

U.S. Capital Purchase Program (CPP)

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Abstract

During the fall of 2008, the U.S. government was faced with a financial crisis of unprecedented scope. Having already exercised the authority to put Fannie Mae and Freddie Mac into conservatorship in September, the stage was set for the U.S. government to intervene more broadly in strained financial markets. This intervention would ultimately come in the form of the Emergency Economic Relief Act (EESA), which was passed on October 3, 2008. The main provision of EESA was the Troubled Asset Relief Program, or TARP, a \$700 billion program initially designed to purchase troubled assets off the balance sheets of struggling financial institutions. Despite initially campaigning that the program would be used to purchase troubled mortgage-related assets, the worsening stress on the financial system, complexity of creating an asset purchase program, and size of the mortgage market caused the Treasury to announce the Capital Purchase Program (CPP), a program of broad-based capital injections, on October 14, 2008. Initially, the CPP was available to publicly traded U.S. banks, but was expanded shortly after to include privately owned banks, S-corporations, and mutual banks, so long as they were based in the U.S. At its launch, Treasury also solicited nine of the largest commercial and investment banks to enroll in the program to encourage broad adoption for banks across the country. These institutions would issue either preferred stock (public and private banks) or subordinated debt (S-corps and mutual banks) to the Treasury at rates of five percent, which would then increase to nine percent after five years. As programs to provide credit to low-income areas and small business, such as the Community Development Capital Initiative (CDCI) and Small Business Lending Fund (SBLF), developed, CPP institutions were also able to refinance CPP investments into lower-cost CDCI and SBLF ones. A total of 707 institutions issued \$204.9 billion in CPP capital to the Treasury, which has recovered \$226.8 billion.

Keywords: Capital Injections, Preferred Stock, Subordinated Debt, Global Financial Crisis, United States, United States Treasury

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At a Glance

By the fall of 2008, the U.S. government was faced with a financial crisis of unprecedented scope. Having already exercised the authority to put the mortgage lenders Fannie Mae and Freddie Mac into conservatorship in September, the stage was set for the U.S. government to intervene more broadly. This intervention would ultimately come in the form of the Emergency Economic Relief Act (EESA), which was passed on October 3, 2008. The main provision of EESA was the Troubled Asset Relief Program, or TARP, a \$700 billion program initially designed to purchase troubled assets off the balance sheets of struggling financial institutions. Despite initially stating that the program would be used to purchase troubled assets, the worsening stress on the financial system, complexity of creating an asset purchase program, and size of the mortgage market caused the Treasury to instead announce the Capital Purchase Program (CPP), a program of broad-based capital injections, on October 14, 2008.

Purpose: To encourage U.S. financial institutions to build capital to increase the flow of financing to U.S. businesses and consumers and to support the U.S. economy.	
Announcement Date	October 14, 2008
Operational Date	October 14, 2008
Sunset Date	October 3, 2010
Program Size	\$250 billion
Usage	\$204.9 billion
Outcomes	\$226.8 billion in revenue
Key Features	Tier 1 and Tier 2 assistance, refinancing into CDCI or SBLF, 9 largest participating

Initially, the CPP was available to publicly traded U.S. banks, but was expanded to include privately owned banks (November 2008), S-corporations (January 2009), and mutual banks (April 2009), so long as they were U.S.-based. Institutions would issue either preferred stock (Public and private banks) or subordinated debt (S-corps and mutual banks) to the Treasury at rates of five percent, which would then increase to nine percent after five years. At its launch, Treasury solicited nine of the largest commercial and investment banks, to enroll in the program to encourage broad adoption for banks across the country. All eligible institutions could participate at the same terms as these nine. Treasury required participating banks to issue warrants to Treasury to purchase additional shares. It also restricted common stock dividends, executive compensation, and non-CPP share repurchases. Initially, Treasury was allowed to make new CPP investments through December 31, 2009. However, Treasury Secretary Tim Geithner extended this authority to October 3, 2010, the maximum amount allowed by EESA, to “maintain the capacity to respond to unforeseen threats.”

As programs to provide credit to low-income areas and small businesses such as the Community Development Capital Initiative (CDCI) and Small Business Lending Fund (SBLF) developed, CPP institutions were also able to refinance CPP investments into lower-cost CDCI and SBLF ones. The largest banks repaid their capital first, with 71 institutions, representing \$1.79 billion in capital, holding onto CPP funds for more than five years. A total of 707 institutions issued \$204.9 billion in preferred stock to Treasury. Treasury has recovered \$226.8 billion as of February 2020.

Summary Evaluation

Much of the evaluation of the CPP has focused on its impact on bank lending, market competition, and the treatment of larger institutions versus smaller ones. Despite an assertion by Paulson that the “whole purpose” of the program was to increase lending, the impact that the CPP had on lending overall was unclear. Some scholars have asserted that the injections themselves led to competitive distortions in the marketplace, and that larger institutions, such as Citi and Bank of America, were given much more leeway in how they exited the program, whereas smaller banks did not receive nearly enough. Despite this, Treasury made over \$20 billion in profits from the program, and it has been credited in the literature as an effective emergency measure for stabilizing frozen U.S. credit markets.

Context

Category	Value (As of 2008)	Data Source
GDP	\$14,712,845,000,000	IMF International Financial Statistics
GDP Per Capita	\$48,283 per capita	IMF WEO (2019)
Sovereign Credit Rating (5-year senior Debt)		
Size of banking system	\$10,238,610,000,000	World Bank – Global Financial Development Database
Size of banking system (% of GDP)	68.3%	Ibid.
Size of banking system (% of financial system)	30.5%	Ibid.
5-bank concentration of banking system	44.9%	Ibid.
Foreign involvement in banking system	18%	Ibid.
Government ownership of banking system	0%	World Bank – Bank Regulation and Supervision Survey (2011 Database)
Existence of Deposit Insurance	100% insurance on deposits up to \$100,000 ²	World Bank – Deposit Insurance Dataset (2013 Database)

² The passage of the Emergency Economic Stabilization Act in October of 2008 authorized a temporary increase of the deposit insurance threshold up to \$250,000 (P.L. 110-343 – pp. 3799). This was made permanent on July 21, 2010 with the passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act ([FDIC PR, 07/21/2010](#)).

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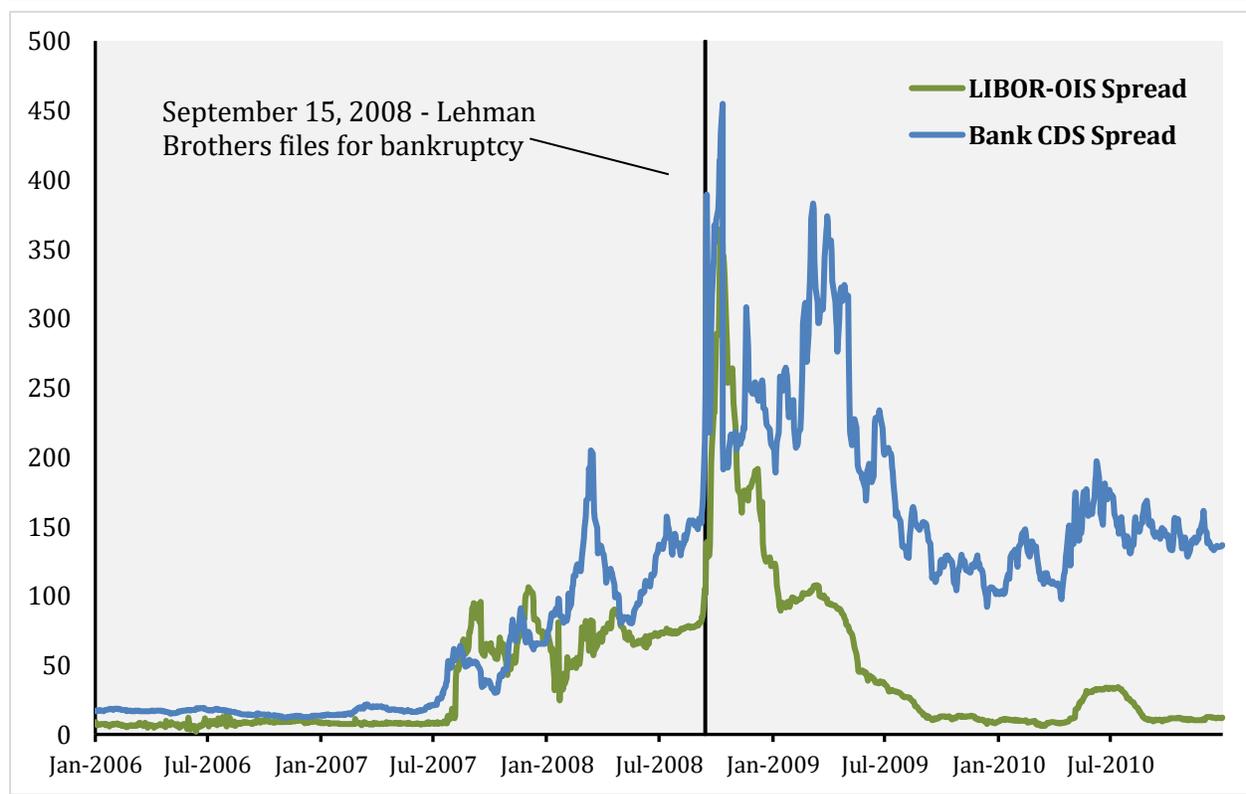
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I. Overview

Background

Despite substantial official interventions in term funding and mortgage markets, the financial crisis in the U.S. that had begun a year earlier reached a tipping point in September of 2008. Lehman Brothers, the fourth largest investment bank in the U.S., filed for bankruptcy on September 15, 2008, despite reporting record earnings in just January of that year (Wiggins, Piontek, Metrick 2014 – pp. 2, Examiner’s Report – pp. 2). Bank CDS spreads and the Libor-OIS spread shot up dramatically following Lehman’s failure, and remained elevated until the middle of October.³

Figure 1: 3-Month LIBOR-OIS Spread and Bank CDS Spreads (bps)



Source 1: Bloomberg

Lehman’s bankruptcy caused the three large remaining investment banks—Goldman Sachs, Morgan Stanley, and Merrill Lynch—to seek further government support to avoid bankruptcy. On the same day that Lehman fell, Merrill Lynch and Bank of America agreed to a \$50 billion merger (Form 8-K, Bank of America, 09/18/2008). Six days later, both Goldman

³ Bank CDS spreads, as shown in Figure 1, are equal-weighted averages of JPMorgan Chase, Citigroup, Wells Fargo, Bank of America, Morgan Stanley, and Goldman Sachs.

Sachs and Morgan Stanley became bank holding companies, which allowed them to obtain access to the Fed's emergency lending facilities ([Guha, 09/22/2008](#)).

During this time, the Bush administration released the first iteration of its \$700 billion plan, called the Troubled Asset Relief Program (TARP), to buy troubled assets from financial institutions ([Calabresi, 09/23/2008](#)). Almost immediately, policymakers critiqued the proposal for its lack of detail and the broad authority that it gave Treasury ([Senate Hearing 110-1012](#)). These concerns caused TARP to fail its first vote on September 29 ([Stohlberg, 09/24/2008](#), [Bensinger, 09/26/2008](#), [Final Vote Results: H.R. 3997](#)). Stock markets crashed after the vote. The S&P 500 fell 8.8%, its largest decrease since the October 1987 stock market crash (Bloomberg, Jester, Nason, Norton 2019 – pp. 5, [Davis, 09/29/2008](#)). After the disastrous market reaction, Congress passed the Emergency Economic Stabilization Act of 2008 (EESA), which had TARP as its centerpiece on October 3 ([Govtrack - EESA](#)). While administration officials had originally described the legislation as a direct asset purchase program for troubled institutions, the administration ultimately decided to use the funds inject capital directly into financial institutions. The largest TARP program was the Capital Purchase Program ([Andrews and Landler, 10/09/2008](#), [UST PR, 10/11/2008](#), [UST PR, 10/13/2008](#)). Administration officials said they revised the mission of TARP after concluding that they would not have had time to value banks' troubled assets and, even if they had, \$700 billion would not have been sufficient given the severity of the problems in the market ([Federal Reserve: Mortgage Debt Outstanding - Year End 2009, SIGTARP 10/5/2009](#)) – pp. 12).

Program Description

The Treasury announced the Capital Purchase Program (CPP) on October 14, 2008, less than two weeks after the bill passed ([UST PR, 10/14/2008](#)). In its initial press release, Treasury specified that it would purchase senior preferred equity “on standardized terms” and that interested institutions would have until November 14, 2008 to apply ([UST PR, 10/14/2008](#)). Of the \$700 billion in TARP funds that Congress appropriated, Treasury planned to use up to \$250 billion for the purchase of equity ([UST PR, 10/14/2008](#), [P.L. 110-343 – pp. 3780](#)). Treasury required interested institutions to submit applications to their federal banking regulator (the FDIC, Federal Reserve, Office of the Comptroller of the Currency, or Office of Thrift Supervision (OTS)) ([FAQ: Publicly traded institutions – pp. 1 – 2](#)).

