I. INTRODUCTION

This Third Tranche Report to Congress meets the requirement for reporting at the $200 billion commitment level under section 105(b) of the Emergency Economic Stabilization Act of 2008 (EESA). The recent transaction with American International Group (AIG) under the Systemically Significant Failing Institution Program, when combined with the previous $161 billion of transactions under the Capital Purchase Program, exceeded the $200 billion commitment level. Treasury will submit the next report when transaction levels reach the $250 billion level.

The Report addresses the following six areas:

- A description of all the transactions made during the reporting period.
- A description of the pricing mechanism for the transaction.
- A justification of the price paid for, and other financial terms associated with, the transactions.
- A description of the impact of the exercise of such authority on the financial system.
- A description of the challenges that remain in the financial system, including any benchmarks yet to be achieved.
- An estimate of additional actions under the authority provided pursuant to EESA that may be necessary to address such challenges.

II. TRANSACTION INFORMATION BY PROGRAM

This Third Tranche Report reflects transactions under two programs. On November 17, 2008, Treasury closed $2.97 billion in transactions under the Capital Purchase Program (CPP). Treasury also closed a $40 billion transaction with AIG under the Systemically Significant Failing Institution (SSFI) Program on November 26, 2008. A report of these transactions was posted on Treasury’s web site and is attached here as Appendix 1.

Capital Purchase Program

The purpose of the CPP is to encourage U.S. financial institutions to build their capital base, which in turn increases their capacity to lend to U.S. businesses and consumers and to support the U.S. economy. Under the CPP, Treasury will purchase up to $250 billion of senior preferred shares on standardized terms. The Program is available to qualifying U.S. controlled banks, savings associations, and certain bank and savings and loan holding companies engaged solely or predominately in financial activities permitted under the relevant law. We reported in detail on the CPP in Treasury’s First Tranche Report to Congress and Second Tranche Report to
There have been no changes to the purpose or use of the CPP since our last report. To date, Treasury has signed final agreements under the CPP with 53 financial institutions, which is reflected in Appendix 1.

**Systemically Significant Failing Institution Program**

On November 25, Treasury issued guidelines for the SSFI Program and completed the first transaction under this program, a $40 billion purchase of senior preferred shares from AIG.

The SSFI Program is designed to provide stability and to prevent disruption to financial markets from the failure of a systemically significant institution. Unlike the CPP, participation in the SSFI Program is on a case-by-case basis. When considering an institution for this program, Treasury may consider these and other factors:

1. The extent to which the failure of an institution could threaten the viability of its creditors and counterparties because of their direct exposure to the institution.
2. The number and size of financial institutions that are seen by investors or counterparties as similarly situated to the failing institution, or that could otherwise be likely to experience indirect contagion effects from the failure of the institution.
3. Whether the institution is sufficiently important to the nation’s financial and economic system that a disorderly failure would, with a high probability, cause major disruptions to credit markets or payments and settlement systems, seriously destabilize key asset prices, significantly increase uncertainty or losses of confidence thereby materially weakening overall economic performance.
4. The extent and probability of the institution’s ability to access alternative sources of capital and liquidity, whether from the private sector or other sources of government funds.

The Federal Reserve Board, the Federal Reserve Bank of New York (FRBNY), and Treasury agreed that AIG’s failure would pose a systemic risk. As was determined at the time of FRBNY’s intervention in mid-September, AIG’s failure would likely have severe repercussions for global financial markets and the economy. In order to protect the financial system, a comprehensive U.S. government sponsored restructuring plan was needed to stabilize the current AIG financial situation.

Under that plan, Treasury purchased $40 billion in the form of senior perpetual preferred stock in AIG, priced at par. The equity has been used to pay down $40 billion of FRBNY’s $85 billion senior secured credit facility. Following Treasury’s investment, the FRBNY’s revolving credit facility will be reduced from $85 to $60 billion, and the draw down rate will decline from Libor+850 basis points to Libor+300 basis points. The length of the facility will also be extended to five years. The TARP’s participation in the restructuring plan should create a more sustainable capital structure for AIG, which will in turn improve the ability of the firm to successfully execute the asset disposition plan. This will reduce AIG’s exposure to troubled assets will be reduced, as well its their leverage ratios.
Appendix 2 contains the term sheet for the AIG transaction, which was posted to Treasury’s web site on November 10, 2008.

III. ASSESSMENT OF CURRENT MEASURES AND THE CHALLENGES AHEAD

Impact of the Transactions

Treasury continues to act aggressively to implement EESA’s Troubled Assets Relief Program (TARP). Through the CPP, Treasury has committed over $161 billion to financial institutions of all sizes, increasing their capital strength and enabling them to increase lending and take losses as they write down or sell troubled assets. We expect banks to increase their lending over time as a result of these efforts and as confidence is restored. Treasury also averted a significant risk to the financial system by investing $40 billion under the SSFI Program in AIG. With these measures, we are pursuing the right strategy to stabilize the financial system and to support the flow of credit into our economy, but the journey ahead will continue to be difficult.

Challenges That Lie Ahead

Although actions announced to date have had a positive effect on the market, significant challenges remain. Equity, credit, and funding markets remain under considerable strain, as banks have been forced to reduce their leverage dramatically and have lowered their risk appetite. In addition, the primary and secondary mortgage finance markets are impaired with reduced liquidity in the agency market. There is no single action the Federal Government can take to eliminate the financial market turmoil and the economic downturn. We are focused, therefore, on developing the most effective combination of tools to alleviate the pressure points in our system.

Treasury and the Federal Reserve announced one of those tools on November 25, a facility to finance the issuance of non-mortgage asset-backed paper. This facility will support lending to consumers and small businesses for such needs as auto loans, student loans, and credit cards. Issuance of asset-backed securities in these areas reached an estimated $240 billion in 2007, but credit market stresses led to a steep decline in the third quarter of 2008, and the market essentially came to a halt in October. As a result, millions of Americans cannot find affordable financing for their basic credit needs. To address this need and to support the return of consumer lending, the Treasury will provide $20 billion of credit protection to the Federal Reserve in connection with its $200 billion Term Asset-Backed Securities Loan Facility. By providing liquidity to issuers of consumer asset-backed paper, the Federal Reserve facility will enable a broad range of institutions to step up their lending, giving borrowers greater access to lower cost consumer finance and small business loans. The facility may be expanded over time and eligible asset classes may be expanded later to include other assets, such as commercial mortgage-backed securities, non-agency residential mortgage-backed securities, or other asset classes.

On November 24, the Federal Government announced a comprehensive assistance plan for Citigroup. As part of that plan, Treasury will use $20 billion of TARP authority to purchase
additional preferred shares,∗ and will guarantee up to $5 billion of potential losses on a pool of Citigroup assets. These actions, in conjunction with those of the Federal Reserve and FDIC, will provide additional assurance to the market and further support overall financial stability.

Treasury is actively engaged in developing other programs to strengthen our financial system so that lending flows into our economy. These include programs to mitigate mortgage foreclosures, provide additional capital, and insure troubled assets as authorized by Section 102 of EESA.

∗ Treasury purchased the first group of preferred shares from Citigroup under the CPP on October 28, 2008.