prospect and less of a drag on GMAC's overall balance sheet. Whatever value remains in ResCap—and it is unclear whether there is any value in ResCap at present—Treasury feels that it can be more easily realized if ResCap's total losses are more transparent.[479] The success of this strategy, however, depends on market confidence that the ResCap losses are in fact bounded and that no further significant write-downs will be necessary. It is too soon to determine if this has occurred.

An analysis of GMAC's five-year credit default swap (CDS) spreads, a market proxy for the perceived risk of an issuer's default, does not indicate a meaningful improvement in market sentiment towards GMAC following the company's announcement of additional Treasury support and strategic actions aimed at ring-fencing ResCap on December 30, 2009. While swap spreads initially tightened (improved) on the announcement from 498 basis points to 372 basis points in mid-January, they have since widened (deteriorated) to prior levels in the weeks thereafter. Despite initially outperforming FMCC, a strongly-capitalized competitor without a mortgage overhang, GMAC spreads have generally performed in line with this competitor. A comparative analysis of the yield on similar debt for the two companies is generally consistent with the CDS data, with GMAC debt narrowing its Yield-To-Worst (YTW) spread vs. FMCC during this period from 11140 basis points to 1160 basis points, before widening again to 11130 basis points. However, the absolute and relative performance of GMAC's CDS spreads and bond yields clearly indicate that the market had already priced continued government support for GMAC well before the latest government assistance.

[477] As a result of these transactions, GMAC recognized a pre-tax charge of approximately $3.8 billion, with $3.3 billion related to the mortgage write-downs at ResCap and Ally Bank and $500 million related to repurchase reserve expense. In addition, ResCap's received approximately $2.7 billion in additional capital, and Ally Bank recognized a $1.3 billion pre-tax charge, while being recapitalized with a $1.3 billion cash infusion from GMAC. *See* GMAC Announces Capital and Strategic Actions, *supra* note 248.

[478] Treasury conversations with Panel staff (Jan. 5, 2010).

[479] This may be advantageous from the standpoint of transparency, although it arguably could also undermine GMAC's (and, thus, Treasury's) efforts to dispose of these assets for as much as possible.

FIGURE 16: 5-YEAR CDS SPREADS—GMAC vs. FMCC [480]

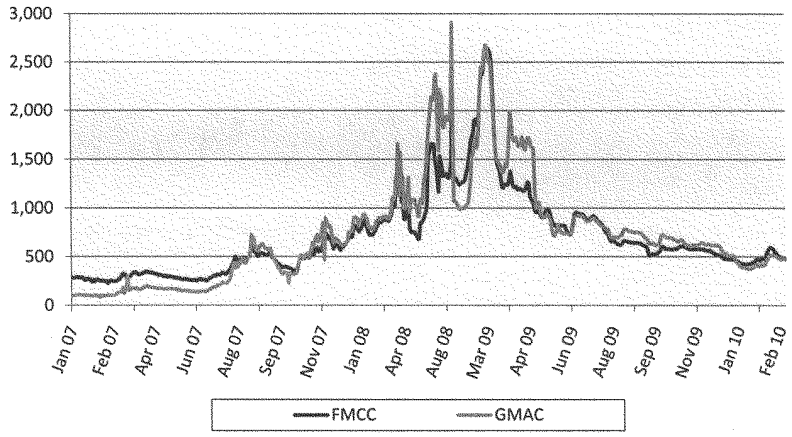
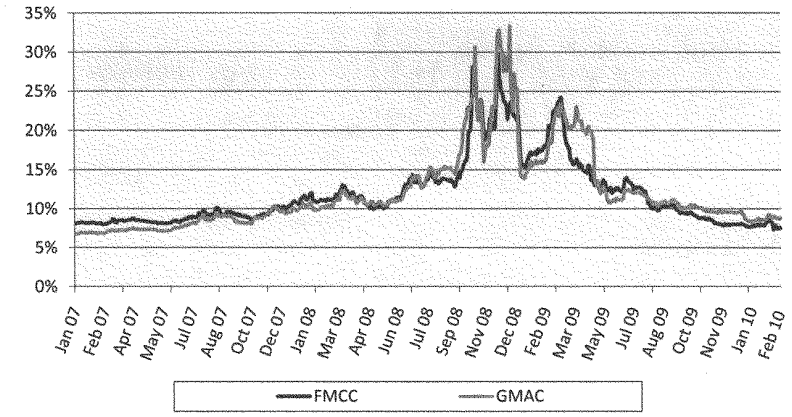


FIGURE 17: YTW—GMAC vs. FMCC [481]



[480] Bloomberg Data Service.
[481] Ford Motor Credit Corp. 8.00% December 15, 2015 maturity and GMAC 8.00% November 1, 2031 maturity. Bloomberg Data Service.

In light of ResCap's muddy but potentially destructive future, one option for ResCap would be a separate bankruptcy. GMAC and Treasury have been varied in their discussion of this possibility. A ResCap bankruptcy was one of the many options discussed by the GMAC board. In the Form 10–Q for the third quarter of 2009 and the 10–K for 2009, GMAC expressed concern that a ResCap bankruptcy proceeding might treat the relationships between the parent and the subsidiary in a way that could disadvantage the parent, particularly with respect to its financing and hedging arrangements with ResCap. GMAC also expressed concern that the other creditors of ResCap would ask the bankruptcy court to subordinate amounts owed to GMAC to their claims.[482] GMAC has also stated that it consulted with advisors and weighed ResCap's involvement with GMAC Financial Services, the disruption a decision to discontinue support would cause for GMAC's access to the capital markets; interparty agreements, and the significant volume of servicing ResCap provides for residential loans and modification assistance.[483] Mr. Carpenter has stated that the board has considered a ResCap bankruptcy as a means of containing the ResCap losses and has concluded that restructuring and seeking alternatives other than bankruptcy were best for the stakeholders, and Treasury representatives have stated that they view this conclusion as reasonable.[484] In that context, Mr. Carpenter said "we're not going to do anything crazy in terms of giving value away."[485] The value of ResCap, however, remains extremely opaque.

ResCap clearly poses a continuing problem for GMAC. In a recent presentation to investors, a not insubstantial amount of the discussion focused on the future for ResCap.[486] GMAC has stated that it believes that given their current value, the ResCap assets can be sold in the market. GMAC does not, however, appear to have any willing buyers at present. Similarly, GMAC is unable to make any commitment that ResCap will not need further capital support. Right now, ResCap has no clear future and no clear strategy for turnaround, although it has posed and may continue to pose a drain on GMAC's balance sheet.

Yet another variable for GMAC lies in its uncertain ability to access the ABS market, a substantial source of liquidity. GMAC has used the TALF to issue ABS and obtain liquidity through securitizations. The TALF, however, will no longer be available to automotive finance after March 31, 2010, unless the Federal Reserve extends the facility.[487] GMAC believes that the TALF has been extremely beneficial to unlocking the securitization market, and is concerned that absent the TALF, it will lose some access to the ABS markets and with it the liquidity it needs to rebuild.[488]

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[482] GMAC Form 10–Q for Q3 2009, *supra* note 22, at 8; *see also* GMAC Form 10–K for 2009, *supra* note 12, at 17. *See* Section E.4., *supra*, for additional discussion.

[483] GMAC conversations with Panel staff (Mar. 3, 2010).

[484] Transcript of COP Hearing on GMAC, *supra* note 12 (Testimony of Jim Millstein).

[485] Investor Call to Discuss Capital and Strategic Actions, *supra* note 457, at 10.

[486] Investor Call to Discuss Capital and Strategic Actions, *supra* note 457.

[487] Term Asset-Backed Securities Loan Facility: FAQs, *supra* note 355.

[488] Although floorplan loans were made eligible for the Small Business Administration (SBA) loan guarantee program, and that program therefore seemed like it might provide a source of liquidity for dealers, the remaining restrictions on the program make it difficult to do the floorplan lending upon which the automotive industry depends. First, floorplan loans often have a 100 percent advance, while the maximum under the SBA program is 90 percent. The maximum loan under the SBA program is $2 million: the average floorplan loan is $5 million. Fi-

Ally Bank also provides GMAC with a source of liquidity in both the retail and wholesale markets. GMAC has stated that it believes that the credit crisis ended the viability of the classic wholesale financing model for itself and other wholesale-funded institutions, and that inflows derived from the wholesale finance market (such as debt issuances and securitizations) will likely be insufficient. GMAC's answer to the problem is to develop a retail bank, Ally Bank, which has been attempting to provide diversified funding (including deposits) for the automotive financing unit.[489] This strategy has several components. GMAC is simultaneously integrating Ally Bank with the automotive products side while expanding its retail products. For example, GMAC is positioning Ally Bank within the dealer network, using a program called Ally Dealer Rewards to provide benefits to frequent users of the bank's automotive financial products.[490] Ally Bank is also participating in auto loan securitizations that are backed by the TALF.[491] At the same time, however, GMAC is expanding Ally Bank's retail product portfolio, recently adding interest checking[492] as part of its growth strategy for Ally Bank.[493]

Although GMAC is cutting costs across the organization, its investment in Ally Bank is staying largely stable. GMAC has been engaged in an aggressive marketing campaign for Ally Bank. Among other things, Ally Bank has been attempting to interest depositors by offering CD rates that are nationally among the highest available.[494] This strategy has been politically contentious regulators view unusually high rates as an indication of instability. In the summer of 2009, when Ally Bank's rates were more than double the national average, the rates prompted a letter of complaint from the American Bankers Association (ABA) to the FDIC. The ABA letter stated that the Ally Bank strategy—aggressive courting of deposits and extremely rapid growth in assets—was risky and required regulatory supervision. The ABA was particularly incensed by Ally Bank's strategy in light of the government bailout, arguing that Ally Bank was shielded from investor and market influences, and was therefore free to follow risky strategies. Citing the high interest rates paid by troubled financial institutions during the banking crisis of the 1980s, the ABA observed that such high rates and risky behavior can create a race to the bottom, in which other banks are also forced to raise their rates above the market rate.[495] In response, Ally Bank vigorously contested the ABA's characterization of Ally Bank as troubled, citing its capital-

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nally, the SBA program is a loan guarantee, not a direct loan program. Although the guarantee is available, it is a private banking institution that must itself make the loan, and these credit markets are still tight. Accordingly, the SBA program is not likely to provide a significant source of dealer floorplan financing in the future.

[489] GMAC conversations with Panel staff (Feb. 1, 2010).

[490] GMAC Reports Preliminary Q3 2009 Results, *supra* note 273.

[491] GMAC Reports Preliminary Q3 2009 Results, *supra* note 273.

[492] GMAC, Inc., *Ally Bank Expands Product Portfolio; Launches Interest Checking Account* (Jan. 20, 2010) (online at media.gmacfs.com/index.php?s=43&item=381).

[493] GMAC Preliminary 2Q 2009 Results, *supra* note 474, at 28.

[494] Bankrate.com, *CD Investment Rates* (online at www.bankrate.com/funnel/cd-investments/cd-investment-results.aspx?local=false&tab=CD&prods=15&ic__id=CR__searchCDNational__cd__1yrCD__V1) (accessed Mar. 8, 2010).

[495] Letter from Edward L. Yingling, president, American Bankers Association, to Sheila Bair, chairman, Federal Deposit Insurance Corporation (May 27, 2009) (online at www.aba.com/aba/documents/News/GMACletter52709.pdf).

ization ratio and protesting that its rates were supported by its relationship with the GM and Chrysler dealership network.[496] Ally Bank's arguments, however, did not persuade the FDIC, which sent a letter conditioning Ally Bank's access to the TLGP on FDIC review of Ally Bank's CD rates[497] and later adopted new regulations setting a variety of standards for the interest rates permissible for insured depository institutions that are not well capitalized.[498] At present, Ally Bank still offers rates that are among the highest available, although Mr. Carpenter has said that Ally Bank hopes to move away from aggressive rates and toward a more traditional banking model, albeit an online one.[499] According to one analyst, however, internet banks do not have a history of success. Among other things, overhead is high because in the absence of branches the banks depend on expensive advertising.[500] In addition, at present Ally Bank has approximately 10 percent of its deposits in brokered deposits.[501] One analyst considers Ally Bank's proportion of brokered deposits and lack of restrictions on deposit withdrawals to be a warning sign of bank instability.[502] Finally, as the Federal Reserve discontinues the extraordinary measures it has been using to keep interest rates low, interest rates are likely to rise and with them Ally Bank's cost of funds.[503] Although these shifts will affect the industry as a whole, Ally Bank already has high deposit costs and a high proportion of brokered deposits. Some commentators note Ally Bank's high costs for acquiring and retaining depositors and low core deposits and liken Ally Bank to the unstable S&Ls of the 1980s.[504] Given that Ally Bank's deposits serve the same

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[496] Letter from Al de Molina, chief executive officer, GMAC LLC to Edward L. Yingling, president, American Bankers Association (Jun. 1, 2009) (online at www.ally.com/files/pdf/AllyResponse-060109-forWeb.pdf).

[497] Letter from Sandra L. Thompson, director, Federal Deposit Insurance Corporation, to Alvaro de Molina, chief executive officer, GMAC LLC, *Notice Regarding the Temporary Liquidity Guarantee Program* (June 4, 2009) (online at www.sec.gov/Archives/edgar/data/40729/000114420409031691/v151811_ex99-1.htm); *see also* GMAC, LLC, *Form 8–K Dated June 4, 2009* (Jun. 4, 2009) (online at www.sec.gov/Archives/edgar/data/40729/000114420409031691/v151811_8k.htm).

[498] Federal Deposit Insurance Corporation, *Final Rule: Interest Rate Restrictions on Insured Depository Institutions That Are Not Well Capitalized* (effective Jan. 1, 2010) (online at www.fdic.gov/news/board/May29no8.pdf). During this period, Ally Bank made an application to the Federal Reserve to become regulated by the Federal Reserve rather than the FDIC. *See* Federal Reserve Bank of Chicago, *Filings Received During the Week Ending May 16, 2009* (May 16, 2009) (online at www.federalreserve.gov/releases/h2/20090516/chicago.htm). Ally Bank subsequently withdrew the application in October 2009. Board of Governors of the Federal Reserve System, *Actions Taken under Delegated Authority*, at 9 (Oct. 31, 2009) (online at www.federalreserve.gov/Releases/H2/20091031/h2.pdf).

[499] Investor Call to Discuss Capital and Strategic Actions, *supra* note 457, at 11.

[500] Testimony of Christopher Whalen, *supra* note 345, at 18–19.

[501] Investor Call to Discuss Capital and Strategic Actions, *supra* note 457, at 11. *See also* Testimony of Christopher Whalen, *supra* note 345, at 6, 18. Brokered deposits, also known as "hot money," are large deposits that deposit brokers shop among depository institutions looking for high rates and are usually viewed as risky for the depository institution. They are short-term investments, which have been associated with high rates of bank failures. See Mindy West and Chris Newbury, *Brokered and High-Cost Deposits* (Mar. 2009) (online at www.fdic.gov/regulations/resources/minority/events/interagency2009/Presentations/Brokered.pdf). *See also* L.J. Davis, *Chronicle of a Debacle Foretold*, Harper's Magazine, at 53–54 (Sept. 1990). GMAC, Inc., *Preliminary 2009 Fourth Quarter Results*, at 25 (Feb. 4, 2010) (online at phx.corporate-ir.net/External.File?item=UGFyZW50SUQ9MjkzNTh8Q2hpbGRJRD0tMXxUeXBlPTM=&t=1).

[502] Investor Call to Discuss Capital and Strategic Actions, *supra* note 457, at 11; Testimony of Christopher Whalen, *supra* note 345, at 18. *See also* Transcript of COP Hearing on GMAC, *supra* note 12 (Testimony of Chris Whalen).

[503] GMAC Form 10–K for 2009, *supra* note 12, at 17–18 ("Rising interest rates could increase our cost of funds"). Board of Governors of the Federal Reserve System, *Press Release, Monetary Policy Releases* (Feb. 18, 2010) (online at www.federalreserve.gov/newsevents/press/monetary/20100218a.htm).

[504] Testimony of Christopher Whalen, *supra* note 345, at 6, 18.

purpose for GMAC as commercial paper,[505] GMAC instability affects not only GMAC and Ally Bank and, downstream, GM but also—and this brings to the fore the moral hazard of using government-insured deposits as the basis for monoline financing—Ally Bank's depositors. Ultimately, Ally Bank appears to be both critical to GMAC and very much a work in progress, and whether it will be a success remains to be seen.

While Ally Bank's integration with dealers and securitization participation appears to be consistent with a focus on the automotive business, the Ally Bank expansion, while furthering GMAC's efforts to become a deposit-funded institution, requires a separate set of management skills. GMAC is aware that its combination of retail online banking and wholesale automotive financial services is untested but believes that it offers good value to Ally Bank's customers while simultaneously involving Ally Bank effectively in the automotive lending side of the business. As Ally Bank is currently an important source of GMAC's liquidity, however, Ally Bank will need to maintain either adequate growth or adequate deposits to fund the automotive finance business. This puts pressure on Ally Bank, and it is difficult to predict how successful the venture is likely to be given the disparate competencies that the two sides of the business may require.

Finally, GMAC remains substantially tied to the domestic automotive industry. Ally Bank and GMAC's focus on this sector—and the continued close relationship between GMAC and GM—concentrates the risk to GMAC of any decline in the automotive industry. As discussed in our September and January Reports, the fate of the domestic automotive industry is not by any means clear.[506] GMAC's strategy of focusing on its core automotive business ties GMAC further into a sector that has been, at best, unstable. If the automotive industry does not thrive, GMAC may share its fate.[507] Further, GMAC's prior major effort at diversification beyond the automotive industry, ResCap, was anything but successful in addressing risk. Future attempts at diversification, if any, might be more successful but would represent another change in strategy. Overall, GMAC's dependence on the auto industry may continue to prove destabilizing.[508]

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[505] Transcript of COP Hearing on GMAC, *supra* note 12 (Testimony of Michael Ward).

[506] September Oversight Report, *supra* note 189, at 79; January Oversight Report, *supra* note 456.

[507] It is also difficult for GMAC to pass too much of its cost of capital through to the dealerships because it then risks hurting the franchises and with them its long-term prospects. Accordingly, GMAC is dependent on reducing its cost of capital. GMAC conversation with Panel staff (Feb. 16, 2010).

[508] One analyst went so far as to describe GM and GMAC as "two drunks holding each other up at a bar." Beyond colorful metaphors, the dependence between the entities could magnify the possibility of taxpayer loss. As a depository institution, Ally Bank's cost of capital is generally low. Its CD rates, as of March 9, 2010, were 1.58 percent for a 12 month CD, in contrast to GMAC's recent unsecured debt deal, which has an 8.3 percent coupon. Ally Bank's cheap deposit base aids GM, but Ally Bank is a source of cheap financing in part because it is the beneficiary of federal insurance. This is true not only of Ally Bank, of course, but also of any such depository institution: the difference is that other depository institutions are much less likely to concentrate their loans in one industry, and any financing arrangements are more likely to be or to be perceived as arm's length. Like GMAC and Ally Bank, JP Morgan's automotive financing is underpinned by the deposits at Chase. JP Morgan, however, does not have an historically close, quasi-captive relationship with an OEM. If the automotive industry suffers another decline such that Ally Bank's deposits are put at risk and the FDIC is required to aid Ally Bank, the taxpayers are, in essence, paying twice for the same impaired assets.

Over and above these potential obstacles to profitability, there is another, more fundamental question about GMAC's future. As a subsidiary, GMAC's interests could be appropriately subordinated to GM's need to sell cars, if necessary, but as a separate entity GMAC owes a duty to its own shareholders, not GM. As discussed above, GMAC's business model has developed as a hybrid: it is a captive/non-captive automotive finance company, a bank, and a holder of impaired mortgage assets. Its status as a separate entity from GM and as a BHC seems as much a matter of accident as strategy. Its fate, further, is substantially tied to GM's: as a continued and significant source of GM's wholesale and retail financing, its relationship with GM remains, at present, critical to its success. Even assuming that the issues presented by ResCap are neutralized, it would not be unreasonable for a potential equity investor to question whether GMAC's relationship with GM is designed to serve GM's rather than GMAC's shareholders' interests. Put another way, an investor could question what long-term value or viability GMAC offers as long as it is separate from GM. Although GM may need a source of financing for cars, it does not necessarily need to look to a separate bank for its financing. In that context, GMAC's non-captive status subjects it to greater risk from GM: the relationship could sour and GMAC could lose its preferred provider role; GM's sales practices could reduce the residual value of autos (a risk to which GMAC, as a finance company, may be subject); and/or GM could, in fact, form its own, new captive finance company.[509] In particular, the last point could form a source of significant instability in the relationship.