As part of the CPP's first press release, Treasury noted that nine large “healthy” institutions had already agreed to participate “to signal the importance of the program for the system” ([UST PR, 10/14/2008](#)).⁴ Together, these nine banks, which represented about 55 percent of all U.S. banking assets, obtained \$125 billion in Treasury capital ([GAO-12-301 – pp. 7 - 8](#)). These nine were strongly encouraged to accept the initial injections as a group, as administration officials believed that doing so as a group would not only eliminate stigma, but prevent differentiation between “strong” and “weak” banks, which could have “further

⁴ The nine banks were, in order of investment size, Citigroup, JP Morgan, Wells Fargo (\$25 billion); Bank of America (\$15 billion); Goldman Sachs, Morgan Stanley, Merrill Lynch (\$10 billion); Bank of New York Mellon (\$3 billion); State Street (\$2 billion). Bank of America received the \$10 billion given to Merrill Lynch as a result of a merger, completed on January 1, 2009 ([SIGTARP 10/15/2009, pp. 20 – 21](#)).

destabilize[ed] financial institutions and markets” (SIGTARP 10/5/2009, - pp. 18 – 19). See KDD #8 for more information on this decision.

Two of the nine initial participants, Citigroup and Bank of America also received \$20 billion each in preferred stock on December 31, 2008 and January 15, 2009, respectively, as part of the Targeted Investment Program (TIP). These preferred shares paid dividends of eight percent, and were given to prevent a loss of confidence that could “result in significant market disruptions that threaten the financial strength of similarly situated financial institutions” (Exhibit 03-01, Citigroup, Board of Governors PR, 1/16/2009, Targeted Investment Program Guidelines, UST – Targeted Investment Program).

Throughout the course of the program, Treasury broadened the types of institutions that could participate. Initially, they only made funds available to publicly traded banks and trusts. Banks and trusts that were not publicly traded were issued a term sheet on November 17, 2008, while S-Corporations and mutual banks received their term sheets on January 14, 2009 and April 14, 2009, respectively (Announcements: [Nonpublic Institutions](#), [S-Corporations](#), [Mutual Banks](#)).

Every institution was required to issue capital that equaled at least one percent of its risk-weighted assets (Term Sheet: [Publicly traded institutions](#) – pp. 1). They could receive assistance up to either \$25 billion or three percent of its risk-weighted assets, whichever was lesser (Term Sheet: [Publicly traded institutions](#) – pp. 1). All securities issued to Treasury carried a face value of \$1,000.

Dividends, interest payments. Dividends or interest payments were paid quarterly. Dividends for preferred shares started at five percent, increasing to nine percent if a Qualified Financial Institution (QFI) had Treasury capital still outstanding after five years. S-Corporations and Mutual Banks issued subordinated debt instead of preferred stock because they don’t issue common shares. Treasury set their initial interest payments higher—at 7.7 percent, rising to 13.8 percent after five years—to adjust for the tax-free status of these companies (Term Sheets: [Publicly Traded Institutions](#), [Nonpublic Institutions](#), [S-Corporations](#), [Mutual Banks](#)). See KDD #10 for more information.

Treasury placed additional restrictions on dividends and interest payments. Dividends were cumulative for QFIs that issued preferred shares at the holding-company level: in other words, those QFIs could not pay any dividends to junior or equivalently ranked preferred shares until they had paid dividends (unpaid and currently due) on the Treasury’s preferred shares. Dividends were non-cumulative for QFIs that were not subsidiaries of bank holding companies. CPP recipients that issued subordinated debt faced similar restrictions, and were not allowed to pay dividends on any equity until they had paid all interest payments (Term Sheets: [Publicly Traded Institutions](#), [Nonpublic Institutions](#), [S-Corporations](#), [Mutual Banks](#)). Bank holding companies that were S-Corporations could defer interest payments on their subordinated debt for up to 20 quarters, though the interest would cumulate and compound (Term Sheet: [S-Corporations](#) – pp. 2).

The term sheets required QFIs to obtain Treasury approval for any increases in dividends in common stock for the first three years the Treasury held QFI shares. After three years, publicly traded institutions no longer needed any Treasury approval for dividend increases, but private institutions, S-Corporations, and Mutual Banks still needed it to approve

increases of over three percent until ten years had passed, or until the Treasury sold its investment (Term Sheets: [Publicly Traded Institutions](#), [Nonpublic Institutions](#), [S-Corporations](#), [Mutual Banks](#)).

All securities issued to Treasury were nonvoting. In the event that dividend or interest payments were not paid for six quarters, Treasury could appoint two directors to the QFI, who would be required to keep the director on until dividends or interest had been repaid for four consecutive periods (for preferred stock), or completely repaid (in the case of subordinated debt) (Term Sheets: [Publicly Traded Institutions](#), [Nonpublic Institutions](#), [S-Corporations](#), [Mutual Banks](#)).⁵

Repurchases and Redemptions. Repurchases of any class of equity required Treasury’s approval so long as the QFI still had Treasury stock outstanding. Similar to the dividend restrictions above, after three years, public QFIs no longer needed to seek Treasury approval, and for the other types of eligible institutions this restriction was lifted after ten years.

Redemptions of CPP securities during the first three years required a qualified equity (or securities) offering that generated proceeds of at least 25 percent of the initial issue price of the securities. After three years, a QFI could redeem the Treasury’s stake with the approval of QFI’s primary federal regulator. Mutual banks did not face this restriction, and could redeem the subordinated debt they issued at will, subject to the aforementioned approval (Term Sheets: [Publicly Traded Institutions](#), [Nonpublic Institutions](#), [S-Corporations](#), [Mutual Banks](#)).

Executive Compensation and Corporate Governance. Section 111(b) of EESA described corporate governance and executive compensation standards as they apply to direct purchases or investments in financial institutions. Treasury passed several interim final rules that expanded on and provided additional guidance on executive compensation post-EESA ([TARP Executive Compensation Rules and Guidance](#)). The American Reinvestment and Recovery Act (ARRA) in February 2009 expanded these guidelines.

Senior executive officers (SEOs), initially defined by EESA as the top five highest paid executives of companies that took CPP money, were the primary targets of these restrictions ([P.L. 110-343 - pp. 3777](#)). The number of SEOs that were affected gradually increased as the program developed, and the restrictions expanded ([UST Interim Final Rule - 06/10/2009](#)). SEOs at CPP recipients were generally unable to receive “golden parachute” payments, as well as bonuses and additional compensation, unless under specific circumstances. Finally, the legislation and subsequent interim final rules required QFI compensation committees to identify features that could “lead SEOs to take unnecessary and excessive risks” and meet with risk officers to discuss these features. Treasury passed its last interim final rule on executive compensation on June 10, 2009 ([UST PR, 06/10/2009](#)). See KDD #5 and KDD #14 for more details.

CDCI and SBLF Conversion. The Community Development Capital Initiative (CDCI), which was created on February 3, 2010, allowed CPP institutions that serviced lower-income areas

⁵ Nonpublic QFIs who paid cumulative dividends on preferred stock were required to pay dividends from all missed quarters, not just the last four consecutive ones ([Term Sheet: Nonpublic Institutions - pp. 4](#)).

to convert their CPP capital into lower-cost CDCI capital ([UST – CDCI, Webel 2013, pp. 15 – 16](#)). If a QFI was accepted, their current CPP capital would be exchanged, and they could be expected to issue additional shares up to a maximum of five percent of their risk-weighted assets ([CDCI FAQ](#)). The CDCI copied the CPP’s architecture while softening key payment factors: the CDCI decreased initial interest/dividend rates from five percent to two percent, delayed the step-up clauses from five years after the original investment to eight years, omitted the requirement on stock warrants, and increased the maximum issuance of government capital from three percent of risk-weighted assets to five percent ([GAO 14-579 - pp. 4 - 5](#)). Further information on the CDCI can be found in Kulam (2019).

The Small Business Lending Fund (SBLF), established on September 27, 2010 as part of the Small Business Jobs Act, encouraged lending to small businesses by providing Tier 1 capital to qualifying community banks with assets of less than \$10 million ([UST – SBLF, SBLF Fact Sheet](#)). Eligible QFIs could apply to the SBLF provided they had not redeemed or applied to redeem any CPP or CDCI investment as of December 16, 2010 ([Term Sheet: SBLF – pp. 1](#)). The dividend structure of the SBLF was tied to the amount of small-business lending a given SBLF participant did. The more a participant’s small-business lending increased after receiving SBLF capital, the lower its dividends would be ([Term Sheet: SBLF – pp. 4](#)).⁶ The program required CPP institutions to pay an annual “lending incentive fee” of two percent of the total amount of preferred stock outstanding after the fifth year of the original CPP investment, and if the institution did not increase its small-business lending relative to how much it was lending prior to the SBLF investment. ([Term Sheet: SBLF – pp. 4 – 5](#)).

Sunset Date and End of Authority. Section 120 of EESA specified that the authority to purchase troubled assets and, by extension, inject capital, would expire on December 31, 2009 ([P.L. 110-343 – pp. 3788](#)). However, the section also specified that the Secretary of the Treasury could extend the authority to buy new capital ~~up~~ through October 3, 2010 ([P.L. 110-343 – pp. 3788](#)). Treasury Secretary Geithner invoked this authority in a letter to Speaker of the House Nancy Pelosi on December 9, 2009, to continue to address the ongoing housing crisis and to “maintain the capacity to respond to unforeseen threats” ([UST PR, 12/09/2009](#)).

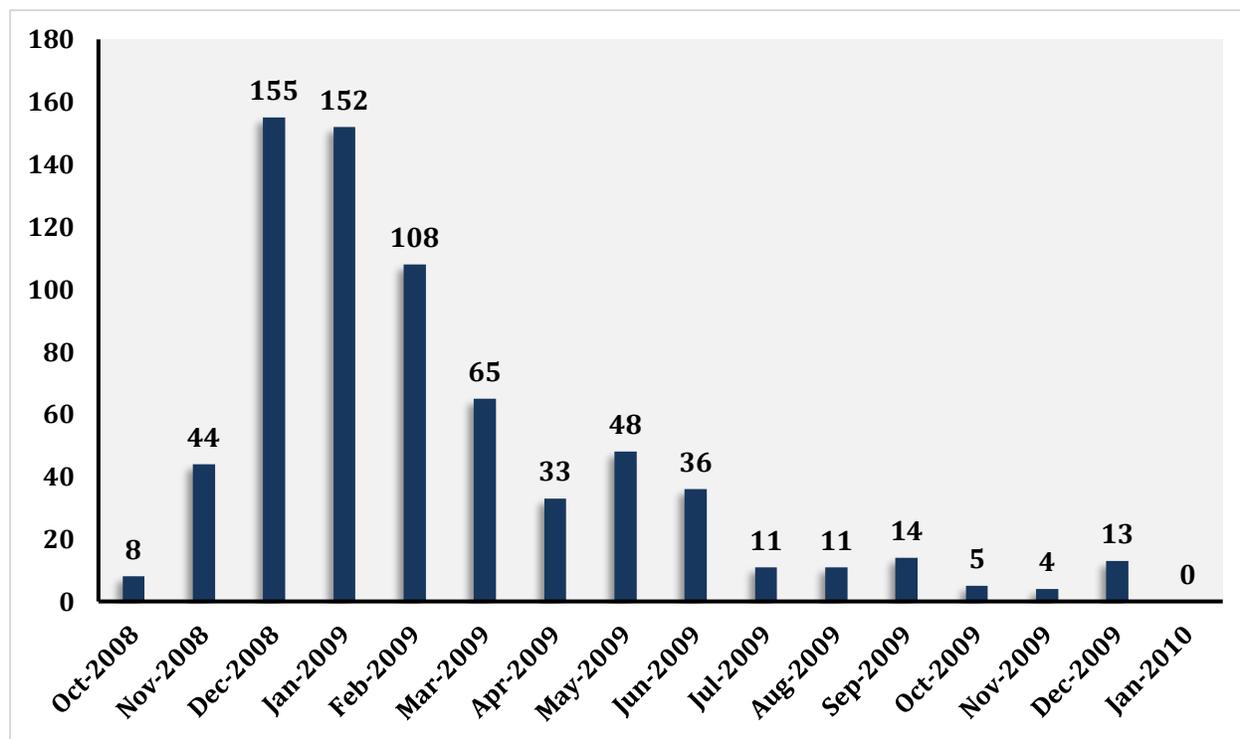
Outcomes

Initial participation in the CPP was swift, with 213 institutions receiving approximately \$187.5 billion in aid by the end of 2008 (Figure 2; CPP Transaction Data). By the end of 2009, 707 institutions had been accepted into the program, and no more would apply despite Geithner extending the authority to purchase equity through October 3, 2010 ([UST PR, 12/09/2009](#)).

⁶ See KDD #11 for more information about the dividend structure for SBLF institutions. After four-and-a-half years, all dividends, irrespective of lenders’ performance, would increase to nine percent ([Term Sheet: SBLF – pp. 4](#)).

Of the 707 participants, 34 went into bankruptcy or receivership. Treasury, in some cases, “receive[d] cash or other securities, which generally [could] be sold more easily than preferred stock, but Treasury’s investments [were] sometimes sold at a discount” (CPP Transaction Data, [TARP Monthly Report to Congress, October 2019 - pp. 1, GAO-16-524 - pp. 6](#)). For a small number of CPP institutions, Treasury made ad-hoc decisions either to restructure or exchange its investment with other securities to help facilitate a merger. Sometimes this meant taking a discount. ([SIGTARP 01/28/2015 - pp. 12](#)). This typically involved banks submitting restructuring (or recapitalization) plans to Treasury, who would then evaluate the plan, including any proposed discounts that Treasury might take. In this evaluation, Treasury received feedback from an external asset manager, who “interviews bank managers, gathers non-public information, and conducts loan loss estimates and capital structure analysis” ([SIGTARP 04/20/2010 - pp. 84](#)). Despite the possibility of losses, Treasury was willing to take part in these transactions because “it believes that inaction may lead to the bank failing, resulting in a total loss to the taxpayer” ([SIGTARP 04/20/2010 - pp. 84](#)).

Figure 2: QFIs Accepted into the CPP, monthly (\$ billions)



Source: CPP Transaction Data

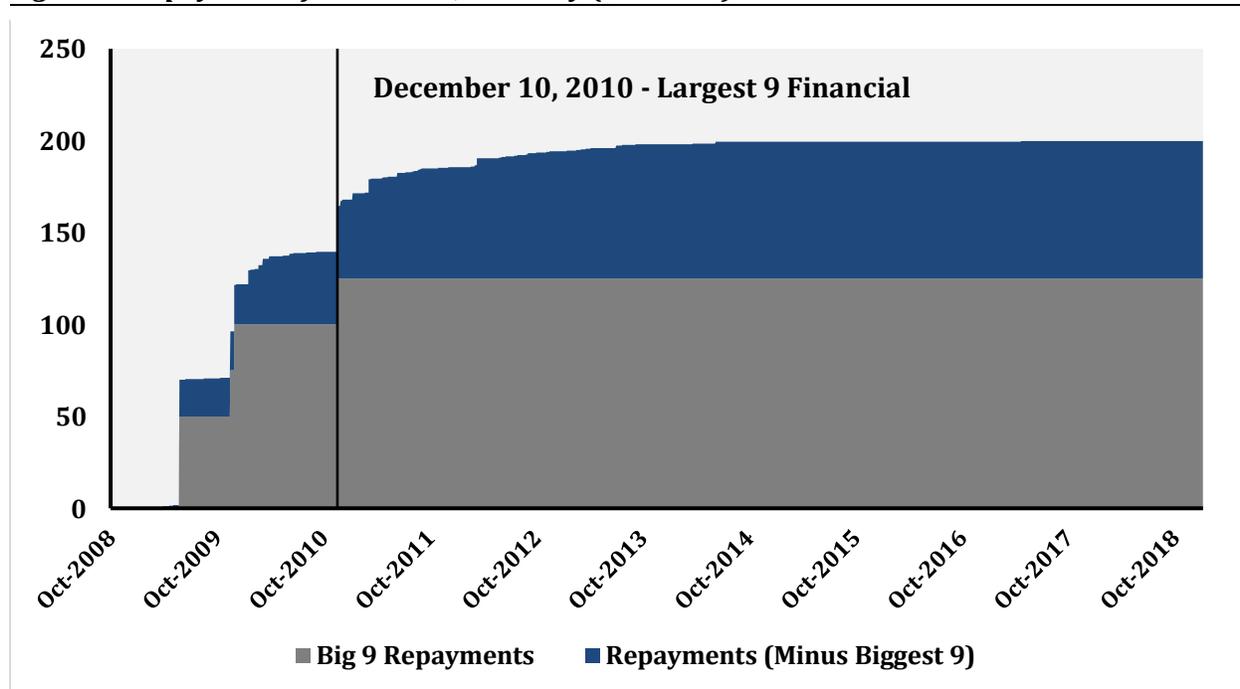
A total of 28 institutions converted their CPP capital into CDCI capital, representing about \$360 million. Another 137 CPP institutions opted to refinance approximately \$2.21 billion in government capital with the SBLF ([Monthly Report to Congress, October 2019 - pp. 1](#)).

The 9 systemically important institutions that received the first \$125 billion in CPP capital repaid the Treasury by December of 2010 (Figure 5). All of these were subject to the Fed’s 2009 stress test, the Supervisory Capital Assessment Program (SCAP). The program, which

“estimated future losses, revenues, and needed reserves” for 19 large institutions, found that five banks—Goldman Sachs, Morgan Stanley, JP Morgan, State Street and Bank of New York Mellon—met the tests’ target capital ratios; this allowed them to repay their CPP capital on June 17, 2009 ([SIGTARP 11-005 - pp. 14](#)). Bank of America and Wells Fargo repaid their CPP capital in December, 2009, and Citigroup repaid its CPP capital in December, 2010 (CPP Transaction Data). (Bank of America acquired the ninth original CPP recipient, Merrill Lynch, in January 2009). Both Bank of America and Citigroup repaid the preferred stock issued under TIP in December of 2009, resulting in a net gain of \$4.4 billion for the Treasury ([TARP Monthly Update, 12/01/2019](#)).

The other CPP institutions repaid their capital at a much slower rate on average, with an average time of repayment of 1,137 days, or over three years. Some institutions paid Treasury back much earlier, with the quickest repayment coming from Centra Financial Holdings, Inc. after just 74 days. However, CPP recipients paid back over 84% of total capital by the end of 2010 (CPP Transaction Data). As of November 2019, two banks, representing approximately \$17.4 million in Treasury stock, still have investments outstanding ([Monthly Report to Congress, October 2019 - pp. 1](#)).⁷

Figure 3: Repayment of CPP Funds, annually (\$ billions)



Source: CPP Transaction Data

Seventy-one CPP institutions did not repay their CPP capital within five years. As a result, their dividends increased, as outlined in the term sheets. These 71 institutions held onto

⁷ The two institutions are OneUnited Bank (\$12.06 million) and Harbor Bankshares Corporation (\$5.31 million).

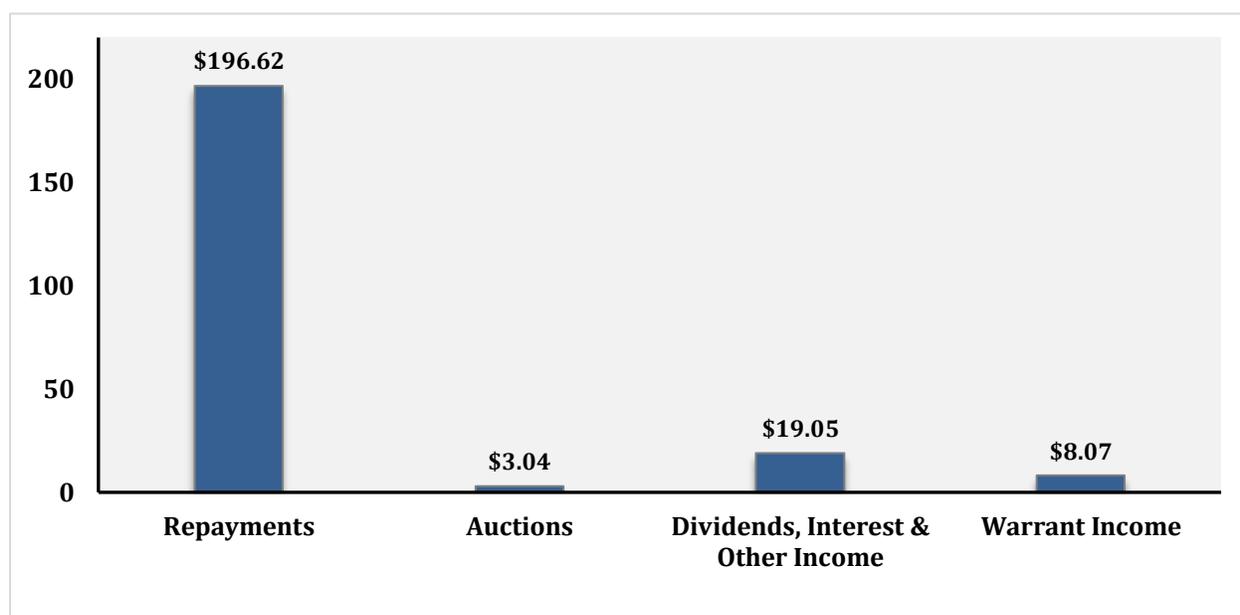
their capital for an average of 2,265 days, compared to 1,011 days for all other institutions. These 71 institutions accounted for less than one percent of total CPP capital, however (CPP Transaction Data).

The Treasury has received \$226.4 billion, as of November 1, 2019 (Figure 4). That figure includes principle repayments (\$197 billion), dividend and interest payments (\$19 billion), proceeds from the sale and exercising of warrants attached to CPP term sheets (\$8 billion), and auctions (\$3 billion).⁸

Treasury had a variety of methods to exit its investments. As mentioned above, CPP institutions could refinance the capital into another program, such as the SBLF or CDCI. Treasury also began using auctions in March of 2012. This test auction, which was modelled after the auctions that Treasury had been conducting to sell its CPP warrants, received eight times as many bids as the number of securities offered. It netted over \$360

million in revenue, despite Treasury receiving less than the par value for the stock ([UST PR, 05/03/2012](#)). Revenue from these auctions, of which the capital from 190 institutions was offered, was just over \$3 billion ([Monthly Report to Congress, October 2019 - pp. 1](#)). After accounting for the various exchanges and refinancing initiatives, net income from the CPP as a whole was about \$27.1 billion ([TARP Monthly Update, 12/01/2010](#)).

Figure 4: CPP Income Breakdown (as of November 1, 2019, \$ billions)



Source: [TARP Monthly Report to Congress, October 2019 - pp. 1](#)

⁸ The total income shown in Figure 4 is actually \$226.78 billion. However, this calculation includes the \$360 million in CPP funds that were exchanged into the CDCI. Since these shares were exchanged into another program, rather than simply having their properties altered by entering another program (SBLF), they were omitted from the profit calculation.

II. Key Design Decisions

- 1. The Capital Purchase Program was part of the Troubled Asset Relief Program (TARP), which included capital injections, as well as housing, auto, and credit market relief programs.**

The program was one of the first parts of a series of interventions aimed at stabilizing several sectors of the struggling American economy. TARP funds were disbursed to provide government investment in individual institutions, such as AIG, as well as entire sectors, such as housing and the auto industry. However, the CPP was considered to be the “centerpiece” of TARP ([UST – TARP Programs, "What's Under the TARP?" - pp. 1](#)).

Some additional TARP programs include the Public-Private Investment Program (PPIP), Home Affordable Modification Program (HAMP), the Automotive Industry Financing Program (AIFP), the Community Development Capital Initiative (CDCI), the Targeted Investment Program (TIP), and the Supervisory Capital Assessment Program (SCAP) ([Bank Investment Programs](#)). TARP also funded individual restructuring agreements for Chrysler and GM. Section 136 of TARP also temporarily increased the deposit insurance threshold from \$100,000 to \$250,000; Congress later made the change permanent ([P.L. 110-343 – pp. 3799](#)).

In total, Congress appropriated \$700 billion of TARP funds in two tranches of \$350 billion. Congress required Treasury to submit a report to Congress requesting that the second tranche of \$350 billion be released should it be needed ([P.L. 110-343 – pp. 3780 – 3781](#)). In total Treasury disbursed about \$442 billion through TARP, with its capital injections through the CPP at almost \$205 billion, and total assistance to banks at \$245 billion ([TARP Monthly Update, 11/01/2019](#)).