Some industry analysts believe that for GM itself to be competitive—and indeed, for GM to have a successful IPO—it must have its own captive, not a captive/non-captive hybrid like GMAC.[510] They say that a captive provides income and financial flexibility—a dividend stream, earnings, and consistent financing flow—and that GM will need these attributes of a captive in order to compete with other automotive companies such as Ford Motor Company.[511] Fundamentally, what these analyses emphasize is that the non-captive public financing company model is fundamentally untried, and if GM determines that it needs a captive, it could destabilize the relationship. All of these are risks attendant upon GMAC's status as a non-captive automotive finance company. An IPO requires a potential shareholder to believe either that GMAC's relationship with GM is sufficiently stable to sustain it as a separate company or that GMAC can expand adequately (through growth strategies for Ally Bank, Chrysler, other automotive companies, or otherwise) to handle the risk of a reduced relationship with GM. The public

[509] The IRA Advisory Service, *GMAC & GM: All of the Political Endgames Lead to Bankruptcy*, at 2–3 (Mar. 1, 2010). GM's need for a new captive finance company has been circulating in analysis for some time. *See, e.g.*, Automotive News, *Editorial* (Jan. 12, 2009) ("GM should be prepared to establish its own captive finance company once GM is healthy again."); Poornima Gupta, *Autonation Says GM Needs New Captive Financing* (Jan. 9, 2009) (online at uk.reuters.com/article/idUKN2147448520090121?pageNumber=1&virtualBrandChannel=0) (quoting AutoNation CEO, Mike Jackson: "It was a strategic mistake splitting the finance company from the operating company. . . Somehow, some way they need their own finance company again").

[510] Transcript of COP Hearing on GMAC, *supra* note 12 (Testimony of Michael Ward).

[511] Transcript of COP Hearing on GMAC, *supra* note 12 (Testimony of Michael Ward); Testimony of Christopher Whalen, *supra* note 345, at 3–4.

equity markets have never had an opportunity to evaluate this question, and their assessment remains unknown.

The centrality of the GM/GMAC relationship and the oddity of the non-captive finance company also raise the question whether it is sensible to consider merging GMAC back into GM. If GM needs a finance company, and the interests of the finance company and GM are most clearly aligned when they are part of the same corporate structure, the market might determine that the entities should, in fact, be merged. This would require a number of structural shifts: because of the ownership restrictions, among other things, GMAC could no longer be a BHC. The Chrysler dealership funding might not serve GM and might need to be spun off. The substantial investment in GMAC's infrastructure, however, and the natural synergies between the captive and the OEM may cause GM, GMAC, and Treasury (presuming it is still a majority shareholder in both) to contemplate this possibility. In a recent investor call, Mr. Carpenter addressed the possibility of a merger between the two companies.[512] Stating that there is no current discussion of that possibility, and without specifically weighing in on the wisdom of a merger, Mr. Carpenter and Mr. Hull observed that success for both entities depends on a very close partnership.

The discussion of a merger is purely hypothetical at this point, but the investment community is interested in the possibility. If there is an effort to fold the entities back into each other, Treasury must walk a difficult line. In a third-party sale of GMAC, the perception of political favoritism could be alleviated by the presence of the outside actor. If Treasury sells GMAC to itself, even if the merger were instigated by the management of either GM or GMAC based purely on market factors, Treasury's substantial involvement in both companies could greatly complicate any merger, particularly in assigning value to either company. Treasury has already come under criticism from a number of sources for perceived favoritism toward one or another party in both the auto and the GMAC bailouts.[513] Any merger between these parties while Treasury is still the majority shareholder of both would likely be subject to similar criticism—that a party with political connections is receiving value at the expense of the taxpayer. To alleviate these concerns, no merger should be effected without a third-party fairness opinion, and the taxpayers' claims upon both businesses must survive the merger. Treasury should under no circumstances be permitted to forgive or negate any claim of the taxpayers for repayment of the TARP as a part of the merger. Ultimately, any potential merger would have to be evaluated not only for synergies between the businesses but also, and equally importantly, for adequate return to and protection for the taxpayer, whose substantial investments have kept both companies afloat.

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[512] GMAC Q4 2009 Earnings Conference Call, *supra* note 111, at 15.

[513] For examples of such commentary, see, e.g., George F. Will, *End Run on the Treasury* (Jan. 8, 2009) (online at www.washingtonpost.com/wp-dyn/content/article/2009/01/07/AR2009010702646.html); Richard A. Epstein, *The Deadly Sins of the Chrysler Bankruptcy*, Wall Street Journal (May 11, 2009) (online at www.forbes.com/2009/05/11/chrysler-bankruptcy-mortgage-opinions-columnists-epstein.html); September Oversight Report, *supra* note 189, at 102 (citing criticisms). *See also* Gallup, *Unions Second to Auto Execs in Bailout Blame Game* (Dec. 16, 2008) (online at www.gallup.com/poll/113431/unions-second-auto-execs-bailout-blame-game.aspx).

Last, the question remains whether GMAC could itself go into the bankruptcy process as a means of restructuring and recapitalizing. There are no present plans for a GMAC bankruptcy, and both Treasury and GMAC maintain that GMAC's current actions—recapitalization of Ally Bank and charges against assets at ResCap plus a new strategic focus on the automotive sector—are the appropriate means of returning GMAC to stability. Treasury stated that GMAC is currently solvent and cites GMAC's recent debt offering spreads as an event suggesting that the market believes that the company is on the right track.[514] As discussed above, however, GMAC still has a substantial and looming debt burden, the ResCap "millstone,"[515] a high cost of funds, dependence on an internet bank, and a reliance on a still uncertain automotive industry. Failure to address these issues, either singly or in tandem, could put GMAC back on a path to crisis. In the absence of a general credit crunch, some of the concerns about stability and continuity in the automotive industry that Treasury says animated its initial investment would likely be less important. According to various analysts, unlike in 2008–2009, other banks would be more likely to absorb the majority of GMAC's floorplan lending if GMAC were to become insolvent.[516] Treasury's equity position, however, while more valuable as capital to GMAC, places Treasury and the taxpayers at the bottom of the bankruptcy heap. This puts Treasury in an unfortunate position: GMAC is still unstable, with an uncertain path to profitability, and if it were to become insolvent, other entities would be more likely to absorb its legacy business—all at the cost of the taxpayers' investment. Treasury's initial involvement has narrowed its options, making it difficult for Treasury to disentangle itself from a weak institution without risking the loss of its entire investment.

3. The Forthcoming Business Plan

According to Treasury, GMAC is still constructing budgets and a strategy plan, which Treasury and a third-party investment bank will evaluate. GMAC's specific plan to become profitable again is therefore still under construction. Treasury expects the budgets and the strategy plan to be evaluated by GMAC's Board within the next few months. While GMAC has explained the broad strokes of its strategy—a deposit-funded institution with a focus on multibrand automotive financing—the specific details and numbers have yet to be constructed. Until the Board approves the various plans, therefore, GMAC's precise route to profitability cannot be concretely evaluated.

This is, by itself, problematic. Treasury's previous and current support is not underpinned by a mature business plan. Although GMAC and Treasury are working to produce a business plan, Treasury has already been supporting GMAC for over a year de-

[514] Treasury conversations with Panel staff (Feb. 18, 2010). As earlier noted, of course, GMAC's current spreads could be as representative of a company that enjoys an implicit guarantee from Treasury as they are representative of a company that is on the right track. In the hearing before the Panel, Mr. Carpenter also stated that GMAC is solvent. Transcript of COP Hearing on GMAC, *supra* note 12 (Testimony of Michael Carpenter).

[515] Investor Call to Discuss Capital and Strategic Actions, *supra* note 457, at 8; GMAC conversations with Panel staff (Feb. 16, 2010).

[516] Analyst conversations with Panel staff (Feb. 17, 2010).

spite the plan's absence. Given industry skepticism about GMAC's path to profitability and the newness of the non-captive financing company model, it is critical that Treasury be given an opportunity to review concrete plans from GMAC as soon as possible.

4. Treasury's Approach to Managing its Shareholder Interests

At present, Treasury, as holder of 56.3 percent of the voting equity, has the right to name four directors to GMAC's nine-person board.[517] After Treasury's majority share, ownership of GMAC's equity is relatively dispersed: Cerberus holds the next largest share of the equity, with 14.9 percent, followed by third-party investors, who collectively hold 12.2 percent, the GM Trust, which holds 9.9 percent, and GM itself, which holds 6.7 percent.[518] Although the third-party investors received their share in distributions from Cerberus, they are not Cerberus affiliates and will not necessarily act in concert with Cerberus. GM, for its part, operates according to a passivity agreement and only has observer status on the GMAC board. The trustee of the GM Trust has sole discretion to vote and dispose of the GM ownership interests held in the trust and must dispose of those interests within three years of the approval of the BHC application.[519] Accordingly, other than Treasury, there is no shareholder whom an outsider would clearly expect to help set a direction for GMAC. The Panel's January Report discussed the difficulties that can arise from a passive majority shareholder, and given Treasury's majority share, these are as applicable to GMAC as they are to GM.[520] Although GMAC's Treasury-appointed board members are reported to be very involved and active, it is not clear whether this is sufficient to give GMAC adequate direction.

It is unfortunate that Treasury has provided very little public information about any specific strategy for GMAC because its approach to GMAC is not identical to its approach to the automotive companies, despite Treasury's assertion that these two investments

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[517] GMAC, LLC, *GMAC Financial Services Announces Key Capital and Liquidity Actions* (May 21, 2009) (online at gmacfs.mediaroom.com/index.php?s=43&item=331%20).

[518] As part of the conditions to the approval of the BHC application, none of these third-party investors own, hold, or control more than 5 percent of the voting shares or 7.5 percent of the total equity of GMAC. The Federal Reserve describes them as sophisticated investors who are independent of Cerberus and each other. *See* Order Approving GMAC's BHC Formation, *supra* note 58. As private equity investors, none of these parties are required to disclose their identities publicly under applicable law, and Cerberus generally avoids the spotlight whenever possible. *See* Letter to Investors, *supra* note 153, at 6.

[519] GM's Passivity Agreement serves to alleviate, to a certain degree, concerns that a power vacuum among GMAC shareholders will result in GM's exerting undue influence on the board. In addition, the trustee of the GM Trust must be independent of GM and have sole discretion to vote and dispose of the ownership interests in the trust. The Passivity Agreement, however, while it may limit GM's influence on GMAC's board, does not change the essential commercial relationship between the two companies. Given GM's critical role for GMAC, GM can presumably exercise enormous influence on GMAC's direction and strategy. The governance solution does not address the commercial dominance. Further, GM has been directed to sell the holdings in the GM Trust over the course of the three years following the BHC application approval. *See* March 24 Letter to B. Robbins Kiessling, Esq., *supra* note 65. Once GM holds below 10 percent of the voting interests of GMAC, it would no longer be deemed to be an affiliate, after which time Ally Bank could increase its levels of funding to GM, thereby increasing GM's commercial dominance over GMAC. *See* GMAC Form 10–K for 2009, *supra* note 12. Accordingly, even if GM does not have a voice on the board, it clearly has enormous influence over GMAC.

[520] Treasury's position is that the government distorts the market when it takes an activist shareholder role; in response, the Panel has noted that Treasury may not be able to protect the taxpayers' investments or effect cultural changes if it is passive. At the same time, however, it is not clear that the government has any aptitude at being an activist shareholder, which further complicates the question. *See* January Oversight Report, *supra* note 456.

are intertwined. Treasury has stated generally, and repeatedly, that it has no intention of becoming actively involved in management.[521] These very general statements, however, while providing an overview of Treasury's approach, have yet to be discussed in the context of GMAC. In December 2009, in an otherwise reasonably comprehensive discussion of Treasury's approach to the government as shareholder, Assistant Secretary Allison did not discuss or, indeed, even mention GMAC.[522] Given that Treasury owned approximately 35 percent of the common equity of GMAC at the time, considerably more than its common equity investments in Chrysler, this omission is somewhat puzzling.[523] It is, however, typical. Treasury has devoted very little of its generalized discussions to GMAC, even though the concerns that animate Treasury's involvement with the automotive companies would also seem to affect GMAC. The paucity of public pronouncements or discussions of GMAC makes it very difficult for the public to assess Treasury's approach to the investment. Treasury's current position has not been provided to the public clearly.[524]

In its recent hearing, Mr. Millstein explained: "We are taking our oversight responsibilities seriously, we have frequent contact with the management to evaluate the strategies they are employing and the results of their operations, but again, I don't think we're in a position to dictate policy for them."[525] By contrast, Assistant Secretary Allison's response to a similar question about Treasury's involvement with Citigroup management appears to downplay its en-

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[521] As discussed in the Panel's January report, Treasury is in most cases firmly committed to its limited role. In its January report, the Panel also described Treasury's belief that the government, as shareholder, distorts the market in such a way that the entities in which it holds investments—and accordingly the taxpayers—will ultimately reap greater benefit from a passive government shareholder. The Panel expressed concern that a "hands off" approach, however, may not provide the influence necessary to achieve the cultural changes most likely to lead to sustained viability for Chrysler and GM, and the same concerns can easily apply to GMAC. In its January report, however, the Panel also voiced the contrary concern: that even if a passive major shareholder might hinder a company, Treasury is at best ill-suited to perform the role of activist shareholder. *See* January Oversight Report, *supra* note 456, at 94–96. In testimony before the House Oversight and Government Reform Committee, Secretary Allison also discussed the major principles guiding Treasury's role as a shareholder with regard to corporate governance issues. These principles were: (1) as a reluctant shareholder, Treasury intends to exit its positions as soon as practicable; (2) Treasury does not intend to be involved in the day-to-day management of any company; (3) Treasury reserves the right to set conditions on the receipt of public funds to ensure that "assistance is deployed in a manner that promotes economic growth and financial stability and protects taxpayer value"; and (4) Treasury will exercise its rights as a shareholder in a commercial manner, voting only on core shareholder matters. *See* House Oversight and Government Reform Committee, Subcommittee on Domestic Policy, Transcript Testimony of Assistant Secretary of the Treasury for Financial Stability Herbert M. Allison, Jr., *The Government As Dominant Shareholder: How Should the Taxpayers' Ownership Rights Be Exercised?*, 111th Cong. (Dec. 17, 2009) (online at oversight.house.gov/index.php?option=com_content&task=view&id=4722&Itemid=31); House Oversight and Government Reform Committee, Subcommittee on Domestic Policy, Written Testimony of Herbert M. Allison, Jr., assistant secretary of the Treasury for financial stability, *The Government As Dominant Shareholder: How Should the Taxpayers' Ownership Rights Be Exercised?*, 111th Cong. (Dec. 17, 2009) (online at oversight.house.gov/images/stories/Allison_Testimony_for_Dec-17-09_FINAL_2.pdf) (hereinafter "Dec. 17, 2009 Written Testimony of Herb Allison"). Treasury's approach to GMAC is, as described above, neither consistently activist nor hands-off. They do not interfere with the day-to-day operations of GMAC but neither do they stand completely aside from the material decisions and directions that GMAC may contemplate.

[522] Dec. 17, 2009 Written Testimony of Herb Allison, *supra* note 521.

[523] The subsequent cash infusion increased Treasury's share in GMAC to over 50 percent.

[524] At the Congressional Oversight Panel hearing, Treasury laid out its GMAC strategy in greater detail than it had previously. Transcript of COP Hearing on GMAC, *supra* note 12 (Testimony of Jim Millstein).

[525] Transcript of COP Hearing on GMAC, *supra* note 12 (Testimony of Jim Millstein).

gagement with Citigroup. In that instance, Assistant Secretary Allison responded:

> We have contacts with Citi, as we do with many other banks. We are taking a very limited role as an investor. We are not getting involved in the day-to-day management of Citigroup. Instead, we will only be active as a shareholder in voting for directors and voting on major corporate events and voting on issuance of significant new shareholdings and major asset sales, and changes in bylaws or charter. Other than that, we intend to act as any public shareholder.[526]

The difference between the two statements (even taking Citigroup's status as a public company into account) would imply greater involvement between Treasury and GMAC management than between Treasury and Citigroup. GMAC similarly states that while Treasury does not manage the business, the Treasury team has frequent and substantive meetings and discussions with GMAC's management and provides advice and guidance on a regular basis.[527]

The effects of this advisory strategy on good corporate governance, however, are mixed. GMAC has the advantage of advisors at Treasury who can help them navigate the public perception of proposed actions and private-party advisors to evaluate their business plan. But, Treasury's engagement with GMAC is not as apparent to outsiders as a Board decision would be. By deciding to offer its advice at a management rather than Board level, Treasury is depriving the market of an opportunity to evaluate its advice. Clearly, Treasury and GMAC must be able to discuss business strategy in a non-public forum; the extent of Treasury's involvement, however, is still not transparent, and the lack of transparency opens the process, and Treasury, to accusations of favoritism or other kinds of misfeasance and raises the possibility of further public suspicion and mistrust, particularly if GMAC continues to struggle. If Treasury judges it to be in the best interests of the taxpayer for it to maintain this advisory role, general and public information about the types and channels of communication would be appropriate.

In the past, the Panel has discussed whether Treasury's equity holdings would be better held in a trust, and Treasury has provided a variety of answers and explanations as to the usefulness or appropriateness of a trust.[528] Treasury has often expressed concern that its active involvement as a shareholder could reduce shareholder value: its actions might be perceived as political, rather than commercial, which would make other potential investors wary. The combination of the passive shareholder and the active board, however, means that perception of Treasury's passivity depends greatly on the perceived independence of the Treasury-appointed directors.[529] Placing the GMAC shares in a trust could help

[526] Transcript of COP Hearing on GMAC, *supra* note 12 (Testimony of Herbert Allison).
[527] GMAC conversations with Panel staff (Feb. 1, 2010).
[528] *See* January Oversight Report, *supra* note 456, at 96.
[529] After Sarbanes-Oxley (SOX), the independence of directors is determined with reference to a variety of sources, including SOX and various exchange listing standards. Factors include,

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avoid the perception that the board members are not genuinely independent. The Panel believes, consistent with past reports, that Treasury should evaluate whether the GMAC shares should be held in a trust. Consistent with the Panel's cautions in past reports, however, establishing a trust does not come without its own set of concerns. Establishing a trust to hold the shares might slow Treasury's exit, prolong its involvement in the market, and make future interventions more palatable, any or all of which could set an inappropriate precedent. Nor does a trust automatically ensure the independence of the trustee. Any trust should include curbs on hiring and firing, methods of addressing conflicts of interest (including fee income), and other obligations for the trustee (such as "noisy withdrawal" if the trustee resigns) to ensure that the shares in a trust are, in fact, isolated from the political process.

5. Evaluating the Investment: Current and Required Value

Treasury's recent financial statements do not break out the value of its GMAC stake. The value of its AIFP investment, overall, is estimated at $42.3 billion as of September 30, 2009, on an outstanding balance of $73.8 billion.[530] The GMAC portion of this stake comprises $11.4 billion in MCP, $2.67 billion in TruPs, and 56.3 percent of the common equity.[531] These numbers represent the outstanding balance, however, and not the present value, for which there are no separate numbers. Based in part on this calculation, and according to Treasury, the total common equity of GMAC needs to be worth approximately $6.9 billion for the taxpayer to be made whole. According to GMAC, its total equity at December 31, 2009, was $20.8 billion, down from $24.9 billion at September 30, 2009.[532] Book value, however, differs from market value, and as GMAC is not publicly traded, there is no way to establish the market value for GMAC's equity. Analysis of whether and when the value of GMAC's common equity will be sufficient to repay the taxpayer, however, awaits evaluation of the forthcoming budgets and strategy plan.

In Section 123 of EESA, Congress required that both the OMB and the Congressional Budget Office (CBO) calculate the budget costs of the TARP transactions under the procedures of the Federal Credit Reform Act of 1990, while using discount rates reflecting market risk rather than simply the government's cost of funds.[533] These subsidy rates, which represent an estimate of the investment

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generally speaking, compensation or employment by the issuer or auditor of the issuer; material relationships with vendors or customers or associated charities; and family relationships with any of the foregoing that could compromise independence. *See generally* Bruce F. Dravis, *The Role of Independent Directors after Sarbanes-Oxley* (2007). The directors whom Treasury has named to the GMAC board are Robert Blakely and Kim Fennebresque, neither of whom appear to have material relationships with Treasury, although Mr. Blakely was the former executive vice president and chief financial officer of Fannie Mae. *See* GMAC, Inc., *Governance* (online at media.gmacfs.com/index.php?s=52) (accessed Mar. 8, 2010). These same sorts of metrics would need to be considered for any trustee appointed to manage a trust with Treasury's shares.

[530] OFS Financial Report: Fiscal Year 2009, *supra* note 463, at 17.