- 2. Congress passed the Emergency Economic Stabilization Act on October 3, 2008, which gave the Secretary of the Treasury authority to purchase troubled assets “from any institution” and served as the legal basis for the CPP.**

Legal Authority for the Capital Purchase Program came from Section 101 of the Emergency Economic Stabilization Act (EESA) of 2008, which was passed on October 3, 2008. Section 101 states that, “The [Secretary of the Treasury] is authorized to establish the Troubled Asset Relief Program (or “TARP”) to purchase, and to make and fund commitments to purchase, troubled assets from any financial institution...”([P.L. 110-343 - pp. 3767](#)). Treasury and the Federal Reserve shortly decided to directly invest in the capital structure of banks rather than purchasing assets off their balance sheets ([SIGTARP 10/5/2009 – pp. 12](#)). It would allocate a total of \$250 billion of the \$700 billion.

3. Initially, the Treasury Secretary and the Chairman of the Federal Reserve cited the need for broad, immediate authority to purchase troubled assets in campaigning for the passage of EESA, but they ultimately turned to capital injections as they were the “most timely, effective step to improve credit market conditions.”

The Bush administration faced considerable difficulty in getting Congress to pass TARP. Its original proposal, which was three pages long and released on September 20, 2008, was met with considerable resistance from Congress and the public ([Calabresi, 09/23/2008](#)). In an attempt to persuade lawmakers and the public, Treasury Secretary Hank Paulson and Federal Reserve Chairman Ben Bernanke testified at the Senate Banking and Finance Committee on September 23 ([U.S. Senate, 09/23/2008](#)).

Paulson testified that the proposal would be “the single most effective thing we [could] do to help homeowners, the American people and stimulate our economy” ([Paulson, 09/23/2008](#)). Bernanke backed the Treasury’s “proposal to buy illiquid assets from financial institutions” ([Bernanke, 09/23/2008 - pp. 4](#)). He said the program would create liquidity, promote price discovery, and restore confidence in the broader system ([Bernanke, 09/23/2008 - pp. 4](#)). Paulson and Bernanke worked in tandem, with Bernanke “provid[ing] the academic gravitas” and Paulson “argu[ing] passionately that [TARP] was the most effective way to recapitalize the banking system” (Jester, Nason, Norton 2019 – pp. 5). The two officials expressed an urgent need for intervention, with Paulson acknowledging the importance of post-crisis regulation ([Paulson, 09/23/2008 - pp. 2](#), [Bernanke, 09/23/2008 - pp. 4](#)). Paulson described TARP as an asset purchase program rather than a recapitalization program. In his testimony to the House Financial Services Committee the next day, he explicitly stated that the program “is not a spending program. It is an asset purchase program, and the assets which are bought and held will ultimately be resold with the proceeds coming back to the government” ([UST PR, 09/24/2008](#)).

The initial reaction from lawmakers was negative. Sen. Chris Dodd, who chaired the Senate committee, called the original proposal “stunning and unprecedented in its scope – and lack of detail...” Dodd said the program would not do anything to help homeowners. He articulated mistrust towards having the Treasury hold so much power. “[It] is not just our economy that is at risk but our Constitution as well” ([Senate Hearing 110-1012 - pp. 3](#)). Much of the criticism from lawmakers centered around the proposal’s lack of detail, its focus on rescuing financial institutions rather than homeowners, and the lack of punishment for the financial institutions that would be receiving TARP aid ([Senate Hearing 110-1012](#)).

Public perception of the original proposal manifested itself in the forms of large scale protests across the nation, with over a thousand protestors rallying outside of the New York Stock Exchange ([Bensinger, 09/26/2008](#)). Senators Sherrod Brown, Barbara Boxer, and Diane Feinstein reported that their offices alone received over 60,000 emails, calls, and letters about the proposal, most of which were decidedly against it ([Stohlberg, 09/24/2008](#), [Bensinger, 09/26/2008](#)). A poll by Pew found broad support for a government intervention; Gallup found that a majority of Americans supported Congressional action, but in a form different from Paulson’s proposal ([Pew, 09/23/2008](#), [Gallup, 09/26/2008](#)).

The House of Representatives failed to pass EESA on September 29, 2008 ([Final Vote Results: H.R. 3997](#)). In a public statement following the vote, Paulson expressed his disappointment, stating that the government's toolkit was "substantial but inefficient" to address the continued stress. ([UST PR, 09/29/2008](#)). Financial markets reacted extremely negatively after the vote, with the Dow Jones Industrial Average dropping 777 points and the S&P500 falling 8.8 percent, with over \$1 trillion in value being lost ([Bloomberg](#), Jester, Nason, Norton 2019 – pp. 5, [Davis, 09/29/2008](#)).

In the aftermath of the failed vote, Treasury and the Federal Reserve communicated internally and to President Bush that the best way to combat the growing crisis was not large-scale asset purchases, but capital injections instead (Jester, Nason, Norton 2019 – pp. 5).

The Senate passed a revised bill on October 1, and on October 3, Congress passed the Senate version and President Bush signed it into law ([Govtrack - EESA](#)). After the successful vote, Paulson reiterated the Treasury would provide "regular updates" in regular press releases and speeches ([UST PR, 10/03/2008](#)). From October 3 to October 14, the day the CPP was announced, the Treasury published updates chronicling the shift in its thinking on October 6, 8, 11, and 13. Paulson's statements on October 8 are the first place where he mentions verbatim that the authority granted to Treasury under EESA allowed it to inject capital into financial institutions ([UST PR, 10/08/2008](#)). A day later, it was reported that capital injections "[had emerged] as one of the most favored new options being discussed in Washington and on Wall Street" ([Andrews and Landler, 10/09/2008](#)). The language in the subsequent updates on October 11 and 13 indicate that capital injections were a serious option that Treasury was considering, despite initially campaigning for asset purchases ([UST PR, 10/11/2008](#), [UST PR, 10/13/2008](#)).⁹

In its first press release on October 8, Treasury specified that the program was "voluntary", but that nine financial institutions had also already agreed to participate, which "signal[ed] the importance of the program for the system." Treasury explicitly stated that these nine were healthy, and that they would participate "on the same terms that will be available to small and medium-sized banks and thrifts across the nation" ([UST PR, 10/14/2008](#)). For more detail on these nine banks, see [KDD #7](#).

In an update made to the public on November 12, 2008, Paulson addressed the decision to avoid using TARP funds for asset purchases, stating that, "At the time, we believed that [asset purchases] would be the most effective means of getting credit flowing again" ([UST PR, 11/12/2008](#)). He described how the continuously deteriorating conditions leading up and subsequent to the passage of EESA made those at Treasury realize that an asset purchase program "would take time to implement and would not be sufficient given the severity of the

⁹ Paulson's remarks at the International Monetary and Financial Committee meeting on October 11, 2008 outlined five key areas of Treasury's response, with one of them being strengthening the capital of financial institutions ([UST PR, 10/11/2008](#)). In his remarks before the Institute of International Bankers, Neel Kashkari's specified that Treasury was "designing a standardized program to purchase equity in a broad array of financial institutions", and that the program would be voluntary and attractive to healthy institutions ([UST PR, 10/13/2008](#)).

problem” (UST PR, 11/12/2008). Ultimately, Paulson stated, capital injections were the “most timely, effective step to improve credit market conditions” (UST PR, 11/12/2008).

4. **Section 104 of EESA established the Financial Stability Oversight Board, which oversaw the activities of the CPP and other TARP programs, as well as the Special Inspector General for the Troubled Asset Relief Program, which conducted independent reviews. The Senate’s Congressional Oversight Panel also oversaw TARP.**

Section 104 of EESA established the Financial Stability Oversight Board (FSOB) to review the policies implemented under section 101. Those policies included reviewing “the appointment of financial agents, the designation of asset classes to be purchased, and plans for the structure of vehicles used to purchase troubled assets...” (P.L. 110-343 - pp. 3770 - 3771). The FSOB was also responsible for examining the effects that programs made under section 101 had on “assisting American families in preserving home ownership, stabilizing financial markets, and protecting taxpayers” (P.L. 110-343 - pp. 3771).

The Board had the following members:

- 1) The Chairman of the Board of Governors of the Federal Reserve system
- 2) The Secretary of the Treasury
- 3) The Director of the Federal Housing Finance Agency (FHFA)
- 4) The Chairman of the Securities Exchange Commission (SEC), and
- 5) The Secretary of Housing and Urban Development (HUD).

Additionally, the Board was required to report to Congress, as well as the Congressional Oversight Panel at least quarterly to discuss the matters described above.

Treasury was the initial holder of all capital issued by Qualifying Financial Institutions (QFIs) under the CPP and had certain powers that allowed it to influence how institutions managed the investment.

The Special Inspector General for the Troubled Asset Relief Program, or SIGTARP, was established through section 121 of EESA. The Special Inspector General was to be appointed by the president and confirmed by the Senate, and was responsible for “coordinat[ing] audits and investigations of the purchase, management, and sale of assets by the Secretary of the Treasury...” (P.L. 110-343 - pp. 3788). SIGTARP did this by collecting the following information:

- 1) Descriptions of categories of troubled assets purchased
- 2) Listings of assets that fell into the aforementioned categories
- 3) Explanations of the reasons for purchasing said assets from the Secretary of the Treasury.
- 4) Listings of the financial institutions that the troubled assets were purchased from.
- 5) Listings of, and “detailed biographical information” on the people hired to manage these troubled assets.

- 6) Estimates on the total number and value of troubled assets, how much remained with the Treasury, how much had been sold, and the profit or loss incurred from said sales ([P.L. 110-343 – pp. 3788 – 3789](#)).

According to its mission statement, SIGTARP “is a federal law enforcement agency and is an independent watchdog protecting taxpayer dollars that fund TARP.” ([SIGTARP Annual Report – FY 2018 – pp. 3](#)). SIGTARP reported to Congress about its supervisory activities twice a year, audited various TARP programs, and conducted and reported on investigations of misconduct for TARP recipients ([SIGTARP – Official Website](#)). SIGTARP’s quarterly reports generally consisted of assessments of various components of the program, such as the CPP, as well as auto and housing industry support programs ([SIGTARP April 2010 – Table of Contents](#)). SIGTARP reports included detailed recommendation sections, informed by the audits and investigations it conducted, and also provided detailed tables of the implementation status of each of these recommendations ([SIGTARP July 2014 – pp. 313 – 336](#)).

The Senate’s Congressional Oversight Panel (COP) was another crucial component of TARP oversight. Created on the same day that TARP was passed, COP’s primary functions were to:

- 1) “Oversee Treasury’s actions
- 2) Assess the impact of spending to stabilize the economy
- 3) Evaluate market transparency
- 4) Ensure effective foreclosure mitigation efforts
- 5) And guarantee that Treasury’s actions are in the best interest of the American people” ([SIGTARP – About Us](#)).

In its approximately two and a half years of operation, the COP held hearings and collected testimony from high-level officials, such as Treasury Secretary Tim Geithner and Senator Elizabeth Warren, as well as published 29 reports on the impacts of key TARP initiatives. Much of COP’s analysis was informed by the functions listed above, with the Panel asking questions about the more immediate, stabilizing effects of TARP, as well as longer-term impacts, such as how TARP recipients were structuring their business and policies after receiving aid ([COP December 2008 – pp. 3](#)). Other reports, such as those about specific firms like GMAC and AIG, as well as Treasury’s conduct with smaller CPP banks, were also published ([COP – Reports](#)). In this way, Congress was able to provide another layer of feedback to Treasury on how they managed still-outstanding investments, while providing guidance on what to do for future initiatives.

The COP was disbanded on April 3, 2011 after releasing its final report. In it, the Panel explained that, while TARP alone was not responsible for the economic recovery, “TARP quelled the immediate panic and helped to avert an even more severe crisis” ([COP March 2011 – pp. 182](#)). However, COP did cite concerns about moral hazard, stigma, and a lack of transparency. TARP, and by extension the CPP, was “one of the most thoroughly scrutinized government programs in U.S. history” ([COP March 2011 – pp. 190](#)).

5. The total size of the CPP was \$250 billion, with specified minimums and maximums for participating institutions.

Despite the varied schedule in announcement dates and capital characteristics, all four classes of institutions had the same individual minimums and maximums for participation. If accepted into the program, all participating institutions were required to issue at eligible securities at a minimum of one percent of their risk-weighted assets. However, no institution could issue qualifying capital up to the lesser of 1) \$25 billion and 2) three percent of its risk-weighted assets (Term Sheets: [Publicly traded institutions](#), [Non-publicly traded](#), [S-Corporations](#), [Mutual Banks](#)).

6. The CPP was funded via Congressional appropriations authorized for Treasury's use under the Troubled Asset Relief Program.

Congress authorized a total of \$700 billion of TARP funds that could be “outstanding at any one time”. However, only \$250 billion was originally allowed to be outstanding, and the president was required to return to Congress with a report asking to disburse the remaining funds, should they be necessary ([P.L. 110-343 – pp. 3780](#)).¹⁰ This authority lasted until October 3, 2010, or two years after the date of the passage of EESA. After this point, Treasury was not able to make new commitments under TARP ([TARP Two Year Retrospective – pp. 14](#)). The Dodd-Frank Wall Street Reform and Consumer Protection Act, passed on July 21, 2010, reduced this original commitment from \$700 billion to \$475 billion ([P.L. 111-203 – pp. 2133](#)).