[531] As of January 31, 2010, GMAC had made $854.8 million in dividend payments associated with the funds it received under the AIFP. U.S. Department of the Treasury, *Cumulative Dividends and Interest Report as of January 31, 2010* (Feb. 19, 2010) (online at www.financialstability.gov/docs/dividends-interest-reports/January%202010_Dividends%20and%20Interest%20Report.pdf) (hereinafter "OFS Cumulative Dividends Report as of January 31, 2010").

[532] GMAC Reports Preliminary Q4 and Full-Year 2009 Results, *supra* note 127.

[533] EESA § 123(a).

that will not be recouped by the federal government, incorporate assumptions concerning the timing of cash flows (mainly principal and interest or dividend payments) as well as defaults on, or (partial) losses of, the amounts invested.

The OMB and CBO valuations of the taxpayer subsidy rate in the automotive industry have produced varying results, owing primarily to the availability of disaggregated data to reflect GMAC specific investments. As noted, the government has expended $17.2 billion in government assistance to GMAC through year-end 2009, of which $16.3 billion was equity or equity-related funding.[534] OMB has calculated a subsidy rate of 39 percent for the government's equity assistance to GMAC, reflecting an estimated subsidy cost, or loss to the government, of $6.3 billion on the $16.3 billion in government equity purchases from GMAC.[535] The CBO currently does not disaggregate subsidy estimates by specific institutions, publishing instead an overall subsidy rate for all TARP automotive industry support programs.[536] The CBO cites an estimated cost of $47 billion on the $79 billion in aggregate assistance—a 59 percent subsidy rate—to GMAC, GM, Chrysler, Chrysler Financial, and various auto suppliers as of mid-December 2009 (note that CBO figures exclude $3.8 billion in additional assistance to GMAC on December 30, 2009). Accordingly, it is impossible to infer from this estimate if the implied GMAC subsidy is greater or less than the overall 59 percent rate calculated by the CBO for all the automotive firms receiving TARP funding.

It is important to note that these subsidy rate estimates are inherently uncertain, particularly given the limitations of fundamental analysis once a company receives government support. The CBO and OMB estimates rely on objective data points that reflect market prices assigned to key securities instruments (bond yields, discount rates, etc.)—the prices of which are often impacted by government support for a particular company or sector. This is certainly the case after the government steps in, as market rates—particularly on debt instruments—are skewed to reflect this presumed halo and its beneficial impact on creditors (as illustrated above in the comparison of GMAC vs. FMCC). Note that Standard & Poor's and other rating agencies have cited this implicit guarantee in justifying higher credit ratings than a company would otherwise merit absent government involvement or—in the case of systemically important financial institutions—the prospect of government support should the company run into trouble in a crisis.

All else equal—as incremental Treasury support was required to offset the worsening outlook for the ResCap portfolio—Treasury's series of investments in GMAC served to progressively increase the value of the company. After taking an initial equity stake, Treasury was put into a position where its interests as an equity holder might have increased its reluctance to put GMAC into bankruptcy.

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[534] The balance of this assistance was a loan made to GM in conjunction with GMAC's rights offering following its conversion into a BHC, which was later converted by Treasury into $884 million in GMAC equity. Treasury Transactions Report, *supra* note 264.

[535] *See* Office of Management & Budget, *Analytical Perspectives: Budget of the U.S. Government, Fiscal Year 2011,* at 40 (online at www.whitehouse.gov/omb/budget/fy2011/assets/spec.pdf) (hereinafter "OMB Analytical Perspectives: FY2011 Budget").

[536] *See* Congressional Budget Office, *The Budget and Economic Outlook: Fiscal Years 2010 to 2020,* at 13 (Jan. 2010) (online at www.cbo.gov/ftpdocs/108xx/doc10871/01-26-Outlook.pdf).

I. Conclusion and Recommendations

Treasury has asserted, and a broad range of industry experts consulted by the Panel have agreed, that support to GMAC was necessary in order to support the automotive industry and protect the investment made by Treasury in GM and Chrysler.[537] The Panel takes no view on whether GM and Chrysler should have been rescued in the first place and similarly takes no view as to the rescue of GMAC. It is clear, however, that credit is a crucial element of the automotive industry, that GMAC played a dominant role in providing that credit, especially for GM vehicles and especially for dealers' floorplan financing, and that alternative sources of credit were increasingly unavailable as the financial crisis deepened. Whether GMAC's role was truly indispensable to the survival of GM and Chrysler, or whether other lenders in the industry could eventually have stepped in (or been encouraged to step in, with short-term government guarantees or other incentives) to fill the breach if GMAC had not been supported, is ultimately unknowable.

Treasury also asserts that once the government had announced in public statements that it would provide capital to the stress tested banks that were unable to raise it privately, it had to carry through on those statements. There is ample precedent in the history of the TARP for changes in strategy—such as the switch in primary TARP strategy from asset purchase to capital injection—and changes in execution—such as the switch from use of CAP funds for GMAC to AIFP funds. There is, however, no precedent in the TARP for the government of the United States specifically stating that it would make funds available to identified recipients on an unconditional basis and then not carrying through with that funding. Treasury's position is that to have done so would not only have adversely affected GMAC itself and the parties doing business with it who relied on the government's statement, but might have had a broader and negative effect both on other institutions dependent upon government support and on the financial markets. It may be possible to criticize the design of the stress tests and the inclusion of GMAC in those tests (and given GMAC's unique status and relationship to the automobile companies that were at the time entering the bankruptcy process, the Panel believes there are serious questions raised by such inclusion), but the fact is that once GMAC was included in those stress tests, Treasury believed that it was necessary for GMAC to receive funds in the amount of the capital buffer established by the supervisors. The result, however, is that it might appear that good money was being thrown after bad.

The establishment of that capital buffer throws some interesting light on the conduct of the stress tests. From the point of view of reducing the amount of money to be invested by the taxpayer in a company with an uncertain future, it is all to the good that the Federal Reserve reduced the required capital buffer. The fact that there was an element of conditionality to its calculation, however, was never made clear when the stress tests were held. The Federal Reserve did publish the first quarter adjustments that were taken into account in calculating the buffer, some of which related to

[537] September Oversight Report, *supra* note 189, at 3.

transactions not yet consummated, but never explicitly spelled out whether and how further adjustments would be made for those BHCs that had still not raised capital by November 2009.

GMAC was included in the stress tests as a result of its becoming a BHC in December 2008. The Federal Reserve has very broad discretion in deciding whether to approve BHC applications, and there is no indication that this discretion was abused in this instance, although clearly the non-unanimous decision was made in light of, and may have been influenced by, the exigent circumstances existing at the time. The decision was, however, crucial to GMAC's subsequent inclusion in the stress tests and the Treasury funding commitments that resulted and to GMAC's access to government assistance under programs such as the TGLP. Possibly even more important was the signal to the markets that BHC approval constituted, in light of uncertainty in the markets, that GMAC would be able to restructure its capital to meet the Federal Reserve's regulatory capital requirements. The supervisors' decision proved decisive in several ways to GMAC's fate, underscoring the extent to which some aspects of the resolution of the financial crisis have been dependent upon the trust placed in the supervisors.

In some ways, GMAC seems to have been treated more favorably than other companies in comparable circumstances. For example, GM and Chrysler were forced into bankruptcy, their shareholders wiped out, and many of their debt holders forced to take losses. They emerged from bankruptcy, however, with cleaner balance sheets and limited liabilities. GMAC was not required to liquidate, and its shareholders continue to hold a small equity interest. The Panel repeatedly requested assurances from witnesses that no third-party shareholder would receive a return unless the taxpayers were made whole, but the fact remains that the only way to ensure that result would have been through a bankruptcy. Although Treasury and GMAC have detailed the factors that may have complicated the use of bankruptcy, the fact remains that by avoiding restructuring, GMAC continues to bear the "millstone" of ResCap. The Panel remains unconvinced that in 2008 or very early 2009 bankruptcy or a similar restructuring, including a sale of the automotive financing business, was not a real possibility; nor has the Panel been convinced that even now a GMAC or ResCap bankruptcy or sale of the automotive financing is impossible. In either case, these actions require analysis of the facts and circumstances, a cost-benefit analysis comparing recovery before and after bankruptcy or sale, and an analysis of any additional TARP contributions that may be required. The extent to which bankruptcy was seriously considered at the time is unclear. What is clear is that policymakers now believe that the decisions made in December 2008 constrained the options in 2009. By decreasing the viability of a GMAC bankruptcy, these constraints may have resulted in a less-viable company, greater risk to public dollars, and troubling moral hazard concerns. Even if the automotive industry needed a financing source, and even if GMAC was the most likely candidate, it does not necessarily follow that Treasury's particular treatment of the GMAC stakeholders was the most advantageous or even the

most cost-effective means of addressing the need for automotive finance.

By reason of Treasury's using AIFP as opposed to CAP funds, GMAC is not subject to the same level of requirements as to disclosure of the use of funds. For the same reason, Treasury is not required to hold the GMAC shares in trust. In other ways, GMAC is less well treated than other TARP recipients: the terms of the MCP provide conversion rights that are more to Treasury's advantage than other TARP securities, for example. A couple of major shifts in approach, such as the change from CAP to AIFP, were made in the course of dealing with GMAC, which may be due to the change in administrations between the first intervention and the final funding. Since Treasury's efforts to explain what it was doing with GMAC and why have been unsuccessful, some of Treasury's actions give the impression of a somewhat ad hoc approach.

Other aspects of the support of GMAC raise additional questions. As discussed in more detail in Section E, support to GMAC may amount to support to GM and Chrysler and triggers questions of compliance with trade and competition laws in many jurisdictions. The Panel takes no position on this issue. Questions are also raised by the amount and nature of the compensation of GMAC's executives, issues which the Panel will pursue further.

At the date of this report, it is unclear whether the U.S. taxpayer will recoup the investments made in GMAC. The total amount at stake in GMAC itself is $17.2 billion. There is still no viable business plan. As GMAC's business plan is still a work in progress, the immediate future of the company, and therefore the investment, remains opaque, and as discussed above, the OMB currently estimates a loss of at least $6.3 billion of that amount. Mr. Bloom asserts that "I don't think as a practical matter, the [old shareholders] are getting anything out of this thing if the government doesn't get its money back." GMAC's CEO also testified that GMAC is unlikely to require additional capital from the Treasury. Even if these assertions prove to be true, since the businesses and future prosperity of GM and Chrysler are so closely interconnected with that of GMAC, it makes sense to view the three companies as a package of support totaling $78.2 billion. The support provided to GMAC amounted to further assistance to GM and Chrysler, and the success of the support to GMAC can only be evaluated as part of the AIFP. Until all three companies repay the taxpayer, the government cannot really be said to have exited its investment in GMAC.

It is not just GMAC's own future that is uncertain. The intervention of the U.S. government into the automotive industry and its sources of financing has increased the near-monopoly position held by GMAC with respect to floorplan financing, and Treasury has not indicated how it plans to promote competition in this industry.

GMAC joins the small group of companies with large government stakes and is subject to the corporate governance guidelines announced by Treasury that govern its relations with those groups. Treasury appears to be largely consistent with its other holdings in its "hands-off" approach to management, but as the Panel has noted before, this results in a potential governance vacuum, with smaller shareholders having disproportionate power. The impact of

this approach is particularly noticeable in this case, where GMAC may play a significant part in GM's hoped-for recovery and where GM still owns substantial portions of GMAC, albeit in part through a trust. With both GM and GMAC majority-owned by Treasury and subject to its hands-off policy, the potential for a governance vacuum is amplified. This means that the parties who wish to operate GMAC in GM's interests become proportionately more powerful, inasmuch as GM has extraordinary commercial influence over GMAC, and there may not be countervailing pressure from involved shareholders. The Panel has previously suggested that Treasury consider placing certain of its holdings in a trust that would be more hands-on. Questions are also raised by the amount and nature of the compensation of GMAC's executives, issues which the Panel will pursue further.

The Panel makes the following recommendations:

• The experience with GMAC reinforces the imperative that any future TARP support that might be given to any entity be subject to more stringent criteria and due diligence to establish that it will become a profitable concern, capable of recouping the taxpayers' investment.

• In the hearing held by the Panel, Mr. Bloom agreed that GMAC will most likely not require any additional taxpayer funding. The Panel expects Treasury to remain consistent on this point. Treasury must make it clear to markets and counterparties that GMAC is exposed to market forces and that government support will eventually end.

• Treasury should insist that GMAC produce a viable business plan showing a path toward profitability and a resolution of the problems caused by ResCap.

• Treasury should formulate, and clearly articulate, a near-term exit strategy with respect to GMAC and articulate how that exit will or should be coordinated with exit from Treasury's holdings in GM and Chrysler.

• Any future use of TARP funds for any entity must be made subject to more stringent "use of funds" disclosure requirements. Treasury should work through the directors it has appointed to impose these requirements on GMAC now.

• To preserve market discipline and protect taxpayer interests, Treasury should go to greater lengths to explain its approach to the treatment of legacy shareholders, in conjunction with both initial and ongoing government assistance.

• Treasury should consider whether it is in the taxpayers' interest to consider promoting a merger with GM, as opposed to letting the companies decide whether to do so. This does not fall within day-to-day management and promoting this or similar alternatives would be consistent with what a private investor would do. The Panel would expect any such action to be premised on rigorous analysis and valuation by outside experts. Treasury should not forgive any taxpayer claim to repayment of TARP funds, commit or guarantee additional taxpayer funds, or assume any liabilities in the process.

• Treasury should periodically disclose its estimate of the overall subsidy or loss rate, as well as the subsidy amount, for each com-

pany receiving assistance from the AIFP so long as these companies have separate legal status.

Viewed from the vantage point of March 2010, or even December 2009, the decision to rescue GMAC is one of the more baffling decisions made under the TARP. A company that apparently posed no systemic risk to the financial system, that did not seem to be too big to fail, too interconnected to fail, or indeed, of any systemic significance, was assisted to the extent of a total of $17.2 billion of taxpayers' money and became one of the five largest wards of state. The decision to save GMAC was not, however, a December 2009 decision. It was made in the turbulent early months of 2009 as an intrinsic part both of the rescue of GM and Chrysler and of the stress tests, and can only be understood in that context. Within that context, Treasury's objectives become clearer, and within that context, it is also clear that there are lessons to be learned.

SECTION TWO: ADDITIONAL VIEWS

A. J. Mark McWatters and Paul S. Atkins

We concur with the issuance of the March report and offer the additional observations noted below. We appreciate the spirit with which the Panel and the staff approached this complex issue and incorporated suggestions offered during the drafting process.

As of today, the American taxpayers have involuntarily invested approximately $17.2 billion in GMAC.[538] Since the CBO has assigned a 59 percent subsidy rate to the various auto-related bailouts—including GMAC—as of mid-December 2009,[539] it is not unreasonable to assume that the taxpayers will lose approximately $10 billion[540] of the $17.2 billion of TARP funds allocated to GMAC.[541]

In making its assessment of whether to subsidize GMAC with taxpayer-funded TARP resources, Treasury was charged with carrying the burden regarding the three fundamental issues analyzed immediately below. We question why Treasury has allocated any TARP funds to GMAC because Treasury has not demonstrated in a satisfactory manner its case with respect to any of these issues.

First, prior to committing taxpayer resources to GMAC, Treasury should have demonstrated that no other group of new or existing financial institutions could reasonably fill the void upon the liquidation of GMAC. Treasury and GMAC have attempted to justify GMAC's systemic importance based upon the "special relationships" that exist between GMAC and its dealer network and the "unique IT system" employed by GMAC to monitor its extensions of credit. Many successful business enterprises rely upon these sorts of factors. It is unclear why GMAC merits more than $17 billion of taxpayer funds based upon its "special relationships" or "unique IT systems." It appears problematic to argue that GMAC—and GMAC alone—is capable of financing a floor plan for a Chrysler or GM dealer.

It is not unreasonable to anticipate that other financial institutions and private equity firms would welcome the opportunity to extend credit to the retail customers and dealers of Chrysler and

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[538] The taxpayers have been forced to bail out GMAC on three separate occasions over the past fifteen months. In December 2008, Treasury allocated $5.0 billion of TARP funds to GMAC. Unfortunately, in May 2009, Treasury committed the taxpayers to pay another $7.5 billion of TARP proceeds. In December 2009, Treasury committed the taxpayers yet again to pay another $3.8 billion of TARP funds to GMAC. Additionally, a loan in the amount of $884 million to GM was converted into GMAC shares in May 2009.

[539] *See* Congressional Budget Office, *The Budget and Economic Outlook: Fiscal Years 2010 to 2020,* at 13 (Jan. 2010) (online at www.cbo.gov/ftpdocs/108xx/doc10871/01-26-Outlook.pdf).

[540] This figure is derived by using the $17.2 billion aggregate TARP allocation to GMAC and multiplying it by the CBO subsidy rate of 59 percent for the auto related bailouts. Since the CBO subsidy rate applies to all of the auto industry bailouts, including the automakers Chrysler and GM as well as GMAC, the actual subsidy rate for GMAC may rise above or fall below 59 percent. The OMB has assigned a subsidy rate of 39 percent to the government's equity investment ($16.3 billion) in GMAC. OMB Analytical Perspectives: FY2011 Budget, *supra* note 535, at 40.

[541] As a comparison, for fiscal year 2011 the National Institutes of Health (NIH) have requested $765 million for breast cancer research. *See* U.S. Department of Health and Human Services, National Institutes of Health, *Estimates of Funding for Various Research, Condition and Disease Categories (RCDC)* (Feb. 1, 2010) (online at report.nih.gov/rcdc/categories/). The latest Nimitz-class aircraft carrier, the USS *George H. W. Bush*, cost approximately $4.5 billion. *See* U.S. Navy, Official Website of USS *George H.W. Bush* (CVN 77), *Information about the Ship* (online at up-www01.ffc.navy.mil/cvn77/static/aboutus/aboutship.html) (accessed Mar. 10, 2010). Thus the question, is the loss of $10 billion from the GMAC bailout worth 13 years of breast cancer research, or two Nimitz-class aircraft carriers with $1 billion left over?

GM and to securitize the instruments received in such transactions.[542] During the dark days of late 2008 and early 2009, Treasury could have encouraged other market participants to enter GMAC's auto finance business by providing short-term guarantees of their financings as well as other credit support. The government could also have encouraged one or more of these market participants to purchase GMAC's auto finance business and retain the services of its employees. The government may have needed to provide short-term financing to fund the acquisition, but it seems reasonable to conclude that the cost of such financing to the taxpayers would have equaled much less than the $17 billion ultimately advanced to GMAC under TARP. Since GMAC's auto finance business is profitable, the taxpayers would have been subject to far less risk than they currently carry under the bailout as actually implemented.

Even if GMAC—and GMAC alone—possessed the expertise necessary to conduct an auto finance business, why does the United States government continue to sanction and subsidize such concentration instead of encouraging healthy competition from other private sector financial institutions and firms seeking to enter the market?[543] Although the bailout of GMAC was in part premised upon the overwhelming market dominance of GMAC's floorplan business, it does not appear that Treasury has taken any action to break up this concentration and foster competition from other market participants with established expertise in the floorplan business. Instead, Treasury has perpetuated GMAC's floorplan market share by providing the company with access to unlimited TARP funds in the name of not reneging on an informal Treasury commitment. By funneling the floorplan business of Chrysler and GM through the narrow—yet virtually exclusive—financing conduit of GMAC, Treasury has left Chrysler and GM susceptible to any future mismanagement of GMAC and raised the possibility that the taxpayers will yet again be called upon to rescue GMAC.

Of course, both Chrysler and GM might ultimately benefit from controlling its own well-managed financing subsidiary, as other vehicle manufacturers do. While such subsidiaries often control a substantial share of their parent's financing needs, they infrequently venture into other high-risk and non-complementary business operations that they are incapable of properly managing—such as ResCap or, perhaps, Ally Bank—the failure of which could undermine the viability of their vehicle financing operations, as ResCap did for GMAC. For these reasons, it is possible that Chrysler and GM may undertake to form a limited liability special purpose entity to acquire the auto finance business of GMAC (without, most likely, any of the operations of the failed ResCap). It is also possible that Chrysler and GM may seek to form their own inde-

[542] This analysis is based upon the assumption that GMAC's business model is not premised upon charging retail customers above-market rates of interest so as to subsidize the below-market rates it charges the dealers.

[543] By contrast, in early February the Administration announced that it plans to end the Ares I program and outsource low earth orbit rocket launches to a group of private sector aerospace companies. *See* Kenneth Chang, *Obama Calls for End of NASA's Moon Program,* New York Times (Feb. 1, 2010) (online at www.nytimes.com/2010/02/02/science/02nasa.html?scp=1&sq=constellation%20nasa&st=cse). If private sector participants are lined up to bid for the right to design and launch rockets, there must be at least a few financial institutions that are prepared to finance retail customers and dealers of Chrysler and GM.

pendent financing subsidiaries to compete with the auto finance business of GMAC.[544] The occurrence of either event may materially influence how and when the taxpayers are repaid their TARP advances to GMAC.