7. Participation in the CPP was voluntary, but the Treasury convinced nine of the largest banks to participate in the program to encourage broader participation and stabilize the system.

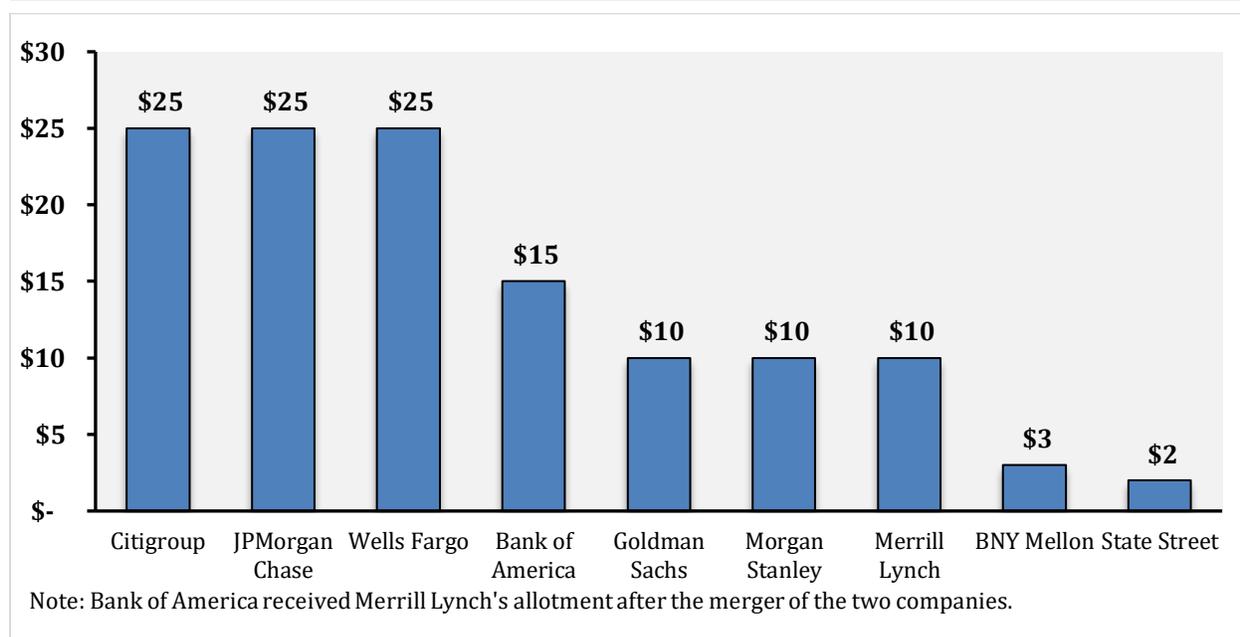
Prior to its official release of the details of the CPP, Paulson and a group of high-level government officials arranged a meeting on October 13, 2008, with the heads of nine of the largest U.S. banks.¹¹ At the time, these institutions held about 55 percent of all U.S. banking assets, and agreed in part to participate “to signal the program’s importance to the stability of the financial system” ([GAO 12-301 – pp. 7](#)). They were selected because government officials viewed them as “systemically important” due to their size, scope of business, and interconnectedness in the broader economy ([SIGTARP, 10/05/2009 - pp. 14 - 15](#)). Although Treasury claimed in its initial announcement of the CPP that these institutions were healthy, other reports suggest that there were internal concerns about the health of the nine, and that protecting them would help protect a “system that was viewed as being vulnerable to collapse” ([SIGTARP, 10/05/2009 – pp. 17](#)). At the time, Chairman Bernanke even acknowledged that having one of these nine institutions fail “could rapidly cause the failure

¹⁰ The phrase “outstanding at any one time”, which implicitly allowed the government to re-use TARP funds, was removed with the passage of The Dodd-Frank Wall Street Reform and Consumer Protection Act in July of 2010. See KDD #14 for more details.

¹¹ The nine banks were JP Morgan, Wells Fargo, Bank of America, Citigroup, Goldman Sachs, Merrill Lynch, Morgan Stanley, Bank of New York Mellon, and State Street.

of others due to the high degree of interconnectedness of the systemically significant institutions” (SIGTARP, 10/05/2009 – pp. 17).

Figure 5: Initial CPP Investments in 9 Large Financial Institutions



Source: CPP Transaction Data

The chief executives of the nine institutions were brought into a meeting at 3pm on October 13 and were told to accept the capital “for the good of the country”, and in less than four hours all nine executives had pledged to take the investment (SIGTARP, 10/05/2009 – pp. 18 - 19). While the injections were initially framed as voluntary, Secretary Paulson later explained that, “if necessary, the government would make clear to the nine executives that they had no choice but to take the money (SIGTARP, 10/05/2009 – pp. 18 - 19). This was done because the government believed that having the institutions all take the capital together would mitigate potential stigmatization issues by eliminating the distinction between “weak” institutions that took the capital and stronger ones that did not need it (SIGTARP, 10/05/2009 – pp. 18 - 19).

8. Initially, public and non-public banks were eligible for the CPP, but in early 2009 Treasury made S-corporations and Mutual Banks also eligible.

Institutions that wished to apply had to do so by applying through their primary federal banking regulator, and bank holding companies were required to apply to their supervisor as well as the regulator that monitored the largest depository institution it controlled. Public institutions had until 5pm on November 14, 2008, to submit applications (UST PR 10/14/2008). The details for privately held institutions (excluding S-corps and mutual banks) were released on November 17, and their application deadline was December 8, 2008 (UST PR 11/17/2008). Applications by publicly traded institutions would be released publicly unless they could “demonstrate the harm (for example, loss of competitive position,

invasion of privacy) that would result from public release of information” ([CPP FAQ: Publicly traded institutions](#) – pp. 2 – 3).

Financial institutions applied to their primary federal regulator by submitting an application form, signed by the institution’s chief executive officer. The form included the amount of preferred stock the institution requested; high-level financial data, such as the amount of authorized but unissued stock; a commitment that the management had reviewed and agreed with the terms of the investment agreement; a description of any conditions in the investment agreements that the bank could not meet; and a description of any mergers, acquisitions, or other capital raisings that were pending or under negotiation. ([Application Guidelines: CPP](#)).

Treasury initially released the term sheet and documentation for publicly traded institutions only, and took more time releasing the details for private financial institutions, S-corporations, and mutual banks. While non-public banks had their participation details released about a month after their public counterparts, S-corps and mutual banks did not get the necessary documents to participate until January and April of 2009, respectively ([UST PR, 11/17/2008](#), [UST PR, 01/14/2009](#), [UST PR, 04/14/2009](#)).¹² Treasury also released sets of Frequently Asked Questions (FAQs) for each of the types of institutions eligible for the CPP, which primarily addressed concerns around institutional requirements, Tier 1 or Tier 2 eligibility of government capital (depending on whether it was preferred stock or subordinated debt), as well as the publicity of individual participants (FAQs: [Publicly-traded institutions](#), [Nonpublic, S-Corporations](#), [Mutual Banks](#)).

According to the term sheets disseminated by Treasury at the outset of the program, a Qualifying Financial Institution (QFI), could not be a foreign bank, foreign savings association, foreign Bank Holding Company (BHC), or foreign Savings and Loan Holding Company (SHLC). S-Corporations and mutual banks were originally not included but would be made eligible in early 2009. QFIs could be the following:

¹² Mutual banks are different from commercial banks in that they do not have common shareholders. They are owned by their members, that is, their depositors, who share in the profits. As of the end of 2018, the largest mutual institution holds just over \$14 billion in assets, and the average mutual institution holds approximately \$593 million in assets ([FDIC: Mutual Institutions Data](#)).

Table 1: Qualified Financial Institution (QFI) definitions

Institution Type	Qualified Institutions¹³	Deadline
Publicly Traded ¹⁴	1) Any U.S. Bank or savings association not controlled by a BHC or SLHC 2) Any “top-tier” U.S. BHC 3) Any “top-tier” U.S. SLHC that solely or predominantly engages in activities permitted for financial holding companies 4) Any U.S. bank or savings association U.S. SLHC that does not solely or predominantly engage in activities permitted for financial holding companies.	November 14, 2008
Private / Nonpublic	1) Any “top-tier” BHC or SLHC that solely or predominantly engages in activities permitted for financial holding companies and are not publicly traded. 2) U.S. banks or savings associations that are not publicly traded nor controlled by a BHC or SLHC 3) U.S. banks or savings associations that are not publicly traded and controlled by a nonpublic SHLC that that does not solely or predominantly engage in activities permitted for financial holding companies.	December 8, 2008
S-Corporations	1) Any “top-tier” BHC or SLHC that solely or predominantly engages in activities permitted for financial holding companies 2) U.S. banks or savings associations that are not publicly traded nor controlled by a BHC or SLHC 3) A U.S. Bank or savings association that is an S-Corp subsidiary of an S-Corp BHC or SLHC that does not solely or predominantly engage in activities that are permitted for financial holding companies.	February 13, 2009
Mutual Banks	1) Any U.S. bank or savings association “organized in mutual form” and not controlled by a BHC or SLHC.	May 14, 2009

*Source: Term Sheets: Publicly Traded Institutions, Nonpublic Institutions, S-Corporations, Mutual Banks.
Announcements: Publicly Traded Institutions, Nonpublic Institutions, S-Corporations, Mutual Banks.*

¹³ BHC stands for Bank Holding Company. SLHC stands for Savings and Loan Holding Company.

¹⁴ Publicly traded companies are companies 1) “whose securities are traded on a national securities exchange and 2) required to file, under the federal securities laws, period reports such as the annual (Form 10-K) and quarterly (Form 10-Q) reports with either the Securities and Exchange Commission or its primary federal bank regulator” ([Term Sheet: Nonpublic Institutions – pp. 1](#)).

9. Federal regulators determined an institution’s eligibility for the CPP and made recommendations to the Treasury, which was responsible for final approval

In reviewing applications, primary federal regulators considered supervisory and other information. Treasury worked with the regulators to establish a common and streamlined applications process. Under this process, the primary federal regulator—or, in some cases, a council of representatives from each federal regulator that supervised an institution—made a recommendation of approval to the Treasury. The Treasury was responsible for final approval. After receiving a recommendation, Treasury conducted its own review before submitting the applications to an internal TARP investment committee. These submissions included additional information about QFIs, such as a more detailed breakdown of the composition of their capital, as well as performance indicators, such as CAMELS, CRA, and (if applicable) C/RFI Ratings ([SIGTARP August 2009 – pp. 26 – 27](#)). This committee then made its recommendations to the Assistant Secretary of financial stability, who made the final decision. On receiving preliminary approval from the Treasury, applicants had 30 days to submit the investment agreements and related documentation. ([FSOB: Quarterly Report to Congress, 12/31/2008 – pp. 7 - 8](#)).

Table 2: Federal Banking Agency (FBA) Classification for QFIs participating in the CPP

QFI Classification	Standards for Classification (one of the following)
Category 1 – Presumptive Federal Banking Agency Approval	1) QFIs with a Composite CAMELS/RFI rating of “1” 2) QFIs with a Composite CAMELS/RFI rating of “2” and for which the most recent examination rating is not more than 6 months old. The Most recent exam should be conducted or confirmed by the Primary Federal Regulator (PFR). 3) QFIs with a composite rating of “2” or “3” and acceptable performance ratios.
Category 2 – Presumptive CPP Council Review	1) QFIs with a Composite CAMELS/RFI rating of “2” who’s most recent examination rating (as determined or confirmed by the PFR) is more than six months old and overall unacceptable performance ratios 2) QFIs with a Composite CAMELS/RFI rating of “3” with overall unacceptable performance ratios.
Category 3 – Presumptive FBA Denial	1) QFIs with a Composite CAMELS/RFI rating of “4” 2) QFIs with a Composite CAMELS/RFI rating of “5”

Source 2: USTJW - pp. 280

10. Initially, institutions would issue perpetual nonvoting senior preferred shares to Treasury, with warrants to purchase additional common stock. S-Corporations and Mutual Banks issued subordinated debt.