Second, if Treasury carries the burden on the first issue, Treasury must next demonstrate that it had no viable choice but to bailout ResCap—the entity through which GMAC made ill-conceived bets in the residential mortgage and subprime housing markets—in hopes of saving GMAC's auto finance business.[545] In satisfying this burden, Treasury should show that no viable approach existed under the U.S. bankruptcy code or otherwise to extricate GMAC's auto finance business from the taint of its insolvent mortgage finance business other than through the expenditure of over $17 billion of hard-earned taxpayer-funded resources.

GMAC could have, for example, sold its auto finance business for fair market value to a third party outside of bankruptcy (and avoided a fraudulent conveyance/transfer claim) or sold its auto finance business to a third party under Section 363 in a bankruptcy proceeding.[546] If GMAC's auto finance business is truly viable and profitable, it is not unreasonable to expect that other financial institutions and private equity firms would welcome the opportunity to acquire the business with its captive group of customers and monopolistic market power in the Chrysler and GM dealer floorplan business. GMAC also could have simply sold its auto finance business at fair market value to a third party outside of bankruptcy.[547] The government may have had little choice in late 2008 and early 2009 but to assist the purchaser of the auto finance business by providing DIP financing or other credit support, but, as noted above, the subsidy rate on the use of TARP funds would have been most likely materially lower since GMAC's auto finance business operates as a profitable going concern and no TARP funds would have been allocated to ResCap. Once the markets stabilized, the auto finance business (as a separate entity under new ownership and management) should have been able to refinance the government-funded bridge facility (with government-sponsored guarantees if absolutely necessary) and the taxpayers would have been repaid

[544] GM may welcome the opportunity to establish its own financing subsidiary if it determines that (1) its common equity in GMAC will be wiped out if the taxpayers suffer the loss of any GMAC allocated TARP funds and (2) the expansion of Ally Bank is inconsistent with GMAC's maintenance of a robust auto finance business. On the other hand, GMAC remits royalties and fees to GM pursuant to a services arrangement.

[545] It appears that GMAC operates three businesses—a retail auto finance and dealer floor planning business, an insurance business and a mortgage finance business. The first business provides financing to retail purchasers of Chrysler and GM vehicles as well as to the dealers themselves. The second underwrites insurance. The third business placed huge un-hedged bets in the residential mortgage and subprime housing markets that blew up and drove GMAC into insolvency.

[546] As noted in the Panel's report, the structuring, negotiating, and closing of the disposition of GMAC's auto finance business within or outside bankruptcy present an array of daunting business and legal issues. Prior to any such disposition, Treasury should conduct a thorough due diligence investigation including: (1) a careful analysis of the relevant facts and circumstances, (2) a cost benefit analysis comparing recovery pre- and post-bankruptcy, and (3) an analysis of any additional TARP contributions required pre- and post-bankruptcy. GMAC's status as a BHC only adds another layer of complexity. Nevertheless, we remain unconvinced that Treasury could not have structured the bailout of GMAC's auto finance business in a much more taxpayer-friendly manner.

[547] If GMAC pursues the sale of its auto finance business or any other division or subsidiary or the merger of GMAC or any of its subsidiaries, Treasury should ascertain that the transaction is structured in a manner that is the most advantageous for the taxpayers and that no TARP funds are forgiven or subordinated.

in full in cash. Following the transfer of the auto finance business, GMAC could have been reorganized by private market participants (if any were interested) or, most likely, liquidated without the expenditure of any TARP funds.

If the bailout of GMAC was premised on the necessity of saving the company's auto finance business, why was Treasury not capable of doing just that? Why was even one dollar of TARP funds allocated to ResCap? Why was ResCap not left for liquidation? If the automakers Chrysler and GM were capable of surviving bankruptcy proceedings, why was GMAC not similarly restructured? It is beyond disappointing that the taxpayers have been forced to squander many billions of dollars.

Third, even if GMAC carries the burden on both issues, Treasury must also demonstrate why GMAC was too big or too interconnected with the financial system and the overall economy to fail and why GMAC merited such unprecedented largess when so many other American businesses and families are suffering from the worst economic downturn in several generations. It appears quite unlikely that the failure of GMAC would have led directly to the collapse of the American financial system.

Treasury has also justified its bailout of GMAC based upon its undertaking to provide each of the 19 stress-tested financial institutions with TARP funds to the extent they were not able to raise capital in the private markets. We do not agree with this simplistic "our word is our bond" justification for the bailout. Treasury seems to argue that once a financial institution has joined (or was drafted into or was specifically selected for inclusion in) the "elite 19," then the United States government had a duty (or some kind of moral obligation or patriotic commitment) to bail it out whatever the cost. It is regrettable for Treasury to assert that it was somehow duty bound to hand a blank check to GMAC. Treasury was required to exercise proper judgment and conduct a thorough due diligence analysis with respect to its investment of taxpayer-sourced TARP funds and not simply throw $17 billion at a problem in hopes that it would go away. The financial markets do not expect the government to act in an irrational or profligate manner, and any such reaction only creates enhanced moral hazard risks and all but codifies GMAC's implicit guarantee from the United States government. The taxpayers also understand the "don't throw good money after bad" mantra and expect the government to allocate their tax dollars accordingly. In addition, it is not entirely clear why GMAC—a non-systemically significant financial institution—was included in the list of stress-tested financial institutions other than, perhaps, to afford the company an explicit guarantee under the TARP program of its seemingly unlimited capital deficiencies. Such circular reasoning offers little in the way of meaningful insight.

Other significant issues have arisen with respect to the bailout of GMAC, including, without limitation, the following:

1. It remains unclear how GMAC has used the $17 billion of TARP funds. The company has not provided any meaningful publicly available analysis of how it has employed such taxpayer resources or why it may not be able to repay all of such funds. It would be helpful for the taxpayers to receive a detailed "uses of

TARP funds" statement from GMAC with an emphasis on those payments made to persons and entities that are not obligated to reimburse GMAC. In other words, if the taxpayers stand to lose up to $10 billion on their allocation of TARP funds to GMAC, it is absolutely critical for GMAC to disclose in a prompt, thorough, and public manner specifically where the money went and why it was so allocated.[548]

2. It appears that some (and quite possibly a substantial part) of GMAC's TARP funds were allocated to ResCap to bail out its risky and ill-considered bets in the residential mortgage and subprime markets. Notwithstanding these allocations, we remain concerned as to whether Treasury and GMAC have truly stemmed the tide of losses at ResCap. The taxpayers have received only modest disclosure regarding the operations of and prospects for ResCap including, without limitation, the amount of ResCap originated mortgage loans that Fannie Mae, Freddie Mac, and other purchasers and guarantors are requiring ResCap to repurchase, and whether ResCap will require additional taxpayer-sourced TARP funds and, if so, why, how much, and when? Why ResCap might have merited even one dollar of TARP funds remains entirely murky.

3. Many questions remain unanswered with respect to Ally Bank. For example, has GMAC allocated taxpayer-sourced TARP funds to Ally Bank? If so, why has Treasury committed the taxpayers to underwrite yet another financial institution, particularly one with an unproven business model? Is Ally Bank using TARP funds to pay above-market rates of interest on its retail accounts that it has aggressively advertised over the past few months, or does its implicit guarantee from Treasury enable it to fund these above-market rates? If so, how does Ally Bank plan to pay these rates after the TARP spigot is shut off? If Ally Bank fails to pay the above-market rates of interest and its deposit base deteriorates, how will GMAC finance its floorplan business? How much, if any, of the projected $10 billion loss of TARP funds allocated to GMAC is attributable to Ally Bank and its payment of above-market rates of interest? If the answer is one dollar or more, why has Treasury committed the taxpayers to subsidize these rates?

4. It was recently announced that the CEO of GMAC will receive a total annual compensation package of $9.5 million, which consists of cash and deferred and restricted stock.[549] Although some have focused on the amount of the compensation, more significant from the taxpayers' perspective is the structure of the compensation package and the consequent incentives that may skew decision-

[548] GMAC should not respond with the statement that "money is fungible." Money is also limited and, without the allocation of $17 billion of TARP funds, GMAC would have no doubt failed.

[549] The bulk of the CEO's compensation is structured as deferred or restricted stock with a cash salary of $950,000. While a stock grant may have appeared attractive to the Special Master, the incentives inherent in a stock grant could cause the CEO to consider actions that may not necessarily be in the best interests of the taxpayers. With a large stock award in GMAC, the CEO may have little interest in pursuing a bankruptcy of GMAC or selling the "crown jewel" auto finance business (to GM and Chrysler among others) and liquidating ResCap. All of these actions could diminish the value of GMAC stock and Mr. Carpenter's stock award. Instead, the CEO appears inclined to pursue a growth strategy at GMAC with Ally Bank. Perhaps it would have been best simply to pay the CEO a higher cash compensation amount so as potentially not to influence his management decisions. It is unfortunate that such an approach might not have been acceptable to the Special Master.

making towards particular outcomes, such as building the company, when dissolution and sale might be best.

5. Even though the taxpayers stand to lose up to $10 billion on the allocation of TARP funds to GMAC, the pre-bailout common shareholders of GMAC may nevertheless profit from their investment in the company. The Panel has made clear that if the taxpayers lose one dollar of TARP funds, the pre-bailout common shareholders should be wiped out and receive no return. Representatives from Treasury appear quite sensitive (if not defensive) regarding this issue. We call upon Treasury to issue a formal legal opinion describing the extent to which pre-bailout common shareholders may profit if the taxpayers lose. Treasury has put the taxpayers in an awkward position of suffering a substantial loss but the pre-bailout common shareholders are not wiped out.

6. It is regrettable that the bailouts of GMAC, Chrysler, and GM could raise subsidy issues under WTO rules. As noted in the Panel's report, in September 2009, the People's Republic of China launched a countervailing duty investigation into the assistance given Chrysler and GM where, among other items, the Chinese automotive industry cited aid to GMAC in its complaint. It is possible that other jurisdictions may raise similar claims with the WTO. Treasury should thoughtfully analyze these and other trade related issues before allocating TARP funds to any entity.[550]

[550] This paragraph is not intended to constitute a legal or other analysis regarding the merits of any action brought under WTO or similar rules by the People's Republic of China or any other jurisdiction or entity regarding the allocation of TARP funds to or any other action taken by the U.S. government with respect to GMAC, Chrysler, or GM.

SECTION THREE: CORRESPONDENCE WITH TREASURY UPDATE

Secretary of the Treasury Timothy Geithner sent a letter to Chair Elizabeth Warren on February 16, 2010,[551] in response to a series of questions presented by the Panel regarding Treasury's role, under EESA, in setting executive compensation and corporate governance standards for TARP recipients and regarding the authority of the Special Master for TARP Executive Compensation.

[551] *See* Appendix I of this report, *infra*.

SECTION FOUR: TARP UPDATES SINCE LAST REPORT

A. TARP Repayments

As of March 5, 2010, Treasury received $8.2 billion in CPP repayments from six institutions during February and March. Of this total, $7.6 billion was repaid by PNC Financial Services Group. A total of 66 banks have fully repaid their preferred stock TARP investments provided under the CPP to date. Treasury has also liquidated the warrants it holds in 44 of these 66 banks.

B. CPP Warrant Dispositions

As part of its investment in senior preferred stock of certain banks under the CPP, Treasury received warrants to purchase shares of common stock or other securities in those institutions. During February, two institutions repurchased their warrants from Treasury for a total of $691,000. Also, on March 1, 2010, Treasury announced that it would offer the Bank of America warrants it received at auction. Treasury announced that gross proceeds from this offering were $1.57 billion. Including this sale, Treasury has received $5.59 billion from the disposition of CPP warrants.

C. CPP Monthly Lending Report

Treasury's Monthly Lending and Intermediation Snapshot tracks loan originations and average loan balances for the 22 largest recipients of CPP funds across a variety of categories, ranging from mortgage loans to commercial real estate to credit card lines. As of the December reporting period, this survey no longer includes data from the ten institutions that repaid the funds they received in June 2009. Furthermore, CIT did not report its lending activity this month due to that institution's ongoing bankruptcy proceedings. Therefore, the Monthly Lending and Intermediation Snapshot now measures only eleven institutions and no longer provides a complete basis of comparison for lending by these institutions since EESA was enacted.

Of the eleven institutions that participated in the survey, new loan origination increased nearly 13 percent in December for a total of $178 billion during December. Survey respondents highlighted a number of economic areas that showed market improvement in December including leasing, business banking and mergers and acquisitions. The survey noted the continuing lack of demand for new commercial real estate loans. Furthermore, respondents cited seasonality in commercial real estate for the 57 percent increase in commercial real estate renewals.

D. Term Asset-Backed Securities Loan Facility

At the February 17, 2010 facility, investors requested $1.3 billion in loans for legacy commercial mortgage-backed securities (CMBS), of which $1.1 billion settled. By way of comparison, investors requested $1.5 billion in loans for legacy CMBS, of which $1.3 billion settled, at the January facility. Investors did not request any loans for new CMBS in February. The only request for new CMBS loans

during TALF's operation was for $72.2 million at the November facility.

The New York Fed's March 4, 2010 facility was a non-CMBS facility, offering loans to support the issuance of ABS collateralized by loans in the credit card, equipment, floorplan, premium financing, small business, and student loan sectors. In total, $4.1 billion in loans were requested at this facility. There were no requests at this facility for auto or servicing advance loans. At the February 5, 2010 facility, $974 million of the $987 million in requested loans settled.

E. Help for Hardest Hit Housing Markets

On February 19, 2010, President Obama announced Help for Hardest Hit Housing Markets (4HM). This initiative will use $1.5 billion of the $50 billion in TARP funds allocated to foreclosure mitigation in order to assist the five states with the highest home price declines stemming from the foreclosure crisis: Nevada, California, Florida, Arizona and Michigan. These states have all experienced home price declines greater than 20 percent. The funds will go directly to the Housing Finance Agencies (HFAs) of the participating states for programs that may include foreclosure mitigation efforts for unemployed borrowers, borrowers owing more than their home is worth, or borrowers facing challenges arising from second liens. The funds will be divided among the five eligible states by a formula based on home price declines and unemployment. State HFAs must submit a proposal for their specific program designs, allowing the local agencies to tailor programs to the local needs.[552]

F. Metrics

Each month, the Panel's report highlights a number of metrics that the Panel and others, including Treasury, the Government Accountability Office (GAO), the Special Inspector General for the Troubled Asset Relief Program (SIGTARP), and the Financial Stability Oversight Board, consider useful in assessing the effectiveness of the Administration's efforts to restore financial stability and accomplish the goals of EESA. This section discusses changes that have occurred in several indicators since the release of the Panel's February report.

- Interest Rate Spreads. Interest rate spreads have continued to tighten since the Panel's February report, further reflecting signs of economic stability. The TED spread, which measures the difference between 3 Month LIBOR and the 3 Month Treasury Bill yield, is used as a measure of the availability of liquidity in the market. As of March 1, 2010, the TED spread was 12 basis points, an 89 percent decrease since the enactment of EESA. The interest rate spread for AA asset-backed commercial paper, which is considered mid-investment grade, has decreased by nearly 13 percent since the Panel's January report. This measure is at its lowest level since July 2007.

[552] The White House, *President Obama Announces Help for Hardest Hit Housing Markets* (Feb. 19, 2010) (online at www.whitehouse.gov/the-press-office/president-obama-announces-help-hardest-hit-housing-markets) (hereinafter "President Announces Help for Housing Markets").

FIGURE 18: INTEREST RATE SPREADS

Indicator	Current Spread (as of 3/1/10)	Percent Change Since Last Report (1/29/10)
TED spread [553] (in basis points)	12	(29.4)
Conventional mortgage rate spread [554]	1.36	3.03
Overnight AA asset-backed commercial paper interest rate spread [555]	0.11	(12.5)
Overnight A2/P2 nonfinancial commercial paper interest rate spread [556]	0.12	10.7

[553] *TED Spread,* SNL Financial.

[554] Board of Governors of the Federal Reserve System, *Federal Reserve Statistical Release H.15: Selected Interest Rates: Historical Data* (Instrument: Conventional Mortgages, Frequency: Weekly) (online at www.federalreserve.gov/releases/h15/data/Weekly__Thursday__/H15__MORTG__NA.txt) (accessed Mar. 1, 2010); Board of Governors of the Federal Reserve System, *Federal Reserve Statistical Release H.15: Selected Interest Rates: Historical Data* (Instrument: U.S. Government Securities/Treasury Constant Maturities/Nominal 10-Year, Frequency: Weekly) (online at www.federalreserve.gov/releases/h15/data/Weekly__Friday__/H15__TCMNOM__Y10.txt) (accessed Mar. 1, 2010).

[555] Board of Governors of the Federal Reserve System, *Federal Reserve Statistical Release: Commercial Paper Rates and Outstandings: Data Download Program* (Instrument: AA Asset-Backed Discount Rate, Frequency: Daily) (online at www.federalreserve.gov/DataDownload/Choose.aspx?rel=CP) (hereinafter ''Federal Reserve Statistical Release: Commercial Paper'') (accessed Mar. 4, 2010); Board of Governors of the Federal Reserve System, *Federal Reserve Statistical Release: Commercial Paper Rates and Outstandings: Data Download Program* (Instrument: AA Nonfinancial Discount Rate, Frequency: Daily) (online at www.federalreserve.gov/DataDownload/Choose.aspx?rel=CP) (accessed Mar. 1, 2010). In order to provide a more complete comparison, this metric utilizes a five day average of the interest rate spread for the last five days of the month.

[556] Federal Reserve Statistical Release: Commercial Paper, *supra* note 555 (accessed Mar. 4, 2010). In order to provide a more complete comparison, this metric utilizes a five day average of the interest rate spread for the last five days of the month.

• Housing Indicators. Foreclosure filings decreased by 9.7 percent from November to December, and are 13 percent above the October 2008 level. The S&P/Case-Shiller Composite 20 Index increased slightly in December, whereas another index that measures home prices, the FHFA House Price Index, decreased by nearly 2 percent in December.

FIGURE 19: HOUSING INDICATORS

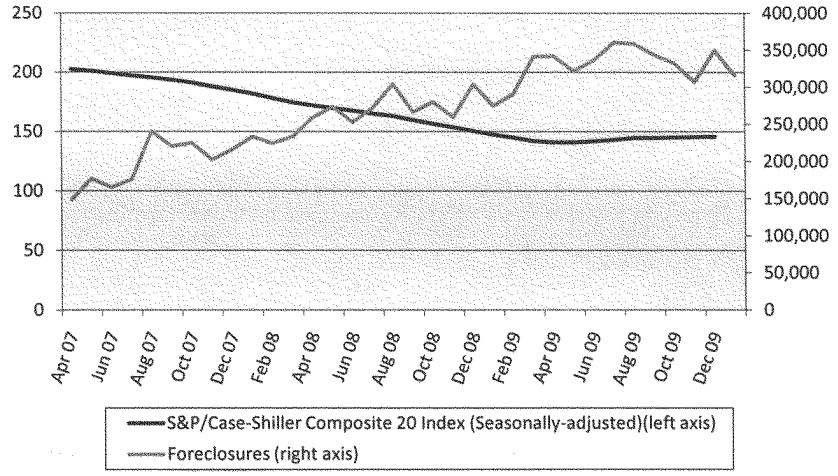
Indicator	Most Recent Monthly Data	Percent Change from Data Available at Time of Last Report	Percent Change Since October 2008
Monthly foreclosure filings [557]	315,716	(9.7)	13
Housing prices—S&P/Case-Shiller Composite 20 Index [558]	145.9	.32	(6.8)
FHFA Housing Price Index [559]	196.1	(1.6)	(3.3)

[557] RealtyTrac, *Foreclosure Activity Press Releases* (online at www.realtytrac.com//ContentManagement/PressRelease.aspx) (hereinafter ''RealtyTrac Foreclosure Activity Press Releases'') (accessed Mar. 1, 2010). Most recent data available for January 2010.

[558] Standard & Poor's, *S&P/Case-Shiller Home Price Indices* (Instrument: Seasonally Adjusted Composite 20 Index) (online at www. standard andpoors.com/prot/servlet/Blob Server?blobheadername3=MDT-Type&blobcol= urldata&blobtable=Mungo Blobs&blobheadervalue2=inline%3B+filename% 3DSA__CSHome Price__History__022330.xls &blobheadername2=Content-Disposition&blobheader value1=application%2Fexcel &blobkey= id&blob headername1=content-type &blobwhere= 1243656054400&blob headervalue3=UTF-8) (accessed Mar. 4, 2010) (hereinafter ''S&P/Case-Shiller Home Price Indices''). Most recent data available for December 2009.

[559] Federal Housing Finance Agency, *U.S. and Census Division Monthly Purchase Only Index* (Instrument: USA, Seasonally Adjusted) (online at www.fhfa.gov/webfiles/15428/Monthly Index__Jan1991__to__Latest.xls) (accessed Mar. 4, 2010). Most recent data available for December 2009.