In its first term sheet, released on October 14, 2008, Treasury specified that the capital that it purchased had to have the following characteristics:

Table 3: Capital Characteristics for types of QFIs

Institution Type	Type of Capital	Regulatory Capital Status	Seniority	Dividends
Publicly Traded	Perpetual Preferred Stock	Tier 1	Senior to all common, pari passu with preferred unless specified	5% (<5 years) 9% (>5 years)
Private / Nonpublic	Perpetual Preferred Stock	Tier 1	Senior to all common, pari passu with preferred unless specified	5% (<5 years) 9% (>5 years)
S-Corporations	30 Year Subordinated Debt	Tier 2, Tier 1 if at a holding company	Senior to all equity, subordinated to other obligations and depositors ¹⁵	7.7% (<5 years) 13.8% (>5 years) ¹⁶
Mutual Banks	30 Year Subordinated Debt	Tier 2	Senior to all equity, subordinated to other obligations and depositors	7.7% (<5 years) 13.8% (>5 years)

Sources: Term Sheets: Publicly Traded Institutions, Nonpublic Institutions, S-Corporations, Mutual Banks

As mentioned in the Evaluation section below, CPP's effect on bank lending was a popular method of examining its overall impact. Treasury Secretary Paulson even stated that "The whole reason for designing the program was so many banks would take it, would have the capital, and that would lead to lending. That was the whole purpose" (FCIC Report – pp. 375). Despite this assertion, Treasury did not, in the term sheet or subsequent regulation, require banks to use this capital for lending purposes. Treasury began publishing a variety of lending reports and data to help track new lending after an institution had received CPP funds. Treasury explained that "lending is clearly one of the most important ways CPP recipients

¹⁵ For holding companies that were issuing subordinated debt to Treasury for itself or a subsidiary, the debt was required to be "subordinated to senior indebtedness of the [institution]" (Term Sheet: S-Corporations – pp. 2).

¹⁶ For S-Corporations that were holding companies and qualified for the CPP, interest could be deferred for up to 20 quarters, but any unpaid interest would cumulate and compound. If the holding company opted to defer interest payments, then they were not allowed to pay dividends on any equity until the deferral ended (Term Sheet: S-Corporations – pp. 2).

can deploy this additional capital, as it affects Americans directly” (UST Lending Snapshot, Oct – Dec 2008 – pp. 1). Treasury published individual bank lending reports as well as “monthly lending and intermediation snapshots”, which were targeted at the largest banks and done so Treasury could provide public analysis of the situation by targeting a section of banks that represented the majority (about 75%) of bank holding company assets in the country (UST Lending Snapshot, Oct – Dec 2008 – pp. 2).

Dividends. All capital issued to Treasury was sold at \$1,000 per instrument.¹⁷ In the case of preferred shares, this price could be raised at the Treasury’s discretion (Term Sheets: Publicly Traded Institutions, Nonpublic Institutions). Dividends and interest payments were cumulative, paid quarterly, and at rates varying from 5 to 7.7 percent, depending on the type of institution and how long it had held the capital for. After five years, step-up clauses in the term sheets would kick in, increasing the dividend or interest rates as high as 13.8 percent, depending on what category the QFI was in.¹⁸ For institutions that took preferred equity and were not controlled by a holding company, their dividends were non-cumulative (Term Sheets: Publicly Traded Institutions, Nonpublic Institutions).

Dividend Restrictions. For all classes of QFIs, dividends on junior or equivalently ranked equities were prohibited from being paid out or declared while the QFI still had Treasury capital outstanding. QFIs were also subject to certain restrictions on repurchases and redemptions, as well (discussed in KDD #11). Additionally, any increases in common dividends were required to be approved by Treasury so long as the government’s investment remained outstanding, or until three years had passed. After the third anniversary of the capital injection, publicly traded QFIs could raise common stock dividends by any amount without Treasury’s consent, while the other three types of QFIs could only do so to a maximum of three percent. If an institution still had Treasury capital outstanding after 10 years, it was allowed to raise common stock dividends by any amount without approval (Term Sheets: Publicly Traded Institutions).

Warrants. Treasury also received 10 year warrants to purchase either common stock, additional preferred shares, or additional subordinated debt depending on the type of QFI it had an agreement with. The terms of these warrants are summarized in Table 4 below.

¹⁷ Preferred stock had a liquidation preference of \$1,000, and subordinated debt was sold with a par value of \$1,000 (Term Sheets: Publicly Traded Institutions, Nonpublic Institutions, S-Corporations, Mutual Banks).

¹⁸ S-Corporations and Mutual Banks paid 7.7 percent in quarterly interest for the first five years of holding Treasury capital, then 13.8 past five years. However, the after tax effective rates of their interest payments were five and nine percent, respectively. Thus, they paid the same amount in interest as publicly traded and privately owned QFIs (Term Sheet: S-Corporations – pp. 2).

Table 4: 10-year CPP Warrant Characteristics for QFIs

Institution Type	Stock obtained	Exercise Price	Voting	Term
Publicly Traded	Purchase common stock equivalent to 15% of the market price of the Preferred stock on the date of investment. ¹⁹	Market price of common stock on date of Preferred investment (20-day trailing avg.)	Nonvoting common stock, if exercised.	10 years
Private /Nonpublic	Purchase net shares of preferred stock with liquidation preference equal to 5% of the Preferred amount purchased on the date of investment.	\$0.01 per share, "or such greater amount as the charter may require..."	Same terms as original preferred. Nonvoting and ability to elect directors if 6 dividend payments are missed. 9% dividends per annum.	10 years, but Treasury intended to immediately exercise.
S-Corporations and Mutual Banks	Purchase a "number of additional Senior Securities" equal to 5% of the amount purchased on the date of investment.	\$0.01 per note representing a Warrant Security.	Same terms as original Senior Securities. Nonvoting and ability to elect directors if 6 dividend payments are missed. 13.8% dividends per annum. ²⁰	10 years, but Treasury intended to immediately exercise.

Source: Term Sheets: [Publicly Traded Institutions](#), [Nonpublic Institutions](#), [S-Corps](#), [Mutual Banks](#)

The warrants for both publicly traded QFIs and Mutual Banks included Reduction clauses, which stated that, if the QFI had not paid back Treasury's investment by the end of 2009, then the number of securities underlying the warrants would be reduced to half of the total amount of Treasury's initial investment (Term Sheets: [Publicly Traded Institutions](#) – pp. 5, [Mutual Banks](#) – pp. 5).

For publicly traded institutions, the warrants could also be exchanged for "senior term debt or another economic instrument or security of the QFI such that [Treasury] is appropriately compensated for the value of the warrant..." (Term Sheet: [Publicly Traded Institutions](#) – pp. 5). Treasury had the option to make this substitution if the QFI ceased to be publicly traded, or if a shareholder vote to issue enough common stock to cover the exercising of the warrant had not passed within 18 months ([Term Sheet: Publicly Traded Institutions](#) – pp. 5).

In the fourth quarter of 2008, the Treasury immediately exercised all warrants for preferred shares in each privately-held QFI that received a CPP investment. Treasury did not require

¹⁹ The initial exercise price of the warrant was the market price of the common stock at the date of the original investment, and would be reduced by 15 percent of the original price every six months following the original investment, with a limit of 45 percent ([Term Sheet: Publicly Trade Institutions](#) - pp. 4).

²⁰ The Senior Securities issued to Treasury had an interest rate of 7.7% for the first five years, then 13.8% after. These rates, while higher than the dividends that public and private banks paid before and after five years, respectively, equated to 5% and 9%, assuming a tax rate of 35% ([Term Sheet: Mutual Banks](#) – pp. 2).

banks classified as community development financial institutions to issue warrants as a condition for a CPP investment ([FSOB: Quarterly Report to Congress, 12/31/2008 – pp. 9](#)).

Voting Rights. In both cases of preferred stock or subordinated debt, Treasury would have no voting rights other than those in instances where i) instruments more senior to their own were being issued, ii) the rights of their equity or debt were being amended, or iii) a merger, exchange, or similar transaction that would affect the rights of their investment (Term Sheets: [Publicly Traded Institutions](#), [Nonpublic Institutions](#), [S-Corporations](#), [Mutual Banks](#)).

11. CPP Agreements did not specifically outline debt restructuring agreements. However, outstanding CPP investments were restructured if a participant went into bankruptcy or receivership.

As of October 2019, 34 institutions that received CPP investments were either undergoing or had gone into bankruptcy or were in receivership. Institutions in receivership would have their assets taken over and subsequently marketed and sold to make their creditors whole ([FDIC Resolutions Handbook – pp. 26](#)). When referencing this category of institutions, the GAO reported that, “When [CPP] investments are restructured, Treasury receives cash or other securities, which generally can be sold more easily than preferred stock, but Treasury’s investments are sometimes sold at a discount” ([GAO-16-524 – pp. 6](#)). For a small subset of CPP institutions, Treasury “would determine whether it would exchange or restructure the Government’s shares to facilitate a merger or acquisition of the TARP bank and whether or not it would take a discount”, though this was done on an ad-hoc basis ([SIGTARP 01/28/2015 – pp. 12](#)).

Repurchases and Redemptions. In effect, the government’s investment subordinated all other holders of equity, though holders of senior and subordinated debt still ranked senior to the senior preferred equity that the government held. Redemption of Treasury’s investment in all types of QFIs except for mutual banks required a qualified equity offering (or qualified securities offering in the case of subordinated debt) in which the institution raises additional Tier 1 or Tier 2 capital in private markets of at least 25% of the original issue price of Treasury’s investment. For mutual banks, redemptions could be done at any time, provided they obtained approval from their federal banking regulator (Term Sheets: [Publicly Traded Institutions](#), [Nonpublic Institutions](#), [S-Corporations](#), [Mutual Banks](#)).

The term sheets also required QFIs that issued preferred equity to obtain Treasury approval for any repurchasing of shares that were either senior or non-government. QFIs that issued subordinated debt had to seek Treasury’s approval for any repurchases of equity. However, if a QFI still had CPP investments outstanding after ten years, then they were no longer required to obtain Treasury approval for repurchases or undergo a qualified equity offering for redemptions (in the cases of publicly traded and nonpublic QFIs). Publicly traded institutions were only required to wait three years before these restrictions were lifted (Term Sheets: [Publicly Traded Institutions](#), [Nonpublic Institutions](#), [S-Corporations](#), [Mutual Banks](#)).

CDCI and SBLF Conversion. The Community Development Capital Initiative (CDCI), which was created on February 3, 2010, allowed certain CPP institutions to convert their CPP capital into lower-cost CDCI capital ([UST – CDCI, Webel 2013, pp. 15 – 16](#)). In order to be eligible for this conversion, CPP institutions had to qualify as a Community Development

Financial Institution (CDFI), which were financial institutions that seek to generally expand economic opportunities in underserved and low-income areas (CDCI FAQ, CDFI Fund: “What are CDFIs?”). If a QFI was accepted, their current CPP capital would be exchanged, and they would be expected to issue additional shares so up to a maximum of five percent of their risk-weighted assets (CDCI FAQ). 28 institutions had \$362 million in CPP investments refinanced through the CDCI.

The Small Business Lending Fund (SBLF), established on September 27, 2010 as part of the Small Business Jobs Act, was a program that “encourage[d] lending to small businesses by providing Tier 1 capital to qualifying community banks with assets of less than \$10 million (UST – SBLF, SBLF Fact Sheet). CPP Institutions that met that requirement could apply to the SBLF through the Treasury provided they had not redeemed or applied to redeem any CPP or CDCI investment as of December 16, 2010 (Term Sheet: SBLF – pp. 1). While the terms of the SBLF in many ways mirrored the CPP and CDCI, the dividend structure was tied to the amount of small business lending a given SBLF participant did. The more a participant’s small business lending increased after receiving SBLF capital, the lower its dividends would be (Term Sheet: SBLF – pp. 4).²¹ This incentive structure was amplified by an annual “lending incentive fee” of two percent of the total amount of preferred stock outstanding that would trigger if the institution did not increase its small business lending relative to its baseline amount after two and a half years in the program. The fee would apply starting on the fifth anniversary of the original CPP investment and each subsequent quarter (Term Sheet: SBLF – pp. 4 – 5). SBLF conversions were quite popular, with a total of 137 QFIs refinancing approximately \$2.2 billion in Treasury capital through the SBLF (Monthly Report to Congress, October 2019 – pp. 1).

12. Treasury had the ability to appoint two directors to institutions that did not pay interest or dividends for six quarters.

If dividends were not paid for six quarters (consecutive or not) then Treasury would have the option to elect two directors, with this right expiring after dividends had been paid for four consecutive quarters (Term Sheet: Publicly traded institutions – pp. 3).²² After Treasury had received these backlogged payments, institutions were under no obligation to keep the government-appointed directors, but could choose to do so (CPP FAQ: Missed dividend or interest payments). If five dividend payments were missed, however, Treasury would request permission from the institution send observers “to help determine how to best exercise its contractual rights to nominate up to two directors” (CPP FAQ: Missed dividend

²¹ There were still step-up clauses present in the CPP/CDCI to SBLF term sheet, however. After the first nine quarters, dividend rates would increase to a maximum of seven percent (from five percent for the first nine quarters). After four-and-a-half years, all dividends, irrespective of lenders’ performance, would increase to nine percent (Term Sheet: SBLF – pp. 4).