FIGURE 20: FORECLOSURE FILINGS AS COMPARED TO THE CASE-SHILLER 20 CITY HOME PRICE INDEX (AS OF DECEMBER 2009) [560]



• Bank Conditions. Data appear to show that commercial banks across the country are still being affected by the economic downturn and troubled loans. Figure 21 shows the percentage of net loan charge-offs has continued to increase since the crisis began. This percentage consists of the total number of charge-offs by domestic commercial banks over the total amount of commercial loans. This percentage, 2.2 as of the third quarter of 2009, has nearly tripled since EESA was enacted. U.S. commercial banks are also negatively affected by loans that are sliding toward default. Nonperforming commercial loans are loans that bank officials classify as 90-days or more past due or nonaccrual. Figure 22 shows nonperforming commercial loans as a percentage of total commercial loans. This ratio was 3.6 at the end of the third quarter of 2009, more than three times its level in October 2008.

[560] RealtyTrac Foreclosure Activity Press Releases, *supra* note 557 (accessed Jan. 27, 2010); S&P/Case-Shiller Home Price Indices, *supra* note 558. Most recent data available is for December 2009.

FIGURE 21: COMMERCIAL NET LOAN CHARGE-OFFS PERCENTAGE (AS OF Q3 2009) [561]

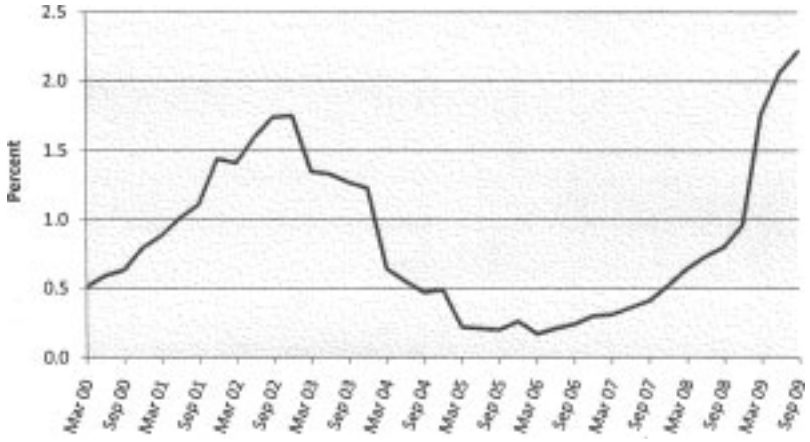
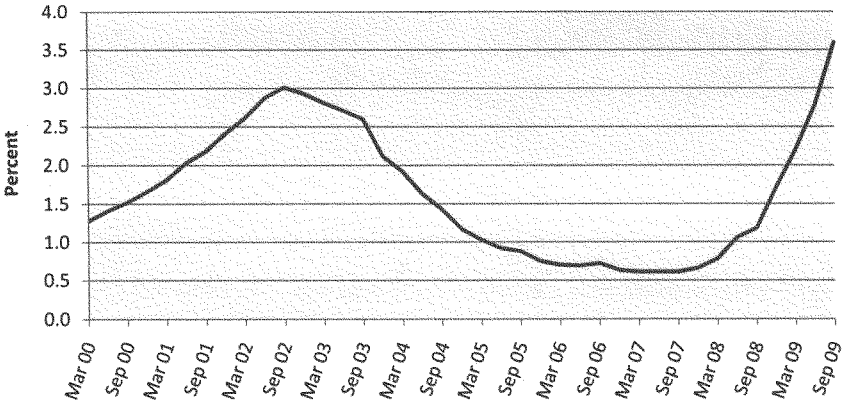


FIGURE 22: NONPERFORMING LOANS AS A PERCENTAGE OF TOTAL LOANS (AS OF Q3 2009) [562]



• Consumer Confidence. There are mixed signs emerging regarding consumer confidence. The University of Michigan's Consumer Sentiment Index is based on a minimum of 500 telephone interviews and contains roughly 50 core questions.[563] The Consumer

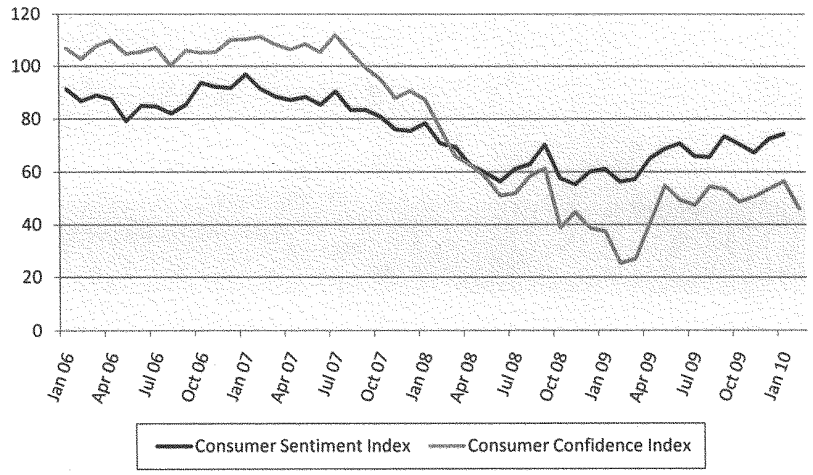
[561] Federal Reserve Bank of St. Louis, *Condition of Banking:Commercial Net Loan Charge-offs* (online at research.stlouisfed.org/fred2/ series/NCOCMC?cid=93) (accessed Mar. 4, 2010).

[562] Federal Reserve Bank of St. Louis, *Condition of Banking:Nonperforming Commercial Loans* (online at research.stlouisfed.org/fred2/series/ NPCMCM/downloaddata?cid=93) (accessed Mar. 4, 2010).

[563] University of Michigan, *Survey of Consumers* (online at www.sca.isr.umich.edu/documents.php?c=i) (accessed Mar. 9, 2010).

Sentiment Index rose 10 percent in January.[564] Another gauge of consumer attitudes is the Consumer Confidence Index. This index is administered by The Conference Board and is based off of a representative sample of 5,000 homes.[565] This measure decreased 18 percent February. The Conference Board notes that a component of the survey, the Present Situation Index, was at its lowest level since February 1983.[566] Both indices have increased significantly since EESA was enacted. As Figure 23 illustrates, the Consumer Sentiment Index has increased nearly 30 percent, while the Consumer Confidence Index is up 18 percent, since October 2008.

FIGURE 23: CONSUMER ATTITUDES [567]



[564] Federal Reserve Bank of St. Louis, *University of Michigan: Consumer Sentiment* (online at research.stlouisfed.org/fred2/series/UMCSENT/) (hereinafter "University of Michigan: Consumer Sentiment") (accessed Mar. 3, 2010).

[565] The Conference Board, *The Conference Board Consumer Confidence Index®* Declines Sharply (Feb. 23, 2010) (online at www.conference-board.org/economics/ConsumerConfidence.cfm) (hereinafter "Conference Board Consumer Confidence Index").

[566] Conference Board Consumer Confidence Index, *supra* note 565.

[567] University of Michigan: Consumer Sentiment, *supra* note 564; Bloomberg Data.

G. Financial Update

Each month, the Panel summarizes the resources that the federal government has committed to economic stabilization. The following financial update provides: (1) an updated accounting of the TARP, including a tally of dividend income, repayments, and warrant dispositions that the program has received as of February 25, 2010; and (2) an updated accounting of the full federal resource commitment as of February 25, 2010.

1. The TARP

a. Costs: Expenditures and Commitments

Treasury has committed or is currently committed to spend $520.3 billion of TARP funds through an array of programs used to purchase preferred shares in financial institutions, offer loans to small businesses and automotive companies, and leverage Federal Reserve loans for facilities designed to restart secondary securitization markets.[568] Of this total, $290.5 billion is currently outstanding under the $698.7 billion limit for TARP expenditures set by EESA, leaving $408.2 billion available for fulfillment of anticipated funding levels of existing programs and for funding new programs and initiatives. The $290.5 billion includes purchases of preferred and common shares, warrants and/or debt obligations under the CPP, AIGIP/SSFI Program, PPIP, and AIFP; and a $20 billion loan to TALF LLC, the special purpose vehicle (SPV) used to guarantee Federal Reserve TALF loans.[569] Additionally, Treasury has allocated $36.9 billion to the Home Affordable Modification Program, out of a projected total program level of $48.5 billion.

b. Income: Dividends, Interest Payments, CPP Repayments, and Warrant Sales

As of February 25, 2009, a total of 65 institutions have completely repurchased their CPP preferred shares. Of these institutions, 39 have repurchased their warrants for common shares that Treasury received in conjunction with its preferred stock investments; Treasury sold the warrants for common shares for three other institutions at auction.[570] Treasury received $7.9 billion in repayments from six CPP participants during February. The largest repayment was the $7.6 billion repaid by PNC Financial Services Group. Treasury also accounted for losses under the CPP for two of the three bankrupt institutions participating in the program: CIT Group and Pacific Coast National Bancorp. These two institutions received a total of $2.3 billion in funds under the CPP.[571] In addition, Treasury receives dividend payments on the preferred shares that it holds, usually five percent per annum for the first five years and nine percent per annum thereafter.[572] Net of these

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[568] EESA, as amended by the Helping Families Save Their Homes Act of 2009, limits Treasury to $698.7 billion in purchasing authority outstanding at any one time as calculated by the sum of the purchases prices of all troubled assets held by Treasury. Pub. L. No. 110–343, § 115(a)–(b); Helping Families Save Their Homes Act of 2009, Pub. L. No. 111–22, § 402(f) (reducing by $1.26 billion the authority for the TARP originally set under EESA at $700 billion).

[569] Treasury Transactions Report, *supra* note 264.

[570] Treasury Transactions Report, *supra* note 264.

[571] Treasury Transactions Report, *supra* note 264.

[572] *See, e.g.*, U.S. Department of the Treasury, *Securities Purchase Agreement: Standard Terms* (online at www.financialstability.gov/docs/CPP/spa.pdf) (accessed Mar. 4, 2010).

losses under the CPP, Treasury has received approximately $18.8 billion in income from warrant repurchases, dividends, interest payments, and other considerations deriving from TARP investments,[573] and another $1.2 billion in participation fees from its Guarantee Program for Money Market Funds.[574]

c. TARP Accounting

FIGURE 24: TARP ACCOUNTING (AS OF FEBRUARY 25, 2010)[575]

[Dollars in billions]

TARP Initiative	Anticipated Funding	Actual Funding	Total Repayments/ Reduced Exposure	Funding Outstanding	Funding Available
Capital Purchase Program (CPP)[576]	$204.9	$204.9	$129.8	[577] $75.1	$0
Targeted Investment Program (TIP)[578]	40.0	40.0	40	0	0
AIG Investment Program (AIGIP)/Systemically Significant Failing Institutions Program (SSFI)	69.8	[579] 46.9	0	46.9	22.9
Automobile Industry Financing Program (AIFP)	81.3	81.3	3.2	78.2	0
Asset Guarantee Program (AGP)[580]	5.0	5.0	[581] 5.0	0	0
Capital Assistance Program (CAP)[582]	0	0	0	0	0
Term Asset-Backed Securities Lending Facility (TALF)	20.0	20.0	0	20.0	0
Public-Private Investment Partnership (PPIP)[583]	30.0	30.0	0	30.0	0
Auto Supplier Support Program (ASSP)	[584] 3.5	3.5	0	3.5	0
Unlocking SBA Lending	15.0	0	0	0	15.0
Home Affordable Modification Program (HAMP)	[585] 48.5	[586] 36.9	0	36.9	11.6
Community Development Capital Initiative (CDCI)	[587] 0.78	0	0	0	0.78
Help for Hardest Hit Housing Markets (4HM)[588]	1.5	0	0	0	1.5
Total Committed	520.3	468.5	—	290.5	51.8
Total Uncommitted	178.4	N/A	178.0	N/A	[589] 356.4
Total	**$698.7**	**$468.5**	**$178.0**	**$290.5**	**$408.2**

[575] Treasury Transactions Report, *supra* note 264.

[576] As of December 31, 2009, the CPP was closed. U.S. Department of the Treasury, *FAQ on Capital Purchase Program Deadline* (online at www.financialstability.gov/docs/FAQ%20on%20Capital%20Purchase%20Program%20Deadline.pdf).

[577] Treasury classified the investments it made in two institutions, CIT Group ($2.3 billion) and Pacific Coast National Bancorp ($4.1 million), as losses on the Transactions Report. Therefore Treasury's net current CPP investment is $72.7 billion due to the $2.3 billion in losses thus far. Treasury Transactions Report, *supra* note 264.

[578] Both Bank of America and Citigroup repaid the $20 billion in assistance each institution received under the TIP on December 9 and December 23, 2009, respectively. Therefore the Panel accounts for these funds as repaid and uncommitted. U.S. Department of the Treasury, *Treasury Receives $45 Billion in Repayments from Wells Fargo and Citigroup* (Dec. 23, 2009) (online at www.treas.gov/press/releases/2009122916198713.htm) (hereinafter "Treasury Receives $45 Billion from Wells Fargo and Citigroup").

[579] Data provided by Treasury in response to a Panel request. AIG has completely utilized the $40 billion made available on November 25, 2008 and has drawn-down $5.3 billion of the $29.8 billion made available on April 17, 2009. This figure also reflects $1.6 billion in accumulated but unpaid dividends owed by AIG to Treasury due to the restructuring of Treasury's investment from cumulative preferred shares to non-cumulative shares. Treasury Transactions Report, *supra* note 264.

[573] Treasury Transactions Report, *supra* note 264; U.S. Department of the Treasury, *Cumulative Dividends and Interest Report as of December 31, 2009* (Jan. 20, 2010) (online at www.financialstability.gov/docs/dividends-interest-reports/December%202009%20Dividends%20and%20Interest%20Report.pdf); Treasury Transactions Report, *supra* note 264.

[574] For CPP investments in privately-held institutions, Treasury received warrants to purchase additional preferred shares. This option was excercised immediately and, as of February 25, 2010, six privately held institutions redeemed the additional preferred shares associated with the warrants provided to Treasury. U.S. Department of the Treasury, *Treasury Announces Expiration of Guarantee Program for Money Market Funds* (Sept. 18, 2009) (online at www.treasury.gov/press/releases/tg293.htm).

[580] Treasury, the Federal Reserve, and the Federal Deposit Insurance Company terminated the asset guarantee with Citigroup on December 23, 2009. The agreement was terminated with no losses to Treasury's $5 billion second-loss portion of the guarantee. Citigroup did not repay any funds directly, but instead terminated Treasury's outstanding exposure on its $5 billion second-loss position. As a result, the $5 billion is now counted as available. Treasury Receives $45 Billion from Wells Fargo and Citigroup, *supra* note 578.

[581] Although this $5 billion is no longer exposed as part of the AGP and is accounted for as available, Treasury did not receive a repayment in the same sense as with other investments. Treasury did receive other income as consideration for the guarantee, which is not a repayment and is accounted for in Figure 25.

[582] On November 9, 2009, Treasury announced the closing of this program and that only one institution, GMAC, was in need of further capital from Treasury. GMAC received an additional $3.8 billion in capital through the AIFP on December 30, 2009. Treasury Announcement Regarding the CAP, *supra* note 240; Treasury Transactions Report, *supra* note 264.

[583] On January 29, 2010, Treasury released its first quarterly report on the Legacy Securities Public-Private Investment Program. As of that date, the total value of assets held by the PPIP managers was $3.4 billion. Of this total, 87 percent was non-agency Residential Mortgage-Backed Securities and the remaining 13 percent was Commercial Mortgage-Backed Securities. U.S. Department of the Treasury, *Legacy Securities Public-Private Investment Program* (Jan. 29, 2010) (online at www.financialstability.gov/docs/External%20Report%20-%2012-09%20FINAL.pdf).

[584] On July 8, 2009, Treasury lowered the total commitment amount for the program from $5 billion to $3.5 billion. This action reduced GM's portion from $3.5 billion to $2.5 billion and Chrysler's portion from $1.5 billion to $1 billion. GM Supplier Receivables LLC, the special purpose vehicle created to administer this program for GM suppliers, has made $240 million in partial repayments. This was a partial repayment of funds that were drawn down and did not reduce Treasury's $3.5 billion in total exposure under the ASSP. Treasury Transactions Report, *supra* note 264.

[585] In information provided to TARP oversight bodies, Treasury has stated that the $1.5 billion for the newly created ''Help for Hardest Hit Housing Markets'' will be taken from the $50 billion in TARP funding committed to foreclosure mitigation.

[586] This figure reflects the total of all the caps set on payments to each mortgage servicer and not the disbursed amount of funds for successful modifications. Treasury Transactions Report, *supra* note 264. In response to a Panel inquiry, Treasury disclosed that, as of January 10, 2010, $32 million in funds had been disbursed under the HAMP.

[587] On February 3, 2010, the Administration announced a new initiative under TARP to provide low-cost financing for Community Development Financial Institutions (CDFIs). Under this program, CDFIs are eligible for capital investments at a 2 percent dividend rate as compared to the 5 percent dividend rate under the CPP. In response to a Panel request, Treasury stated that it projects the CDCI program to utilize $780.2 million; U.S Department of the Treasury, *Community Development Capital Initiative* (Feb. 18, 2010) (online at www.financialstability.gov/roadtostability/comdev.html).

[588] On February 19, 2010, President Obama announced 4HM, a plan to use $1.5 billion of the $50 billion in TARP funds allocated to HAMP to assist the five states with the highest home price declines stemming from the foreclosure crisis: Nevada, California, Florida, Arizona, and Michigan. President Announces Help for Housing Markets, *supra* note 552. For further discussion of this initiative, *see* Section Four of this report.

[589] This figure is the sum of the uncommitted funds remaining under the $698.7 billion cap ($178.4 billion) and the repayments ($178 billion).

FIGURE 25: TARP PROFIT AND LOSS

[Dollars in millions]

TARP Initiative	Dividends [590] (as of 1/31/10)	Interest [591] (as of 1/31/10)	Warrant Repurchases (as of 3/4/10)	Other Proceeds (as of 2/25/10)	Losses [592] as of 2/25/10	Total
Total	$12,502	$478	$5,587	$2,531	($2,334)	$18,764
CPP	8,283	18	[593] 5,572	—	(2,334)	11,539
TIP	3,004	N/A	0	—		3,004
AIFP	936	443	15	—		1,394
ASSP	N/A	13	N/A	—		13
AGP	277	N/A	0	[594] 2,234		2,511
PPIP	2	4	N/A	21		27
Bank of America Guarantee	—	—	—	[595] 276		276

[590] OFS Cumulative Dividends Report as of January 31, 2010, *supra* note 531.

[591] OFS Cumulative Dividends Report as of January 31, 2010, *supra* note 531.

[592] Treasury classified the investments it made in two institutions, CIT Group ($2.3 billion) and Pacific Coast National Bancorp ($4.1 million), as losses on the Transactions Report. A third institution, UCBH Holdings, Inc., received $299 million in TARP funds and is currently in bankruptcy proceedings. Treasury Transactions Report, *supra* note 264.

[593] This figure is comprised of the $4.03 billion in proceeds from warrant dispositions as of February 25, 2010, and the $1.54 billion in funds from the auction of Bank of America warrants completed on March 4, 2010. Treasury Transactions Report, *supra* note 264; U.S. Department of the Treasury, *Treasury Department Announces Public Offerings of Warrants to Purchase Common Stock of Bank of America Corporation* (Mar. 4, 2010) (online at www.financialstability.gov/latest/pr_03042010.html).

[594] Treasury received $4.03 billion in Citigroup preferred stock and warrants as a fee for taking a second-loss position up to $5 billion on a $301 billion pool of ring-fenced Citigroup assets as part of the AGP; Treasury exchanged these preferred stocks for TruPs in June 2009. Following the early termination of the guarantee, Treasury cancelled $1.8 billion of the TruPs, leaving Treasury with a $2.23 billion investment in Citigroup TruPs in exchange for the guarantee. At the end of Citigroup's participation in the FDIC's TLGP, the FDIC may transfer $800 million of $3.02 billion in Citigroup Trust Preferred Securities it received in consideration for its role in the AGP to the Treasury. Treasury Transactions Report, *supra* note 264.