²² For non-publicly traded applicants, the right to elect directors ended when dividends had been paid for four consecutive periods (for non-cumulative preferred) or when all prior dividends had been paid (for cumulative preferred) (Term Sheet: Non-public banks – pp. 4). For S-Corps and Mutual Banks, the right to elect directors ended when interest was paid for all prior missed quarters (Term Sheets: S-Corps – pp. 4, Mutual Banks – pp. 3).

or interest payments). If multiple institutions required directors to be nominated, Treasury prioritized them based on the size of its investment, with large institutions receiving attention first. Specifically, they stated that, “Treasury [would] focus first on institutions where [its] investment exceeds \$25 million” (CPP FAQ: Missed dividend or interest payments).

13. Treasury included executive compensation and corporation governance restrictions modeled after those originally passed in EESA in its agreements with applicants.

Section 111 of EESA outlines executive compensation restrictions and corporate governance standards. Specifically, Section 111(b) describes these standards as they apply to direct purchases or investments in financial institutions. Section 111(b)(2) specified that there would be:

- 1) “limits on compensation that exclude incentives for senior executive officers of a financial institution to take unnecessary and excessive risks that threaten the value of the financial institution during the period that the Secretary holds an equity or debt position in the financial institution;
- 2) a provision for the recovery by the financial institution of any bonus or incentive compensation paid to a senior executive officer based on statements of earnings, gains, or other criteria that are later proven to be materially inaccurate; and
- 3) a prohibition on the financial institution making any golden parachute payment to its senior executive officer during the period that the Secretary holds an equity or debt position in the financial institution” (P.L. 110-343 - pp. 3777).

Senior executive officers (SEO’s) were defined by EESA as the top 5 highest paid executives of companies that took TARP money (P.L. 110-343 - pp. 3777). Treasury passed several interim final rules that provided additional guidance on executive compensation post-EESA, as well (TARP Executive Compensation Rules and Guidance). Treasury passed one of these rules on October 20, 2008, which gave additional clarification to the three rules outlined in Section 111 of EESA with respect to CPP investments.

The rule required that a financial institution accepting CPP funds had to identify features that may “lead SEOs to take unnecessary and excessive risks that threaten the value of the financial institution” and ensure that they are not encouraged to take these risks. Compensation committees had a maximum of 90 days to make these reviews, and were required to meet at least once a year with senior risk officers to discuss these policies (UST Interim Rule 10/20/2008 - pp. 7 - 8). The regulation also required that any bonuses and incentive compensation paid to SEO’s were to subject to a clawback if they were earned through inaccurate financial statements or “any other materially inaccurate performance metric criteria” (UST Interim Rule 10/20/2008 - pp. 9). For the third and final provision under Section 111(b)(2), golden parachutes were defined as “any payment in the nature of compensation to (or for the benefit of) a SEO made on account of an applicable severance from employment to the extent that the aggregate present value...equals or exceeds an amount equal to three times the SEO’s base amount” (UST Interim Rule 10/20/2008 - pp. 9).

Treasury released additional guidance in an announcement on February 4, 2009 by distinguishing between institutions that required “exceptional assistance”, such as AIG, and Bank of America and Citi, and institutions participating in “generally available capital access program[s]”, such as the CPP (UST PR - 02/04/2009). For generally available capital access programs, CEO compensation was further limited to \$500,000 in total yearly compensation, though this could be waived with “full public disclosure and [a] shareholder vote” (UST PR - 02/04/2009). The aforementioned clawback provisions also applied to the next twenty highest paid employees, in addition to the top five. Golden parachutes were further restricted to one year’s compensation, instead of three.

Treasury published their last Interim Final Rule on June 10, 2009. The final rule limited bonuses paid to CEO’s to one-third of total compensation, with the number of CEO’s affected by this limit increasing based on the amount of CPP aid given.²³ The \$500,000 limit specified in the February guidance would be amended to “link compensation to long-term firm value” by allowing additional compensation over \$500,000, providing that this was in the form of long-term, restricted stock (UST PR, 06/10/2009). The final rule also included the creation of a Special Master for TARP Executive Compensation, and further accountability for the Board of Directors of TARP recipients (UST PR, 06/10/2009).²⁴ The Special Master was responsible for reviewing compensation plans at firms receiving “exceptional” assistance in such a way that “maximize(s) long-term shareholder value and protect(s) taxpayer interests” (UST PR, 06/10/2009).²⁵ Treasury specified that institutions that received exceptional assistance included AIG, Citigroup, Bank of America, as well as automakers such as GM and Chrysler (UST PR, 06/10/2009). Institutions that participated in the CPP did not fall under this category (UST PR, 06/10/2009).

14. Treasury did not develop an explicit strategy for exiting its CPP investments, but began using auctions to exit its investment in May of 2012.

The preferred stock issued to Treasury by banks (both public and non-public) was perpetual life, whereas the subordinated debt issued to them from S-Corps and Mutual Banks had a 30-year term (Term Sheets: Publicly traded institutions - pp. 2, Non-publicly traded - pp. 2, S-Corporations - pp. 2, Mutual Banks - pp. 1). In the case of preferred stock, Treasury stated that, “In order for the investment to be considered high-quality capital for regulatory purposes, we could not require a bank to repay Treasury on a specific timeline” (UST PR,

²³ Institutions that received over \$500 million in assistance had their top 5 highest paid executives, as well as the 20 next highest paid affected by the one-third of total compensation limit.

²⁴ A number of the provisions laid out in the June 10 Interim Final Rule, such as the one-thirds limit on total compensation, as well as the number of CEO’s and employees affected by executive compensation restrictions based on total TARP aid received, were originally passed via Section 111 of the American Recovery and Reinvestment Act of 2009 (ARRA). The June 10 Interim Final Rule implemented and clarified these restrictions.

²⁵ In addition to approving compensation agreements, the Special Master was also responsible for reviewing compensation that was paid prior to the passage of ARRA, as well as negotiating reimbursements for these where relevant (UST PR, 06/10/2009).

05/03/2012). The characteristics of these investments, coupled with the statement from Treasury, indicates that there was no concrete exit strategy.

In a letter written to Congress in December 2009, Treasury Secretary Geithner stated that the CPP “is effectively closed”, and that the only commitments for capital injections would be “to provide capital to small and community banks, which are important sources of credit for small business” (UST PR, 12/09/2009). At the same time, Geithner reiterated that, despite limiting its new commitments, the government should maintain an “adequate financial stability reserve” in case that conditions further worsened (UST PR, 12/09/2009). In terms of CPP investments, Geithner stated that they would be managing them, “in a commercial manner and [would] dispose of them as soon as practicable” (UST PR, 12/09/2009).

From this point on, CPP was largely in a wind-down phase, with 649 of 707 institutions remaining in the program at the end of 2009, and the vast majority of these were institutions with less than \$100 million in assets (SIGTARP 01/28/2015 – pp. 11). At the beginning of 2010, 74 CPP institutions had already missed dividend or interest payments. This number would continue to grow as the program went on, despite the program approaching profitability (SIGTARP 01/28/2015 – pp. 11).

On May 3, 2012, Treasury announced a strategy to more quickly exit its investment from the 343 remaining banks (UST PR, 05/03/2012). Despite nearly half of the total number of institutions still involved in the program, Assistant Secretary for Financial Stability Tim Massad stated that, of the \$245 billion that they had invested in the capital structure of the banking system, Treasury had recovered \$264 billion.²⁶ Most of the remaining institutions were “smaller, community lenders” that were having a more difficult time attracting private capital. Massad discussed three options that Treasury was planning to exit its involvement in three ways:

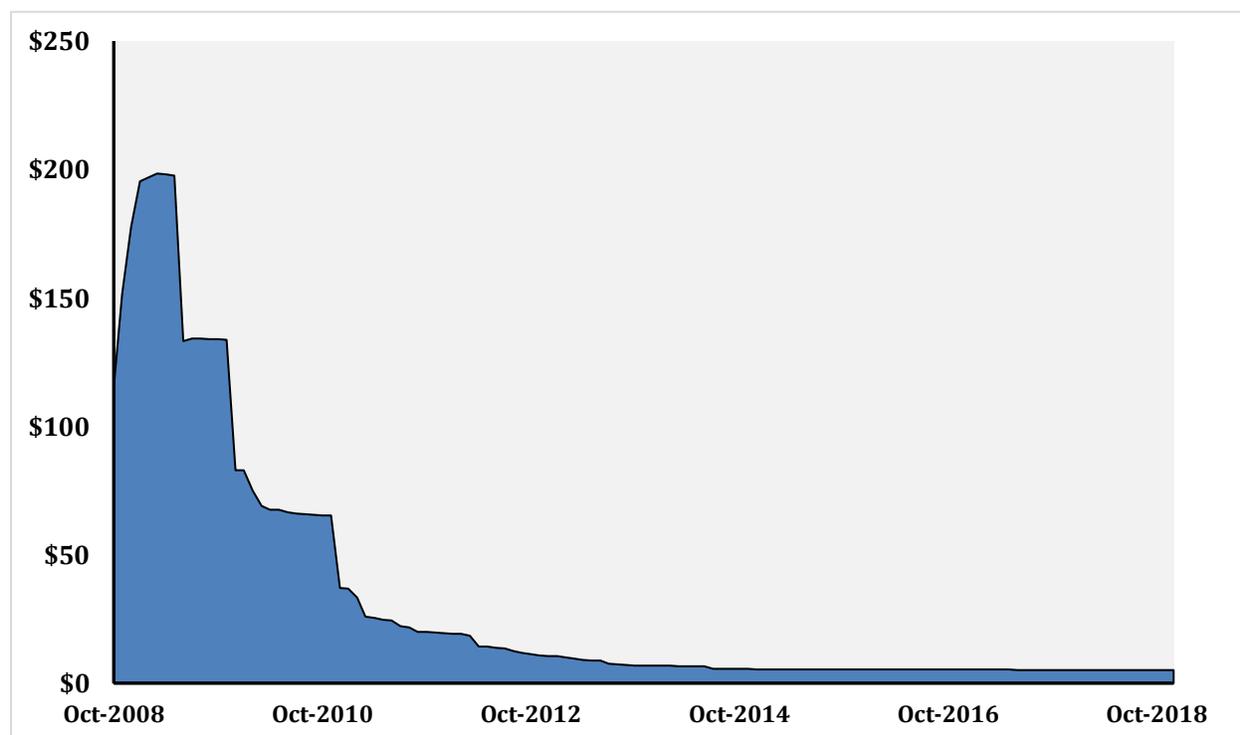
- 1) Repayments. This was the most common method in which institutions exited the CPP (TARP Monthly Update, April 2013 – pp. 7). According to Treasury, the majority of the remaining CPP institutions were unlikely to exit the program in this way.
- 2) Restructurings. As discussed above, a “handful” of participants had already approached Treasury about restructuring their investment, usually within the context of a merger or plan to raise private capital. Treasury only agreed to these if “the terms represent[ed] the best deal for taxpayers under the circumstances.”
- 3) Auctions and sales. Treasury had already auctioned off some of the warrants associated with its investments for a profit, and had conducted a test auction of preferred stock in March of 2012. The auction, which received “eight times as many bids as the number of securities offered”, suggested that this was a beneficial way for the government to exit as it would attract private capital to replace their investment (UST PR, 05/03/2012).

²⁶ The \$245 billion figure includes \$40 billion invested into both Citigroup (\$20 billion) and Bank of America (\$20 billion) as part of the Targeted Investment Program (TIP).

The auctions ultimately had mixed results, with the vast majority (70%) of auctioned CPP investments being bought by large, private fund investors that were “unknown to the banks and not from the banks’ communities” (SIGTARP 01/28/2015 – pp. 14 - 15). These investors bought these shares at discounts ranking from 1% to 90%, with some buyers “[having] already flipped them back to the bank at a premium to what Treasury received at auction, sometimes getting the full amount of what was owed in TARP” (SIGTARP 01/28/2015 – pp. 17). A number of these smaller institutions were often unable to or unsuccessful at repurchasing their own shares at auction, and, as of January 2015, only two banks had been able to repurchase all of the shares it had issued to Treasury (SIGTARP 01/28/2015 – pp. 15).

As of October 2019, only two institutions have about \$17.4 million in CPP investments outstanding (Monthly Report to Congress, October 2019 – pp. 1). Of the \$204.9 billion that Treasury invested, they obtained approximately \$226.4 billion in repayments, dividend payments, and interest income for a profit of about \$27.1 billion (Monthly TARP Update, October 2019). See Figure 4 for a complete breakdown of this calculation.