[595] Although Treasury, the Federal Reserve, and the FDIC negotiated with Bank of America regarding a similar guarantee, the parties never reached an agreement. In September 2009, Bank of America agreed to pay each of the prospective guarantors a fee as though the guarantee had been in place during the negotiations. This agreement resulted in payments of $276 million to Treasury, $57 million to the Federal Reserve, and $92 million to the FDIC. U.S. Department of the Treasury, Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, and Bank of America Corporation, Termination Agreement, at 1–2 (Sept. 21, 2009) (online at www.financialstability.gov/docs/AGP/BofA%20-%20Termination%20Agreement%20-%20executed.pdf).

d. Rate of Return

As of March 4, 2010, the average internal rate of return for all financial institutions that participated in the CPP and fully repaid the U.S. government (including preferred shares, dividends, and

warrants) is 10.6 percent. The internal rate of return is the annualized effective compounded return rate that can be earned on invested capital.

e. TARP Warrant Disposition

FIGURE 26: WARRANT REPURCHASES FOR FINANCIAL INSTITUTIONS WHO HAVE FULLY REPAID CPP FUNDS AS OF MARCH 4, 2010

Institution	Investment Date	QEO	Warrant Repurchase Date	Warrant Repurchase/Sale Amount	Panel's Best Valuation Estimate at Repurchase Date	Price/Estimate Ratio	IRR (Percent)
Old National Bancorp	12/12/2008	No	5/8/2009	1,200,000	2,150,000	0.5581	9.30
Iberiabank Corporation	12/5/2008	Yes	5/20/2009	1,200,000	2,010,000	0.5970	9.40
Firstmerit Corporation	1/9/2009	No	5/27/2009	5,025,000	4,260,000	1.1796	20.30
Sun Bancorp, Inc	1/9/2009	No	5/27/2009	2,100,000	5,580,000	0.3763	15.30
Independent Bank Corp.	1/9/2009	No	5/27/2009	2,200,000	3,870,000	0.5685	15.60
Alliance Financial Corporation	12/19/2008	No	6/17/2009	900,000	1,580,000	0.5696	13.80
First Niagara Financial Group	11/21/2008	Yes	6/24/2009	2,700,000	3,050,000	0.8852	8.00
Berkshire Hills Bancorp, Inc.	12/19/2008	No	6/24/2009	1,040,000	1,620,000	0.6420	11.30
Somerset Hills Bancorp	1/16/2009	No	6/24/2009	275,000	580,000	0.4741	16.60
SCBT Financial Corporation	1/16/2009	No	6/24/2009	1,400,000	2,290,000	0.6114	11.70
HF Financial Corp	11/21/2008	No	6/30/2009	650,000	1,240,000	0.5242	10.10
State Street	10/28/2008	Yes	7/8/2009	60,000,000	54,200,000	1.1070	9.90
U.S. Bancorp	11/14/2008	No	7/15/2009	139,000,000	135,100,000	1.0289	8.70
The Goldman Sachs Group, Inc.	10/28/2008	No	7/22/2009	1,100,000,000	1,128,400,000	0.9748	22.80
BB&T Corp.	11/14/2008	No	7/22/2009	67,010,402	68,200,000	0.9826	8.70
American Express Company	1/9/2009	No	7/29/2009	340,000,000	391,200,000	0.8691	29.50
Bank of New York Mellon Corp	10/28/2008	No	8/5/2009	136,000,000	155,700,000	0.8735	12.30
Morgan Stanley	10/28/2008	No	8/12/2009	950,000,000	1,039,800,000	0.9136	20.20
Northern Trust Corporation	11/14/2008	No	8/26/2009	87,000,000	89,800,000	0.9688	14.50
Old Line Bancshares Inc.	12/5/2008	No	9/2/2009	225,000	500,000	0.4500	10.40
Bancorp Rhode Island, Inc.	12/19/2008	No	9/30/2009	1,400,000	1,400,000	1.0000	12.60
Centerstate Banks of Florida Inc.	11/21/2008	No	10/28/2009	212,000	220,000	0.9636	5.90
Manhattan Bancorp	12/5/2008	No	10/14/2009	63,364	140,000	0.4526	9.80
Bank of Ozarks	12/12/2008	No	11/24/2009	2,650,000	3,500,000	0.7571	9.00
Capital One Financial	11/14/2008	No	12/3/2009	148,731,030	232,000,000	0.6411	12.00

FIGURE 26: WARRANT REPURCHASES FOR FINANCIAL INSTITUTIONS WHO HAVE FULLY REPAID CPP FUNDS AS OF MARCH 4, 2010—Continued

Institution	Investment Date	QEO	Warrant Repurchase Date	Warrant Repurchase/Sale Amount	Panel's Best Valuation Estimate at Repurchase Date	Price/Estimate Ratio	IRR (Percent)
JP Morgan Chase & Co.	10/28/2008	No	12/10/2009	950,318,243	1,006,587,697	0.9441	10.90
TCF Financial Corp	1/16/2009	No	12/16/2009	9,599,964	11,825,830	0.8118	11.00
LSB Corporation	12/12/2008	No	12/16/2009	560,000	535,202	1.0463	9.00
Wainwright Bank & Trust Company	12/19/2008	No	12/16/2009	568,700	1,071,494	0.5308	7.80
Wesbanco Bank, Inc.	12/5/2008	No	12/23/2009	950,000	2,387,617	0.3979	6.70
Union Bankshares Corporation	12/19/2008	Yes	12/23/2009	450,000	1,130,418	0.3981	5.80
Trustmark Corporation	11/21/2008	No	12/30/2009	10,000,000	11,573,699	0.8640	9.40
Flushing Financial Corporation	12/19/2008	Yes	12/30/2009	900,000	2,861,919	0.3145	6.50
OceanFirst Financial Corporation	1/16/2009	Yes	2/3/2010	430,797	279,359	1.5421	6.20
Monarch Financial Holdings, Inc.	12/19/2008	Yes	2/10/2010	260,000	623,434	0.4170	6.70
Bank of America	[596]10/28/2008 [597]1/9/2009 [598]1/14/2009	No	3/3/2010	1,542,717,553	1,006,416,684	1.5329	6.50
Total				**$5,567,737,053**	**$5,373,683,352**	**1.0361**	**10.60**

[596] Investment date for Bank of America in CPP.
[597] Investment date for Merrill Lynch in CPP.
[598] Investment date for Bank of America in TIP.

FIGURE 27: WARRANT VALUATION OF REMAINING WARRANTS

[Dollars in millions]

	Warrant Valuation		
	Low Estimate	High Estimate	Best Estimate
Stress Test Financial Institutions with Warrants Outstanding:			
Wells Fargo & Company	$511.52	$2,184.69	$668.21
Citigroup, Inc.	17.33	660.59	144.36
The PNC Financial Services Group, Inc.	116.03	402.14	183.17
SunTrust Banks, Inc.	20.53	278.35	95.02
Regions Financial Corporation	15.30	166.93	69.56
Fifth Third Bancorp	122.37	385.90	179.47
Hartford Financial Services Group, Inc.	812.43	1,017.87	812.43
KeyCorp	20.31	164.16	60.62307167
All Other Banks with Outstanding Warrants	874.40	2,711.59	1,671.03
Total	**$2,510.23**	**$7,972.22**	**$3,883.87**

2. Other Financial Stability Efforts

Federal Reserve, FDIC, and Other Programs

In addition to the direct expenditures Treasury has undertaken through the TARP, the federal government has engaged in a much broader program directed at stabilizing the U.S. financial system. Many of these initiatives explicitly augment funds allocated by Treasury under specific TARP initiatives, such as FDIC and Federal Reserve asset guarantees for Citigroup, or operate in tandem with Treasury programs, such as the interaction between the PPIP and the TALF. Other programs, like the Federal Reserve's extension of credit through its section 13(3) facilities and SPVs and the FDIC's TLGP, operate independently of the TARP.

Figure 28 below reflects the changing mix of Federal Reserve investments. As the liquidity facilities established to face the crisis have been wound down, the Federal Reserve has expanded its facilities for purchasing mortgage related securities. The Federal Reserve announced that it intends to purchase $175 billion of federal agency debt securities and $1.25 trillion of agency mortgage-backed securities.[599] As of February 25, 2010, $166 billion of federal agency (government-sponsored enterprise) debt securities and $1 trillion of agency mortgage-backed securities have been purchased. The Federal Reserve has announced that these purchases will be completed by April 2010.[600] These purchases are in addition to the $214.4 billion in GSE MBS Treasury purchased under the GSE Mortgage-Backed Securities Purchase Program prior to the program's closing on December 31, 2009.[601]

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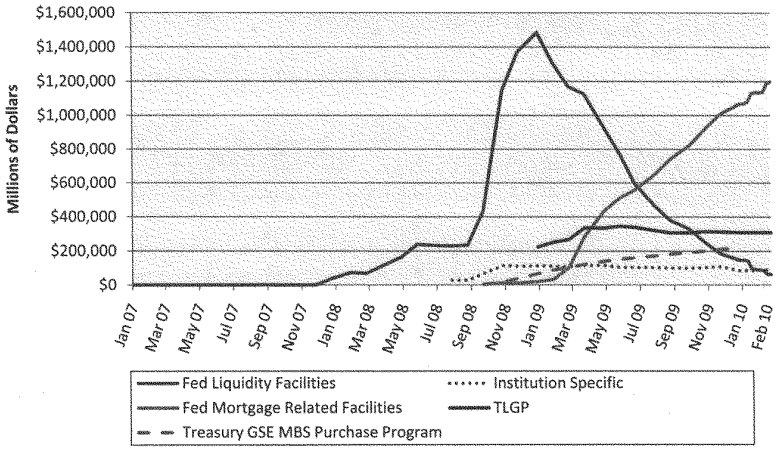
[599] Board of Governors of the Federal Reserve System, *Minutes of the Federal Open Market Committee,* at 10 (Dec. 15–16, 2009) (online at www.federalreserve.gov/newsevents/press/monetary/fomcminutes20091216.pdf) ("[T]he Federal Reserve is in the process of purchasing $1.25 trillion of agency mortgage-backed securities and about $175 billion of agency debt").

[600] Board of Governors of the Federal Reserve System, *FOMC Statement* (Dec. 16, 2009) (online at www.federalreserve.gov/newsevents/press/monetary/20091216a.htm) ("In order to promote a smooth transition in markets, the Committee is gradually slowing the pace of these purchases, and it anticipates that these transactions will be executed by the end of the first quarter of 2010"); Board of Governors of the Federal Reserve System, *Factors Affecting Reserve Balances* (Mar. 4, 2010) (online at www.federalreserve.gov/Releases/H41/Current/).

[601] Treasury received $36 billion in principal and interest payments from these securities. U.S. Department of the Treasury, *2009 Financial Report of the United States Government,* at vii (updated Mar. 4, 2010) (online at www.fms.treas.gov/fr/09frusg/09frusg.pdf).

FIGURE 28: OTHER FEDERAL GOVERNMENT FINANCIAL STABILITY EFFORTS (AS OF FEBRUARY 24, 2010)[602]



[602] Federal Reserve Liquidity Facilities include: Primary credit, Secondary credit, Central Bank Liquidity Swaps, Primary dealer and other broker-dealer credit, Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility, Net portfolio holdings of CPFF, Seasonal credit, Term auction credit, Term Asset-Backed Securities Loan Facility. Federal Reserve Mortgage Related Facilities include: Federal agency debt securities and Mortgage-backed securities held by the Federal Reserve. Institution Specific Facilities include: Credit extended to American International Group, Inc., and the net portfolio holdings of Maiden Lanes I, II, and III. Board of Governors of the Federal Reserve System, *Factors Affecting Reserve Balances (H.4.1)* (online at www.federalreserve.gov/datadownload/Choose.aspx?rel=H41) (accessed Mar. 4, 2010). For related presentations of Federal Reserve data, see Board of Governors of the Federal Reserve System, *Federal Reserve System Monthly Report on Credit and Liquidity Programs and the Balance Sheet,* at 2 (Feb. 2010) (online at www.federalreserve.gov/monetarypolicy/files/monthlyclbsreport201002.pdf). The TLGP figure reflects the monthly amount of debt outstanding under the program. Federal Deposit Insurance Corporation, *Monthly Reports on Debt Issuance Under the Temporary Liquidity Guarantee Program* (Dec. 2008–Dec. 2009) (online at www.fdic.gov/regulations/resources/TLGP/reports.html). The total for TALF has been reduced by $20 billion throughout this exhibit in order to reflect Treasury's $20 billion first-loss position under the terms of this program. U.S. Department of the Treasury, *MBS Purchase Program: Portfolio by Month* (online at www.financialstability.gov/docs/Feb%202010%20Portfolio%20by%20month.xls) (accessed Mar. 4, 2010).

3. Total Financial Stability Resources (as of December 31, 2009)

Beginning in its April 2009 report, the Panel broadly classified the resources that the federal government has devoted to stabilizing the economy through myriad new programs and initiatives as outlays, loans, or guarantees. Although the Panel calculates the total value of these resources at nearly $3 trillion, this would translate into the ultimate "cost" of the stabilization effort only if: (1) assets do not appreciate; (2) no dividends are received, no warrants are exercised, and no TARP funds are repaid; (3) all loans default and are written off; and (4) all guarantees are exercised and subsequently written off.

With respect to the FDIC and Federal Reserve programs, the risk of loss varies significantly across the programs considered here, as do the mechanisms providing protection for the taxpayer against such risk. As discussed in the Panel's November report, the FDIC assesses a premium of up to 100 basis points on TLGP debt guarantees.[603] In contrast, the Federal Reserve's liquidity programs are generally available only to borrowers with good credit, and the loans are over-collateralized and with recourse to other assets of the borrower. If the assets securing a Federal Reserve loan realize a decline in value greater than the "haircut," the Federal Reserve is able to demand more collateral from the borrower. Similarly, should a borrower default on a recourse loan, the Federal Reserve can turn to the borrower's other assets to make the Federal Reserve whole. In this way, the risk to the taxpayer on recourse loans only materializes if the borrower enters bankruptcy. The only loan currently "underwater"—where the outstanding principal amount exceeds the current market value of the collateral—is the loan to Maiden Lane LLC, which was formed to purchase certain Bear Stearns assets.

FIGURE 29: FEDERAL GOVERNMENT FINANCIAL STABILITY EFFORT (AS OF FEBRUARY 25, 2010)

[Dollars in billions]

Program	Treasury (TARP)	Federal Reserve	FDIC	Total
Total	**$698.7**	**$1,555.2**	**$646.4**	**$2,900.3**
Outlays [i]	278.9	1,198.7	69.4	1,547
Loans	43.5	356.5	0	400
Guarantees [ii]	20	0	577	597
Uncommitted TARP Funds	356.3	0	0	356.3
AIG	**69.8**	**67.6**	**0**	**137.4**
Outlays	[iii] 69.8	0	0	69.8
Loans	0	[iv] 67.6	0	67.6
Guarantees	0	0	0	0
Citigroup	**25**	**0**	**0**	**25**
Outlays	[v] 25	0	0	25
Loans	0	0	0	0
Guarantees	0	0	0	0
Capital Purchase Program (Other)	**50.1**	**0**	**0**	**50.1**
Outlays	[vi] 50.1	0	0	50.1
Loans	0	0	0	0
Guarantees	0	0	0	0
Capital Assistance Program	**N/A**	**0**	**0**	[vii] **N/A**
TALF	**20**	**180**	**0**	**200**

[603] November Oversight Report, *supra* note 458, at 36.

FIGURE 29: FEDERAL GOVERNMENT FINANCIAL STABILITY EFFORT (AS OF FEBRUARY 25, 2010)—Continued

[Dollars in billions]

Program	Treasury (TARP)	Federal Reserve	FDIC	Total
Outlays	0	0	0	0
Loans	0	[ix] 180	0	180
Guarantees	[viii] 20	0	0	20
PPIP (Loans) [x]	**0**	**0**	**0**	**0**
Outlays	0	0	0	0
Loans	0	0	0	0
Guarantees	0	0	0	0
PPIP (Securities)	[xi] **30**	**0**	**0**	**30**
Outlays	10	0	0	10
Loans	20	0	0	20
Guarantees	0	0	0	0
Home Affordable Modification Program	**48.5**	**0**	**0**	[xiii] **48.5**
Outlays	[xii] 48.5	0	0	48.5
Loans	0	0	0	0
Guarantees	0	0	0	0
Automotive Industry Financing Program	[xiv] **78.2**	**0**	**0**	**78.2**
Outlays	59	0	0	59
Loans	19.2	0	0	19.2
Guarantees	0	0	0	0
Auto Supplier Support Program	**3.5**	**0**	**0**	*.5*
Outlays	0	0	0	0
Loans	[xv] 3.5	0	0	3.5
Guarantees	0	0	0	0
Unlocking SBA Lending	[xvi] **15**	**0**	**0**	**15**
Outlays	15	0	0	15
Loans	0	0	0	0
Guarantees	0	0	0	0
Community Development Capital Initiative	**0.78**	**0**	**0**	**0.78**
Outlays	0	0	0	0
Loans	.78	0	0	.78
Guarantees	0	0	0	0
Help for Hardest Hit Housing Markets	**1.5**	**0**	**0**	**1.5**
Outlays	1.5	0	0	1.5
Loans	0	0	0	0
Guarantees	0	0	0	0
Temporary Liquidity Guarantee Program	**0**	**0**	**577**	**577**
Outlays	0	0	0	0
Loans	0	0	0	0
Guarantees	0	0	[xvii] 577	577
Deposit Insurance Fund	**0**	**0**	**69.4**	**69/4**
Outlays	0	0	[xviii] 69.4	69.4
Loans	0	0	0	0
Guarantees	0	0	0	0
Other Federal Reserve Credit Expansion	**0**	**1,307.6**	**0**	**1,307.6**
Outlays	0	[xix] 1,198.7	0	1,198.7
Loans	0	[xx] 108.9	0	108.9
Guarantees	0	0	0	0
Uncommitted TARP Funds	**356.3**	**0**	**0**	**356.3**

[i] The term ''outlays'' is used here to describe the use of Treasury funds under the TARP, which are broadly classifiable as purchases of debt or equity securities (e.g., debentures, preferred stock, exercised warrants, etc.). The outlays figures are based on: (1) Treasury's actual reported expenditures; and (2) Treasury's anticipated funding levels as estimated by a variety of sources, including Treasury pronouncements and GAO estimates. Anticipated funding levels are set at Treasury's discretion, have changed from initial announcements, and are subject to further change. Outlays used here represent investment and asset purchases and commitments to make investments and asset purchases and are not the same as budget outlays, which under section 123 of EESA are recorded on a ''credit reform'' basis.

[ii] Although many of the guarantees may never be exercised or exercised only partially, the guarantee figures included here represent the federal government's greatest possible financial exposure.

[iii] This number includes investments under the AIGIP/SSFI Program: a $40 billion investment made on November 25, 2008, and a $30 billion investment committed on April 17, 2009 (less a reduction of $165 million representing bonuses paid to AIG Financial Products employees). As of January 5, 2010, AIG had utilized $45.3 billion of the available $69.8 billion under the AIGIP/SSFI and owed $1.6 billion in unpaid dividends. This information was provided by Treasury in response to a Panel inquiry.

[iv] This number represents the full $35 billion that is available to AIG through its revolving credit facility with the Federal Reserve ($25.5 billion had been drawn down as of February 25, 2010) and the outstanding principal of the loans extended to the Maiden Lane II and III SPVs to buy AIG assets (as of February 25, 2010, $15.2 billion and $17.4 billion respectively). Income from the purchased assets is used to pay down the loans to the SPVs, reducing the taxpayers' exposure to losses over time. Board of Governors of the Federal Reserve System, *Federal Reserve System Monthly Report on Credit and Liquidity Programs and the Balance Sheet*, at 17 (Oct. 2009) (online at www.federalreserve.gov/monetarypolicy/files/monthlyclbsreport200910.pdf). On December 1, 2009, AIG entered into an agreement with FRBNY to reduce the debt AIG owes the FRBNY by $25 billion. In exchange, FRBNY received preferred equity interests in two AIG subsidiaries. This also reduced the debt ceiling on the loan facility from $60 billion to $35 billion. American International Group, *AIG Closes Two Transactions That Reduce Debt AIG Owes Federal Reserve Bank of New York by $25 billion* (Dec. 1, 2009) (online at phx.corporate-ir.net/External.File?item=UGFyZW50SUQ9MjE4ODI8Q2hpbGRJRD0tMXxUeXBlPTM=&t=1).

[v] As of February 4, 2009, the U.S. Treasury held $25 billion of Citigroup common stock under the CPP. U.S. Department of the Treasury, *Troubled Asset Relief Program Transactions Report for Period Ending February 25, 2010* (Mar. 4, 2010) (online at www.financialstability.gov/docs/transaction-reports/3-1-10%20Transactions%20Report%20as%20of%202-25-10.pdf).

[vi] This figure represents the $204.9 billion Treasury has disbursed under the CPP, minus the $25 billion investment in Citigroup ($25 billion) identified above, and the $129.8 billion in repayments that are reflected as available TARP funds. This figure does not account for future repayments of CPP investments, nor does it account for dividend payments from CPP investments. U.S. Department of the Treasury, *Troubled Asset Relief Program Transactions Report for Period Ending February 25, 2010* (Mar. 4, 2010) (online at www.financialstability.gov/docs/transaction-reports/3-1-10%20Transactions%20Report%20as%20of%202-25-10.pdf).

[vii] On November 9, 2009, Treasury announced the closing of the CAP and that only one institution, GMAC, was in need of further capital from Treasury. GMAC, however, received further funding through the AIFP, therefore the Panel considers CAP unused and closed. U.S. Department of the Treasury, *Treasury Announcement Regarding the Capital Assistance Program* (Nov. 9, 2009) (online at www.financialstability.gov/latest/tg__11092009.html).

[viii] This figure represents a $20 billion allocation to the TALF SPV on March 3, 2009. However, as of February 25, 2010, TALF LLC had drawn only $103 million of the available $20 billion. Board of Governors of the Federal Reserve System, *Factors Affecting Reserve Balances (H.4.1)* (Jan. 28, 2010) (online at www.federalreserve.gov/Releases/H41/Current/); U.S. Department of the Treasury, *Troubled Asset Relief Program Transactions Report for Period Ending February 25, 2010* (Mar. 4, 2010) (online at www.financialstability.gov/docs/transaction-reports/3-1-10%20Transactions%20Report%20as%20of%202-25-10.pdf). As of January 28, 2010, investors had requested a total of $68 billion in TALF loans ($11.9 billion in CMBS and $56 billion in non-CMBS) and $66 billion in TALF loans had been settled ($11 billion in CMBS and $55 billion in non-CMBS). Federal Reserve Bank of New York, *Term Asset-Backed Securities Loan Facility: CMBS* (accessed Mar. 4, 2010) (online at www.newyorkfed.org/markets/CMBS__recent__operations.html); Federal Reserve Bank of New York, *Term Asset-Backed Securities Loan Facility: non- CMBS* (accessed Mar. 4, 2010) (online at www.newyorkfed.org/markets/talf__operations.html).

[ix] This number is derived from the unofficial 1:10 ratio of the value of Treasury loan guarantees to the value of Federal Reserve loans under the TALF. U.S. Department of the Treasury, *Fact Sheet: Financial Stability Plan* (Feb.10, 2009) (online at www.financialstability.gov/docs/fact-sheet.pdf) (describing the initial $20 billion Treasury contribution tied to $200 billion in Federal Reserve loans and announcing potential expansion to a $100 billion Treasury contribution tied to $1 trillion in Federal Reserve loans). Because Treasury is responsible for reimbursing the Federal Reserve Board for $20 billion of losses on its $200 billion in loans, the Federal Reserve Board's maximum potential exposure under the TALF is $180 billion.

[x] It is unlikely that resources will be expended under the PPIP Legacy Loans Program in its original design as a joint Treasury-FDIC program to purchase troubled assets from solvent banks. *See also* Federal Deposit Insurance Corporation, *FDIC Statement on the Status of the Legacy Loans Program* (June 3, 2009) (online at www.fdic.gov/news/news/press/2009/pr09084.html) and Federal Deposit Insurance Corporation, *Legacy Loans Program—Test of Funding Mechanism* (July 31, 2009) (online at www.fdic.gov/news/news/press/2009/pr09131.html). The sales described in these statements do not involve any Treasury participation, and FDIC activity is accounted for here as a component of the FDIC's Deposit Insurance Fund outlays.

[xi] As of February 25, 2010, Treasury reported commitments of $19.9 billion in loans and $9.9 billion in membership interest associated with the program. On January 4, 2010, the Treasury and one of the nine fund managers, TCW Senior Management Securities Fund, L.P., entered into a ''Winding-Up and Liquidation Agreement.'' U.S. Department of the Treasury, *Troubled Asset Relief Program Transactions Report for Period Ending February 25, 2010* (Mar. 4, 2010) (online at www.financialstability.gov/docs/transaction-reports/3-1-10%20Transactions%20Report%20as%20of%202-2-10.pdf).

[xii] Of the $50 billion in announced TARP funding for this program, $36.9 billion has been allocated as of February 4, 2010. However, as of January 2010, only $32 million in non-GSE payments have been disbursed under HAMP. Disbursement information provided in response to Panel inquiry on February 4, 2010; U.S. Department of the Treasury, *Troubled Asset Relief Program Transactions Report for Period Ending February 25, 2010* (Mar. 4, 2010) (online at www.financialstability.gov/docs/transaction-reports/3-1-10%20Transactions%20Report%20as%20of%202-2-10.pdf).

[xiii] Fannie Mae and Freddie Mac, government-sponsored entities (GSEs) that were placed in conservatorship of the Federal Housing Finance Housing Agency on September 7, 2009, will also contribute up to $25 billion to the Making Home Affordable Program, of which the HAMP is a key component. U.S. Department of the Treasury, *Making Home Affordable: Updated Detailed Program Description* (Mar. 4, 2009) (online at www.treas.gov/press/releases/reports/housing-fact-sheet.pdf).

[xiv] *See* U.S. Department of the Treasury, *Troubled Asset Relief Program Transactions Report for Period Ending February 25, 2010* (Mar. 4, 2010) (online at www.financialstability.gov/docs/transaction-reports/3-1-10%20Transactions%20Report%20as%20of%202-25-10.pdf). A substantial portion of the total $81 billion in loans extended under the AIFP have since been converted to common equity and preferred shares in restructured companies. $19.2 billion has been retained as first lien debt (with $6.7 billion committed to GM, $12.5 billion to Chrysler). This figure ($78.2 billion) represents Treasury's current obligation under the AIFP after repayments.

[xv] *See* U.S. Department of the Treasury, *Troubled Asset Relief Program Transactions Report for Period Ending February 25, 2010* (Mar. 4, 2010) (online at www.financialstability.gov/docs/transaction-reports/3-1-10%20Transactions%20Report%20as%20of%202-25-10.pdf).

[xvi] U.S. Department of Treasury, *Fact Sheet: Unlocking Credit for Small Businesses* (Oct. 19, 2009) (online at www.financialstability.gov/roadtostability/unlockingCreditforSmallBusinesses.html) (*''Jumpstart Credit Markets For Small Businesses By Purchasing Up to $15 Billion in Securities''*).

[xvii] This figure represents the current maximum aggregate debt guarantees that could be made under the program, which is a function of the number and size of individual financial institutions participating. Of debt subject to the guarantee, $309 billion is currently outstanding, which represents about 54 percent of the current cap. Federal Deposit Insurance Corporation, *Monthly Reports on Debt Issuance Under the Temporary Liquidity Guarantee Program: Debt Issuance Under Guarantee Program* (Dec. 31, 2009) (online at www.fdic.gov/regulations/resources/tlgp/total__issuance12-09.html) (updated Feb. 4, 2010). The FDIC has collected $10.4 billion in fees and surcharges from this program since its inception in the fourth quarter of 2008. Federal Deposit Insurance Corporation, *Monthly Reports on Debt Issuance Under the Temporary Liquidity Guarantee Program* (Nov. 30, 2009) (online at www.fdic.gov/regulations/resources/TLGP/fees.html) (updated Feb. 4, 2010).

[xviii] This figure represents the FDIC's provision for losses to its deposit insurance fund attributable to bank failures in the third and fourth quarters of 2008 and the first, second and third quarters of 2009. Federal Deposit Insurance Corporation, *Chief Financial Officer's (CFO) Report to the Board: DIF Income Statement (Fourth Quarter 2008)* (online at www.fdic.gov/about/strategic/corporate/cfo_report_4qtr_08/income.html); Federal Deposit Insurance Corporation, *Chief Financial Officer's (CFO) Report to the Board: DIF Income Statement (Third Quarter 2008)* (online at www.fdic.gov/about/strategic/corporate/cfo_report_3rdqtr_08/income.html); Federal Deposit Insurance Corporation, *Chief Financial Officer's (CFO) Report to the Board: DIF Income Statement (First Quarter 2009)* (online at www.fdic.gov/about/strategic/corporate/cfo_report_1stqtr_09/income.html); Federal Deposit Insurance Corporation, *Chief Financial Officer's (CFO) Report to the Board: DIF Income Statement (Second Quarter 2009)* (online at www.fdic.gov/about/strategic/corporate/cfo_report_2ndqtr_09/income.html); Federal Deposit Insurance Corporation, *Chief Financial Officer's (CFO) Report to the Board: DIF Income Statement (Third Quarter 2009)* (online at www.fdic.gov/about/strategic/corporate/cfo_report_3rdqtr_09/income.html). This figure includes the FDIC's estimates of its future losses under loss-sharing agreements that it has entered into with banks acquiring assets of insolvent banks during these five quarters. Under a loss-sharing agreement, as a condition of an acquiring bank's agreement to purchase the assets of an insolvent bank, the FDIC typically agrees to cover 80 percent of an acquiring bank's future losses on an initial portion of these assets and 95 percent of losses of another portion of assets. *See, e.g.*, Federal Deposit Insurance Corporation, *Purchase and Assumption Agreement Among FDIC, Receiver of Guaranty Bank, Austin, Texas, FDIC and Compass Bank* at 65–66 (Aug. 21, 2009) (online at www.fdic.gov/bank/individual/failed/guaranty-tx_p_and_a_w_addendum.pdf). In information provided to Panel staff, the FDIC disclosed that there were approximately $132 billion in assets covered under loss-sharing agreements as of December 18, 2009. Furthermore, the FDIC estimates the total cost of a payout under these agreements to be $59.3 billion. Since there is a published loss estimate for these agreements, the Panel continues to reflect them as outlays rather than as guarantees.

[xix] Outlays are comprised of the Federal Reserve Mortgage Related Facilities. The Federal Reserve balance sheet accounts for these facilities under Federal agency debt securities and mortgage-backed securities held by the Federal Reserve. Board of Governors of the Federal Reserve System, *Factors Affecting Reserve Balances (H.4.1)* (online at www.federalreserve.gov/datadownload/Choose.aspx?rel=H41) (accessed Mar. 4, 2010). Although the Federal Reserve does not employ the outlays, loans and guarantees classification, its accounting clearly separates its mortgage-related purchasing programs from its liquidity programs. *See* Board of Governors of the Federal Reserve, *Credit and Liquidity Programs and the Balance Sheet*, at 2 (Nov. 2009) (online at www.federalreserve.gov/monetarypolicy/files/monthlyclbsreport200911.pdf).

On September 7, 2008, the Treasury Department announced the GSE Mortgage Backed Securities Purchase Program (Treasury MBS Purchase Program). The Housing and Economic Recovery Act of 2008 provided Treasury the authority to purchase Government Sponsored Enterprise (GSE) MBS. Under this program, Treasury purchased approximately $214.4 billion in GSE MBS before the program ended on December 31, 2009. Treasury received $36 billion in principal and interest payments from these securities. U.S. Department of the Treasury, *Fact Sheet: GSE Mortgage Backed Securities Purchase Program* (Sept. 7, 2008) (online at www.mbaa.org/files/ResourceCenter/GSE/TreasuryFactSheetonGSEMBSPurchaseProgram.pdf); U.S. Department of the Treasury, *2009 Financial Report of the United States Government*, at vii (updated Mar. 4, 2010) (online at www.fms.treas.gov/fr/09frusg/09frusg.pdf).

[xx] Federal Reserve Liquidity Facilities classified in this table as loans include: Primary credit, Secondary credit, Central bank liquidity swaps, Primary dealer and other broker-dealer credit, Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility, Net portfolio holdings of Commercial Paper Funding Facility LLC, Seasonal credit, Term auction credit, Term Asset-Backed Securities Loan Facility, and loans outstanding to Bear Stearns (Maiden Lane I LLC). Board of Governors of the Federal Reserve System, *Factors Affecting Reserve Balances (H.4.1)* (online at www.federalreserve.gov/datadownload/Choose.aspx?rel=H41) (accessed Feb. 4, 2010).

SECTION FIVE: OVERSIGHT ACTIVITIES

The Congressional Oversight Panel was established as part of EESA and formed on November 26, 2008. Since then, the Panel has produced fifteen oversight reports, as well as a special report on regulatory reform, issued on January 29, 2009, and a special report on farm credit, issued on July 21, 2009. Since the release of the Panel's February oversight report, which assessed Treasury's strategy for addressing issues in commercial real estate markets across the country, the following developments pertaining to the Panel's oversight of the TARP took place:

- The Panel held a hearing in Washington, DC on February 25, 2010, discussing the government assistance provided to GMAC under the TARP, the government's strategy for managing and ultimately divesting its 56.3 percent ownership stake in the company, and the company's plans to return to profitability and return the taxpayers' investment in it. The Panel heard testimony from senior Treasury officials and GMAC executives, including its CEO Michael Carpenter, as well as independent industry analysts.
- The Panel held a hearing in Washington, DC on March 4, 2010, to discuss the exceptional government assistance provided to Citigroup under three separate programs: the Capital Purchase Program, the Targeted Investment Program, and the Asset Guarantee Program. The Panel heard testimony from Assistant Secretary of the Treasury for Financial Stability Herbert M. Allison, Jr. and Citigroup CEO Vikram Pandit.

Video recordings of the hearings, the written testimony from the hearing witnesses, and Panel Members' opening statements all can be found online at http://cop.senate.gov/hearings.

Upcoming Reports and Hearings

The Panel will release its next oversight report in April. The report will address ongoing efforts under the TARP to mitigate home foreclosures.

SECTION SIX: ABOUT THE CONGRESSIONAL OVERSIGHT PANEL

In response to the escalating financial crisis, on October 3, 2008, Congress provided Treasury with the authority to spend $700 billion to stabilize the U.S. economy, preserve home ownership, and promote economic growth. Congress created the Office of Financial Stability (OFS) within Treasury to implement the Troubled Asset Relief Program. At the same time, Congress created the Congressional Oversight Panel to "review the current state of financial markets and the regulatory system." The Panel is empowered to hold hearings, review official data, and write reports on actions taken by Treasury and financial institutions and their effect on the economy. Through regular reports, the Panel must oversee Treasury's actions, assess the impact of spending to stabilize the economy, evaluate market transparency, ensure effective foreclosure mitigation efforts, and guarantee that Treasury's actions are in the best interests of the American people. In addition, Congress instructed the Panel to produce a special report on regulatory reform that analyzes "the current state of the regulatory system and its effectiveness at overseeing the participants in the financial system and protecting consumers." The Panel issued this report in January 2009. Congress subsequently expanded the Panel's mandate by directing it to produce a special report on the availability of credit in the agricultural sector. The report was issued on July 21, 2009.

On November 14, 2008, Senate Majority Leader Harry Reid and the Speaker of the House Nancy Pelosi appointed Richard H. Neiman, Superintendent of Banks for the State of New York, Damon Silvers, Director of Policy and Special Counsel of the American Federation of Labor and Congress of Industrial Organizations (AFL–CIO), and Elizabeth Warren, Leo Gottlieb Professor of Law at Harvard Law School, to the Panel. With the appointment on November 19, 2008, of Congressman Jeb Hensarling to the Panel by House Minority Leader John Boehner, the Panel had a quorum and met for the first time on November 26, 2008, electing Professor Warren as its chair. On December 16, 2008, Senate Minority Leader Mitch McConnell named Senator John E. Sununu to the Panel. Effective August 10, 2009, Senator Sununu resigned from the Panel, and on August 20, 2009, Senator McConnell announced the appointment of Paul Atkins, former Commissioner of the U.S. Securities and Exchange Commission, to fill the vacant seat. Effective December 9, 2009, Congressman Jeb Hensarling resigned from the Panel and House Minority Leader John Boehner announced the appointment of J. Mark McWatters to fill the vacant seat.

ACKNOWLEDGEMENTS

The Panel wishes to acknowledge 13 industry experts/analysts and 11 academics and industry participants who were willing to share their insight.

APPENDIX I: LETTER FROM SECRETARY TIMOTHY GEITHNER TO CHAIR ELIZABETH WARREN, RE: RESPONSE TO QUESTIONS ON EXECUTIVE COMPENSATION, DATED FEBRUARY 16, 2010

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.

SECRETARY OF THE TREASURY

February 16, 2010

Elizabeth Warren
Chair
Congressional Oversight Panel
732 North Capitol Street NW
Rooms C-320 and C-617
Mailstop: COP
Washington, DC 20401

Dear Chair Warren:

Thank you for your letter of December 24, 2009, concerning the executive compensation restrictions of the Emergency Economic Stabilization Act of 2008 (EESA), as amended by the Recovery Act, applicable to recipients of financial assistance under the Troubled Asset Relief Program (TARP). Reforming executive compensation practices, particularly at firms that received financial assistance under EESA, is central to this Administration's efforts to restore trust and confidence in our financial system.

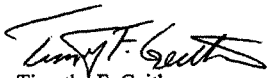
Under EESA, Treasury is charged with setting compensation and corporate governance standards applicable to all TARP recipients. As you noted in your letter, in June 2009 Treasury issued an Interim Final Rule that both implemented the compensation restrictions set forth in EESA and used the discretion granted to Treasury in the statute to add further restrictions and requirements. The Interim Final Rule reflects the Administration's commitment to the process of bringing compensation practices at those financial institutions in line with the interests of shareholders and reinforcing the stability of the financial system.

Among the additional restrictions and requirements Treasury imposed under the Interim Final Rule was the creation, within Treasury's Office of Financial Stability, of the Office of the Special Master for TARP Executive Compensation, headed by Kenneth Feinberg. The Special Master is charged with the review and approval of compensation payments and structures for the top earners at firms receiving exceptional TARP assistance. Mr. Feinberg is empowered to make sure that compensation structures are appropriate in light of the particular circumstances at each firm, and that compensation plans reward performance, maximize taxpayer return, and avoid incentives for excessive risk. Mr. Feinberg's first two rounds of decisions on compensation structures at firms receiving exceptional assistance reflect significant progress toward striking the right balance between incentives and risk-taking – all in the public interest.

Of course, our efforts to reform compensation practices are not limited to the firms that received assistance under EESA. Accordingly, the Interim Final Rule, and Mr. Feinberg's work, must be placed in the broader context of what we are doing to encourage better design of compensation to minimize risks to the system as a whole. The Administration has proposed, and the House has passed, legislation that will give shareholders a "say on pay" and strengthen independence of compensation committees at all U.S. public companies. In addition, new supervisory standards from Federal bank regulators, as well as new SEC rules requiring greater disclosure of the relationship between compensation and risk, will help better align pay practices with long-term value creation and prudent risk management.

Your letter included extensive questions with respect to Treasury's adoption of the Interim Final Rule and the work of the Office of the Special Master. Detailed answers to each of those specific questions, prepared by Treasury legal staff in consultation with Mr. Feinberg, are enclosed. Please let me know if you have additional questions on this matter.

Sincerely,



Timothy F. Geithner

cc: Mr. Paul Atkins
Mr. Mark McWatters
Mr. Richard H. Neiman
Mr. Damon A. Silvers

Written Responses to Letter from Chair Warren Dated December 24, 2009

Staff of the Congressional Oversight Panel met with Treasury staff on November 10, 2009, to discuss the work of the Special Master as well as aspects of the Interim Rule generally. The meeting was informative and helpful, but a number of questions remain:

1. The compensation rules bar payment of any bonus, retention award, or incentive compensation other than through long-term restricted stock that cannot constitute more than one-third of the employee's total compensation and whose full vesting cannot occur when TARP assistance is outstanding (the "bonus restrictions").

a. Some commentators have expressed concern that a substantial portion of the increase in value of the restricted stock issued under the bonus restrictions could result in a windfall to covered individuals, because the stock has been granted at historic lows in each institution's stock price and any rise in that price will derive in part from public investment and the implicit cushion created by a perceived "too-big-to-fail" guarantee by federal authorities.

For example, the closing price of a share of common stock of Bank of America on February 12, 2009, when the Interim Rule went into effect, was $5.84, and the price on December 1, 2009, was $15.89, an increase of 172 percent; for Wells Fargo the respective numbers are $16.70 on February 12, 2009, and $27.99 on December 1, 2009, an increase of 67.6 percent.

Please explain the extent to which Treasury considered this issue in drafting the Interim Rule. If this issue was considered, please explain why Treasury rejected the imposition of some cap on the gain covered individuals could receive from their restricted stock.

Answer: In requiring that incentive compensation for covered employees be paid in stock, the Interim Final Rule (IFR) implements the structure of the Emergency Economic Stabilization Act of 2008 (EESA), as amended by the Recovery Act, which expressly mandated that bonuses for these employees be paid in stock. Since incentive compensation is not paid until the end of the fiscal year, however, this stock was generally not granted at the February 2009 prices described in your question. Rather, incentive compensation was paid at the end of 2009, by which time stock prices had risen considerably, as your question points out. Accordingly, most employees received stock grants pursuant to the IFR at those higher prices. By that time, public investment in several large TARP recipients had already been repaid.

With respect to the broader question of whether there should nonetheless be a "cap" on gains covered employees can receive from this restricted stock – again, awarded not at February 2009 prices but at year-end 2009 prices – Treasury concluded that EESA's requirement that bonuses be paid in stock should be interpreted to give employees incentives aligned with long-term value creation. That interpretation is consistent with the goal of having TARP recipients repay taxpayers as soon as possible and maximizing the value of the equity stake that EESA required Treasury to obtain from TARP recipients. That is why the IFR prohibits the stock from being transferred unless TARP assistance is repaid, and requires the stock to be forfeited unless the

employee continues to work for the TARP recipient. Given that EESA did not include a "cap" on the gains resulting from increases in the long-term value of the TARP recipient, Treasury concluded that the IFR should not require that approach.

1b. Please explain the protections the Interim Rule provides against employment contract "make-up" provisions designed to avoid the effect of the bonus restrictions. During the November 10 meeting, Treasury staff explained that the Interim Rule effectively prohibits such provisions by preventing accrual of benefits to be paid after a TARP recipient exits the TARP. However, under the Financial Accounting Standards Board No. 5 (FASB 5), *Accounting for Contingencies*, in order for a liability to be accrued the amount must be both probable and estimable. Please explain how the provisions of the Interim Rule would apply under FASB 5.

Answer: FASB 5 has no effect on the provisions of the IFR. Rather than adopt the accrual standard set forth in FASB 5, the IFR takes a broader view of an "accrual" of a prohibited payment, to make certain that a TARP recipient cannot "make up" a prohibited bonus, retention award, or incentive payment once the employee is no longer subject to the restrictions. For example, if one of the requirements to receive a payment is that the employee provided services during the period the employee was subject to the restrictions, that payment, whenever it is actually made, will be treated as accrued during that period and thus subject to the restrictions.

1c. Please explain why an economic payment equivalent to that foregone by the bonus restrictions cannot be built into a "golden parachute" payment, by formula or amount, for the period for which the bonus restrictions operate, even if the parachute payments may not be made until the end of the coverage period (or, in the case of any employee other than an SEO and the next five most highly-compensated employees, during the coverage period).

Answer: As noted in our response to your Question 1(b) above, the IFR's prohibition on the accrual of any bonus to a covered employee applies broadly, and generally encompasses any payment for services provided while the employee was subject to the restrictions. Thus, a TARP recipient cannot simply increase a retirement payment or other payment due upon a termination of employment (often called "golden parachute" payment) as a substitute for a prohibited bonus.

1d. For financial institutions that have received at least $25 million in TARP assistance, the number of employees subject to the bonus restrictions is set in the statute, but the statute gives Treasury the general discretion to expand that number in the public interest.

Please explain why Treasury has not made use of that authority (other than to authorize review of the "structure of the compensation" of the next 75 most highly-compensated of the seven institutions), and the standards it has employed in deciding not to do so, in light of the fact that the Interim Rule's definition of "highly-compensated employee" includes individuals, such as traders, who are not executive officers. Has Treasury considered extending compensation restrictions to these very senior executives, notwithstanding the fact that they are not among the very most highly compensated employees in their institutions?

Answer: As noted in your question, Treasury extended compensation restrictions to all of the executive officers of TARP recipients that received exceptional assistance. The IFR requires that each recipient of exceptional financial assistance under the TARP obtain the Special Master's approval for the compensation structures for all executive officers, regardless of whether those executives are among the TARP recipient's most highly compensated employees.

With respect to the application of EESA's compensation restrictions to the "executive officers" of TARP recipients, the IFR implements EESA's statutory design, which identifies the employees subject to the restrictions as the "senior executive officers" and, in some cases, the "most highly compensated employees" of each TARP recipient. Neither EESA nor the IFR separately provide for the restrictions to apply to employees serving as executive officers, except insofar as those officers are covered by virtue of their status as "senior executive officers" or "most highly compensated employees."

1e. Treasury officials explained during the November 10 meeting that the bonus restrictions are not applied to executives hired in 2009 to direct the recovery of the relevant institutions. Please explain the standards Treasury has used in applying this exception, as well as the levels of compensation that executives covered by the exception are allowed to received. Please include in that explanation details reflecting actual compensation paid to a selected group of such employees who have become one of the five SEOs of an institution to which this exception has been applied.

Answer: The IFR does not include an exception for executives hired in 2009 to direct the recovery of TARP recipients. Generally, the executives covered by the IFR are determined by reference to total compensation for the previous fiscal year. However, a newly hired chief executive officer or chief financial officer of a TARP recipient becomes subject to Treasury's regulations on the first day that the executive serves in that role.

For examples of the application of the IFR to executives hired in 2009 to direct the recovery of TARP recipients, the Panel may wish to review determinations of the Special Master related to the newly hired chief executive officers for American International Group, Inc. and General Motors Acceptance Corporation, and the newly hired chief financial officer for General Motors Company. As required by the IFR, those determinations, and detailed information with respect to the compensation structures for those executives, are publicly available on the Internet at http://www.financialstability.gov/about/executivecompensation.html, and also at http://www.financialstability.gov/about/spcMaster.html.

1f. Under the statute, restricted stock, granted under the bonus restrictions, may not fully vest during the coverage period. The Interim Rule interprets this language to permit partial vesting as TARP assistance is repaid and final vesting when TARP assistance is fully repaid. Why was repayment of TARP assistance the only relevant standard used in the Interim Rule, in light of the number of key statutory purposes – for example, increasing lending levels and strengthening banks capital position – for the TARP?

Answer: EESA contains detailed language requiring that any incentive compensation paid to an employee subject to the bonus restrictions may not fully vest until TARP assistance is repaid. Treasury determined that TARP repayment should be a condition of the payment of any bonus, retention award, or incentive compensation paid in the form of long-term restricted stock for all employees subject to the bonus restrictions, and the IFR reflects this determination.

However, repayment of TARP assistance is not the only requirement that must be satisfied for an employee to vest. Treasury used its authority under EESA to promulgate additional restrictions on this stock to also require that this stock be forfeited unless the employee provides at least two years of service to the TARP recipient after the stock is granted.

Both EESA and the IFR give TARP recipients the flexibility to impose additional requirements relating to the vesting or transferability of this stock such as those described in your question. However, Treasury determined that prescribing a single set of vesting or transferability criteria for all TARP recipients would impose a one-size-fits-all solution that would be undesirable in view of the substantial variation among firms.

1g. The nation's largest financial institutions have received hundreds of billions of dollars in taxpayer assistance. The statute requires Treasury to review "bonuses, retention[,] awards, and other compensation" paid on or before February [17], 2009 (the date of the statute's enactment) by any institution that has received TARP assistance to determine "whether any such payments *were inconsistent with the purposes of the statute or the TARP or were otherwise inconsistent with the public interest.*" (Emphasis supplied.)

i. Has Treasury conducted such a "look-back" review? Has it conducted such a review for any institution other than one of the seven institutions? In either case, what standards has it used, or will it use, in such a review, that are more specific than the general discretionary standards outlined in the Interim Rule?

Answer: The Special Master expects to turn to this "look-back" review following the issuance of determinations for 2010 compensation for certain employees at exceptional-assistance firms. The IFR sets forth clear principles that the Special Master must use in making the determination whether a payment is inconsistent with the purposes of EESA or the TARP or are otherwise inconsistent with the public interest. These principles include:

(1) *Risk.* Compensation should avoid incentives that reward employees for short-term or temporary increases in value that may not ultimately result in an increase in the long-term value of the TARP recipient.

(2) *Taxpayer return.* Compensation should reflect the need for the TARP recipient to remain a competitive enterprise and ultimately repay TARP obligations.

(3) *Appropriate allocation.* Compensation should be appropriately allocated among each element of pay (*e.g.*, salary, short- and long-term incentive pay, and current and deferred compensation or retirement pay).

(4) *Performance-based compensation.* Compensation should be performance-based, and determined through tailored metrics that encompass individual performance and/or the performance of the TARP recipient or relevant business unit.

(5) *Comparable payments.* Compensation should be consistent with, and not excessive in comparison to, pay for those in similar roles at similar entities.

(6) *Employee contribution.* Compensation should reflect the current or prospective contributions of the employee to the value of the TARP recipient.

Treasury believes that consistent application of these principles by the Special Master, based upon expertise developed in the review of compensation at recipients of exceptional financial assistance, will best serve the purposes of EESA Section 111(f).

ii. The possibility of compensation restrictions was apparent, based on the original language of section 111 of EESA, before enactment of the statute, and it is likely that protective provisions were placed into employment contracts as a result. If Treasury has not conducted a review of such provisions for any group of relevant institutions, why has it not done so?

iii. If Treasury makes a determination described immediately above for a particular TARP recipient, it must "seek to negotiate with the TARP recipient and the subject employee for appropriate reimbursements to the Federal Government." Has Treasury done so? Has it done so for any institution other than the seven institutions? If Treasury has not done so, please explain why not. Does Treasury have any plans to do so? If so, when?

Answer: The Special Master is still determining the procedures that will be used in conducting the review of payments under EESA Section 111(f), which must occur before any employment contracts are reviewed or any negotiations commence.

iv. The Interim Rule gives authority to the Special Master to conduct all of the look-back reviews, not just those for the seven institutions. Please explain this expansion of the Special Master's authority beyond the seven institutions.

Answer: As noted in your question, Treasury used its authority under EESA to create the Office of the Special Master, and the IFR gives the Special Master authority to approve compensation at institutions that received exceptional assistance (initially there were seven such institutions; following repayments by Bank of America and Citigroup, there are now five). Section 111(f) of EESA mandates that the review of compensation payments applies to all TARP recipients. Therefore, although the Special Master's jurisdiction is generally limited to institutions that received exceptional assistance, his review of payments under Section 111(f) will, as required by statute, encompass all TARP recipients.

2. The statute requires that the rules promulgated by Treasury bar incentives for SEOs to

take "unnecessary and excessive risks that threaten the value of the [financial institution]."

a. The Interim Rule does not explain the meaning of this requirement generally. Instead it merely restates the language of the statute. Please explain why this is so.

Answer: Because the appropriate approach to balancing the relationship between incentives and risk-taking will differ based on the institution's size, risk profile, and compensation structures, the IFR does include a standard of general applicability drawn from the statutory language. However, the IFR does not simply restate the statutory language. The IFR also requires that the compensation committee of each TARP recipient (which is required, under EESA and the IFR, to be composed solely of independent directors) provide Treasury with a narrative description that explains why pay plans do not encourage unnecessary or excessive risk-taking. Treasury believes that this requirement will encourage financial institutions to pursue the complex analysis necessary to balance incentives and risk-taking.

b. The Interim Rule [. . .] contains an extensive explanation of the meaning and application of [the] prohibition against "unnecessary and excessive risks" for the seven institutions (or for any other institution that seeks an advisory opinion from the Special Master). Please explain this difference in treatment, given that many recipients other than the seven institutions continue to hold large amounts of TARP assistance.

Answer: As noted in your question, the IFR separately describes considerations related to risk that the Special Master must take into account when determining compensation structures at firms receiving exceptional assistance and the risk-related review of compensation plans that all TARP recipients are required to conduct. The Special Master has applied those considerations in determining 2009 compensation at those firms, and Treasury expects that TARP recipients' reviews of compensation plans will be guided by those determinations.

3. The statute requires a "claw-back" of bonus, retention award, or incentive compensation to a covered individual based on financial information or "other criteria" that are "found to be materially misleading."

a. Under the Interim Rule, the claw-back provision applies in two situations:

The first is [the relevant] "employee . . . *knowingly engag[ing]* in providing inaccurate information (including knowingly failing to timely correct inaccurate information) relating to . . . [the institution's] financial statements or performance metrics [on which the employee's bonus compensation is based]." (Emphasis supplied.)

The second is any case in which "a financial statement or performance metric criteri[on] is materially inaccurate [under] *all the facts and circumstances*." (Emphasis supplied.)

b. What are the ramifications under the federal securities laws of a senior employee's provision of materially inaccurate information for the financial statement of a public company?

Answer: Interpretation and application of the federal securities laws is in the purview of the Securities and Exchange Commission.

Why is it appropriate to provide a definition for operation of the claw-back rule that requires a serious violation of the securities laws before the former comes into operation? The Interim Rule makes use of provisions of the regulations issued under the securities laws in a number of critical places. The Panel requests Treasury's view on this matter.

Answer: The IFR does not limit the "clawback" to situations that give rise to a violation of the securities laws, serious or otherwise. Under the IFR, the "clawback" must apply *whenever* the facts and circumstances show that a bonus is based on materially inaccurate financial statements or performance metric criteria. In addition, the TARP recipient's exercise of its clawback rights is not merely discretionary: the IFR requires a TARP recipient to exercise its rights under the "clawback" unless it demonstrates that to do so would be unreasonable.

c. Except for the situation described immediately above [in Question 3(b)], the Interim Rule states that whether information is materially misleading "depends on all the facts and circumstances." *SEC Staff Accounting Bulletin 99* provides extensive definitions of materiality applicable to the financial disclosure of public companies. Why did Treasury not adopt this guidance as the basis for operation of the claw-back provision, especially in light of the fact that the claw-back rule and *Accounting Bulletin 99* apply to the same set of financial disclosures?

Answer: *SEC Staff Accounting Bulletin 99* is one of many sources of legal authority and guidance as to what materiality means in the context of financial reporting, and is limited by its terms to a particular issue. There is a deep and wide variety of other sources that address the meaning of materiality, including case law, SEC rules, other SEC staff bulletins, the SEC's Division of Corporate Finance Financial Disclosure and Reporting Manual, and the SEC's Division of Corporate Finance Compliance and Disclosure Interpretations. Treasury concluded that the purposes of EESA are best served by not limiting the "clawback" to the meanings set forth in one piece of guidance on a particular issue.

Treasury was particularly reluctant to limit the operation of the "clawback" in this manner because a TARP recipient may determine a bonus on the basis of qualitative performance metric criteria that are not amenable to analysis under standard financial reporting measures. In such a case, a materiality definition limited to the financial reporting context could permit TARP recipients to avoid the "clawback" requirement, on the view that the inaccuracy could not be deemed material under financial reporting guidance.

4. The Interim Rule mainly relies on certifications of the compensation committee of the institutions' board[s] of directors and of the principal executive [officers] and [principal] financial officers of the institution to assure that the terms of the Interim Rule have been observed.

a. Please explain this approach, in light of the fact that many of the compensation arrangements before the financial crisis were themselves approved by such compensation committees, senior executives, or both[.]

Answer: The IFR implements EESA provisions requiring certifications of compliance from the principal executive officer, principal financial officer, and compensation committee of each TARP recipient. These certifications differ substantially from the approval of compensation plans in other contexts. For one thing, the certifications refer to compliance with the specific, extensive compensation requirements of EESA and the IFR. For another, the certifications acknowledge the serious penalties that accompany false statements to a federal agency. Treasury believes that the certification process provides executives and directors with incentives to make certain that each TARP recipient is in compliance with EESA and the IFR.

Treasury does not, however, rely solely on this process to ensure that TARP recipients have complied with EESA and the IFR. As described in further detail in our response to your Question 5 below, Treasury has established the Office of Internal Review within the Office of Financial Stability to, among other things, examine whether TARP recipients are in compliance with the requirements of EESA and the IFR.

b. In the case of the compensation committee, the committee must include the certification in their required annual financial disclosures. In Treasury's view, what would be the consequences of a materially inaccurate certification under the federal securities laws?

c. What are the consequences under the federal securities laws if the certification required of an institution's CEO and CFO is materially inaccurate?

d. Would any of the certifications required by the Interim Rule be subject to audit by a public company's independent public accountants? Would they be subject to the internal control provisions of the Sarbanes-Oxley Act of 2002?

Answer: Interpretation and application of the federal securities laws is in the purview of the Securities and Exchange Commission. However, as noted in our response to your Question 4(a) above, Treasury believes that the certification requirements of the IFR, provide directors and executives with strong incentives to make certain that the TARP recipient is in compliance with the requirements of EESA and the IFR, particularly insofar as misstatements in certifications would have consequences under the federal securities laws or would be subject to audit by a public company's independent public accountants or the internal control provisions of the Sarbanes-Oxley Act of 2002.

5. How will Treasury enforce the terms of the statute and the Interim Rule? What are the consequences for any institution that fails to observe those terms?

Answer: Treasury has established the Office of Internal Review within the Office of Financial Stability. The Office of Internal Review is charged with, among other tasks, reviewing the compliance of TARP recipients with the requirements of EESA and the IFR. To enable the

Office of Internal Review to conduct these reviews, the IFR requires each TARP recipient to maintain compliance records for at least six years. The IFR also requires that TARP recipients promptly furnish to Treasury true, complete, and current copies of those records upon request.

6. The Interim Rule creates the Office of the Special Master for TARP Executive Compensation.

a. Are the Special Master's decisions subject to review by the Assistant Secretary of the Treasury for Financial Stability, or by any other senior official of the Department?

Answer: Pursuant to the Special Master's position description, the Special Master reports to the Assistant Secretary for Financial Stability.[1] In addition, under the IFR, the Special Master serves at the pleasure of the Secretary, and may be removed by the Secretary without notice, without cause, and prior to the naming of any successor Special Master.

The Secretary has delegated responsibility for determinations under the IFR to the Special Master, and the Special Master has reached those determinations by independent application of the principles set forth in the IFR. The Special Master has, however, consulted with senior officials of the Treasury Department in connection with his 2009 compensation determinations, including with the Assistant Secretary for Financial Stability.

b. If not, has authority similar to that given the Special Master (*i.e.*, authority to act without review) been delegated to any other employee of the Treasury?

Answer: Not applicable.

c. What unique authorities has Treasury assigned to the Special Master? To the extent that the Special Master's authorities are unique, what authority does either section 111 or any other provision of EESA provide for this arrangement?

Answer: No "unique" authorities have been assigned to the Special Master; EESA Section 111(b)(2) provides the authority for the Special Master's activities. Pursuant to that section, the Secretary "shall require each TARP recipient to meet appropriate standards for executive compensation and corporate governance," in addition to the standards expressly enumerated elsewhere in EESA Section 111. Treasury concluded that, given the federal government's (and the taxpayers') particular financial interest in firms that received exceptional financial assistance under the TARP, the compensation structures for each of the 100 most highly compensated employees and executive officers of each recipient of exceptional assistance should be subject to review and approval by the Special Master.

d. Officials at the November 10 meeting confirmed that the Special Master is an uncompensated special government employee, as defined in 18 U.S.C. § 202. Who

[1] *See* Department of the Treasury, *Position Description, Special Master, Executive Compensation, GS-0501-15* (June 5, 2009).

determined that such a status was appropriate for the Special Master, and what factors were considered in making that determination?

Answer: Federal law defines a Special Government Employee as "an employee . . . who is retained, designated, appointed, or employed" by the Government to perform temporary duties, with or without compensation, for not more than 130 days during any period of 365 consecutive days. The determination whether an employee is a Special Government Employee is made prospectively, at the time the individual is appointed or retained.

When the Special Master was appointed, it was determined that his duties would require him to work for the Treasury Department for no more than 130 days during any period of 365 consecutive days. Consequently, the appointment of the Special Master met the definition of a Special Government Employee.

The Special Master is compensated for his services. The Special Master has advised Treasury that he has chosen to refund to the Federal Government substantially all of his compensation.

What statutory and regulatory ethical provisions and restrictions, that apply to regular Treasury employees – and what additional standards – apply to the Special Master and other special government employees whom he has chosen to assist him?

Answer: Substantially all of the ethics provisions that apply to regular government employees also apply to Special Government Employees. Some provisions are not applicable to Special Government Employees, or are modified in their application.[2] Beyond those that apply to all government employees, there are no additional standards that apply to the Special Master.

What restrictions will apply to the Special Master and such other employees, and any firm with which they are or become affiliated, after they leave the Treasury's employ?

Answer: All Special Government Employees, including the Special Master, are subject to the criminal post-employment statute,[3] which imposes a number of restrictions on the activities of former Government employees. Most of these restrictions apply to Special Government Employees (including, for example, the lifetime prohibition, under 18 U.S.C. § 207(a)(1), on representing others in connection with the same particular matter involving specific parties in which the former employee participated personally and substantially).

Has the Special Master's list of clients in his private law and consulting practice, and those of related persons subject to the ethical provisions that apply to the Special Master, been reviewed by appropriate Treasury officials to determine the absence of any conflicts of interest? If so, what has been the result of that review?

Answer: Yes. The Special Master filed with Treasury financial disclosure forms which require

[2] *See, e.g.*, 18 U.S.C. §§ 203, 205, 207, 209.

[3] *See* 18 U.S.C. § 207.

a listing of clients and employees. Treasury's Designated Agency Ethics Official and his staff reviewed these financial disclosure forms and advised on conflicts, and the Special Master has confirmed to Treasury that all conflicts have been remediated.