Figure 6: CPP funds outstanding (\$ billions)



Source: CPP Transaction Data

15. The American Reinvestment and Recovery Act, as well as the Dodd-Frank Wall Street Reform and Consumer Protection Act, decreased TARP’s total size and broadened its restrictions on executive compensation.

The American Reinvestment and Recovery Act (ARRA) passed on February 17, 2009 amended EESA in several key ways, though it primarily broadened EESA’s executive

compensation and corporate governance restrictions. Title VII of ARRA further restricted bonus payments made to CEO's based on information that was "materially inaccurate" from the 5 highest paid executives to 20, as well as increasing the number of employees that golden parachute payment prohibitions applied to (P.L. 111-5 - pp. 517 - 518).

ARRA also restricted, "any bonus[es], retention award[s], or incentive compensation during the period in which any obligation arising from financial assistance provided under the TARP remains outstanding" (P.L. 111-5 - pp. 518) CEO's were prohibited from receiving these bonus based the size of Treasury's investment. Despite these substantial restrictions on any bonuses and awards, they did not apply retroactively. Specifically, ARRA said that these prohibitions "shall not be construed to prohibit any bonus payment required to be paid pursuant to a written employment contract executed on or before February 11, 2009" (P.L. 111-5 - pp. 404). This portion of the legislation was highly controversial, and was what allowed the controversial decision by AIG to pay out \$165 million in bonuses to its executives (Compensation and Benefits Review, May/June 2009 - pp. 25).

Table 5: Summary of ARRA CPP Thresholds for Executive Compensation Restrictions

TARP Aid Amount	Number of CEO's Restricted (ARRA)
Less than \$25,000,000	Only the most highly compensated employee.
Between \$25,000,000 and \$250,000,000	5 most highly compensated employees, or more at the discretion of the Secretary of the Treasury.
Between \$250,000,000 and \$500,000,000	All senior executive officers and the 10 next most highly compensated employees, or more at the discretion of the Secretary of the Treasury.
More than \$500,000,000	All senior executive officers and the 20 next most highly compensated employees, or more at the discretion of the Secretary of the Treasury.

Source: P.L. 111-5 - pp. 517 - 518

In June of 2009, Treasury released a final rule on executive compensation that codified and implemented these provisions from ARRA, as well as earlier guidance issued on the subject of executive compensation and corporate governance (UST PR, 06/10/2009). See KDD #12 for details on Treasury's earlier guidance.

The Dodd-Frank Wall Street Reform and Consumer Protection Act, passed on July 21, 2010, included the "Pay It Back Act". This act had three key features that affected TARP:

- 1) A decrease in the amount authorized under TARP from \$700 billion to \$475 billion (P.L. 111-203 - pp. 2133).
- 2) A removal of the phrase, "outstanding at any one time" from all subsections of Section 115(a), which removed the implicit authority that the Secretary of the Treasury to reuse TARP funds after assets were sold (P.L. 110-343 - pp. 3780, P.L. 111-203 - pp. 2133, Weibel 2013 - pp. 10).

3) A limitation on the usage of TARP funds for programs that were initiated subsequent to June 25, 2010 (P.L. 111-203 - pp. 2133).

The temporary increase in the maximum deposit insurance amount to \$250,000 was made permanent in Section 355 of Dodd-Frank, as well (P.L. 111-203 – pp. 1540). Section 120 of EESA stated that the authority to purchase troubled assets (and by extension, inject capital), would expire on December 31, 2009 (P.L. 110-343 – pp. 3788). However, the Secretary of the Treasury could extend this authority up through two years from the enactment of EESA (P.L. 110-343 – pp. 3788). On December 9, 2009, Treasury Secretary Tim Geithner made this extension to “enable us to continue to implement programs that address housing markets and the needs of small businesses, and to maintain the capacity to respond to unforeseen threats...” (UST PR, 12/09/2009). This authority expired on October 3, 2010, at which point Treasury began the wind-down of its TARP investment programs (TARP Four Year Retrospective – pp. 4).

III. Evaluation

SIGTARP. SIGTARP’s analysis, while broadly congratulating the Treasury on how well it did on recovering the hundreds of billions that it had invested into the banking system, outlined three key problems. SIGTARP first noted that, despite owning shares in hundreds of banks, Treasury’s role changed dramatically from a “very public and active” one that of a “passive, private investor” in how it managed its investments in smaller banks. In particular, Treasury’s “extraordinary” assistance to Citigroup, such as offering it additional capital through the TIP and the large ringfence loss-sharing agreement, as well as the “careful and orderly” way in which it liquidated its holdings, contrasted starkly with the auction-based method it used to exit its investment in smaller banks (SIGTARP 1/28/2015 – pp. 1 – 2).

This asymmetric treatment was echoed in criticism of TARP’s mandate – to protect and promote stability in the financial system. Treasury was also required to fulfill goals such as “protect[ing] home values, life savings, retirement [and college] funds, preserv[ing] homeownership, and promot[ing] jobs and economic growth” (SIGTARP 1/28/2015 – pp. 2 – 3). SIGTARP felt that, unlike the extensive aid provided to larger institutions, Treasury could have acted more aggressively to support the constituents who funded TARP rather than “forcing smaller community banks out of the program owing money to private parties” (SIGTARP 1/28/2015 – pp. 3). These acquisitions by private parties would be a centerpiece of its final criticism: Treasury’s exit strategy for the CPP banks that remained after 2009.

SIGTARP reported that, after the largest banks had exited the program, “Treasury stopped working hand-in-hand with Federal Banking regulators and receiving confidential information related to the health of the banks” despite there still being a large amount of bank failures and having done so with the larger CPP banks (SIGTARP 1/28/2015 – pp. 13 - 14). Per the report, Treasury did very little to monitor the health of these smaller institutions, and instead “only relied on the decision of the Federal banking regulator as to whether it could exit the banks and then auctioned the bank off immediately” (SIGTARP 1/28/2015 – pp. 13).

These auctions were a particularly prominent point of criticism by SIGTARP, as the body felt as though Treasury “gave up oversight of the financial health of these institutions and of being able to impact most of the communities in which these banks play important roles to ensure that the other purposes of TARP are met...” (SIGTARP 1/28/2015 – pp. 14). In many cases, Treasury would auction off its investments in banks that were struggling to make dividend payments or attempting to negotiate restructurings, repurchases, or suspensions of step-up clauses with them. These smaller banks attempted to negotiate with Treasury in the same way that larger banks had successfully done, but with worse results.

70% of auctioned CPP banks had their shares acquired by Private Funds, while only 7% of these shares were repurchased by 45 banks that had issued them (SIGTARP 1/28/2015 – pp. 14 - 15). These banks often purchased them at discounts of up to 40%. The banks that now had large, private funds as some of their principal investors often tried to buy the shares back quickly because the new stakeholders “[were] not generally the typical investor in a community bank such as an individual or entity from that community who has a vested economic interest in the economic health of that community” (SIGTARP 1/28/2015 – pp. 17). Finally, SIGTARP reported that, in some cases, banks were able to repurchase these shares after Treasury had sold them at a loss just months later (SIGTARP 1/28/2015 – pp. 18).

GAO. The U.S. Government Accountability Office (GAO), which “examines how taxpayer dollars are spent and provides Congress and federal agencies with objective, reliable information to help the government save money and work more efficiently, authored a number of reports on both the CPP and TARP more generally (U.S GAO – Overview). In a report released in March of 2012, GAO expressed concerns about the institutions that remained in the CPP. Despite Treasury only having \$16.7 billion in CPP investments outstanding at that point, “a growing number of the remaining institutions have missed scheduled dividend or interest payments or appeared on the FDIC’s problem bank list” (GAO 12-301 – pp. 13). GAO reported that “the number of institutions missing dividend or interest payments increased steadily from 8 in February 2009 to 158 in November 2011 (GAO 12-301 – pp. 14). This analysis was corroborated by the fact that, in general, these remaining institutions were financially weaker, less profitable, and held riskier assets, even compared to those that had not participated in the program at all (GAO 12-301 – pp. 19 – 29). In order to better assess these weaknesses, GAO recommended that Treasury conduct additional analysis on remaining CPP participants rather than lump their performance together with those that had already exited (GAO 12-301 – pp. 30).

Similarly to SIGTARP’s analysis, GAO also criticized Treasury’s use of auctions to help exit its CPP investments. CPP institutions were notified by Treasury that they would be part of an upcoming auction, and were required to submit documents ranging from prospectus settlements and underwriting agreements (for publicly traded banks), to additional disclosures. To bid on their own shares, these institutions also had to obtain permission from their federal banking regulator. However, these institutions had “a number of concerns with the process”, which included rushed and expensive documentation preparation, as well as

heavier burdens placed on them by Treasury if they wished to repurchase their own shares.²⁷

Bank Lending and risk taking. CPP's effect on bank lending was a popular method of examining its overall impact. Black and Hazelwood (2013) examine the lending behavior of 81 banks, 37 of which received TARP funds. Larger and medium-sized TARP banks after receiving funds showed an increase in the risk profile of their Commercial and Industrial (C&I) loans compared to those of non-TARP banks (Black and Hazelwood (2013) pp. – 10 – 13). Smaller banks (<\$2.5 billion in assets), however, appeared to reduce their risk profile after receiving funds. In addition to this, the authors found no evidence to suggest that TARP banks of any size increased their C&I lending volume, and in fact decreased it immediately following the injections, though these levels would return to normal after about a year (Black and Hazelwood (2013) pp. – 15 – 16).

Li (2014) discussed both the lending and riskiness channels, as well, but finds that CPP injections increased bank loan supply by 6.36%, or just over \$400 billion (Li (2014) – pp. 2). The quality of these loans after receiving CPP capital and increasing lending did not decrease in a meaningful way, unlike what was found in the Black and Hazelwood paper (Li (2014) – pp. 24). Banks that were more politically connected, such as those that had executives as Federal Reserve Bank (FRB) directors or were located in states that had representatives on the House Subcommittee on Financial Institutions and Consumer Credit, were significantly more likely to receive TARP funds (Li (2014) – pp. 17 – 20).

Duchin and Sosyura (2014) corroborated similar results to those found in Black and Hazelwood, finding “no significant effect of [the] CPP on the volume of credit origination at approved banks, compared to their denied peers” (Duchin and Sosyura (2014) – pp. 2). Despite there being no significant effect on the volume of loans, the riskiness of loans made by CPP banks increased by 5.4 percent relative to banks that did not receive assistance. However, the authors also found that this behavior translates to smaller banks as well, although the relationship is much stronger at larger banks (Duchin and Sosyura (2014) – pp. 12). This difference was negligible prior to the capital injections. However, these differences did not show up in approved banks' regulatory ratios, as both low-yield and high-yield mortgages carried the same risk weight, despite the former being less risky than the latter (Duchin and Sosyura (2014) – pp. 11).

²⁷ These burdens included unclear guidance from Treasury on how the opt-out bid, which was a bid that could be submitted by the institution to opt-out of pooled auctions and immediately repurchase their own shares, was used. The opt-out bid was used as a floor price for many pooled auctions, which frustrated institutions who reported that they “would have submitted a higher bid in order to win the auction and retain ownership if they had known that the opt-out bid would be used this way” (GAO 12-301 – pp. 14). Institutions wishing to repurchase their own shares were required to disclose their intent to bid, as well as the amount of capital they were raising to bid on their shares, to the SEC, which raised the prices of the shares and gave other bidders additional information (GAO 12-301 – pp. 14 – 15). Finally, institutions wishing to repurchase their own shares were often not able to match the highest bid to repurchase their own shares, as Treasury felt that doing so “would make other bidders less competitive, and could, in turn, discourage potential bidders from participating” (GAO 12-301 – pp. 15).

Puddu and Waelchli (2015) analyzed the bank lending channel of CPP assistance with respect to small business lending at the county level. The authors found that participation in the CPP increased small business loan originations by 19 percent (Puddu and Waelchli (2015) – pp. 17). The authors then examined the county-level effect of this lending, specifically using unemployment and poverty rates as proxies for temporary and chronic economic distress, respectively. The positive effect on small business loan origination was only significant in counties that had high unemployment, which the authors explain intuitively makes sense, as a program like the CPP “[was] useless in counties that suffer from more persistent economic issues (high poverty)” (Puddu and Waelchli (2015) – pp. 18 – 19).

Harris, Huerta, and Ngo (2013) examined the operating efficiency of CPP banks versus those that did not receive capital using a variety of “bank soundness variables” such as tier 1 capital ratios, return on assets, funding costs, and others (Harris, Huerta and Ngo (2013) – pp. 89 – 90). According to their models, CPP banks became less efficient after the capital injection compared to non-CPP banks, which the authors attribute to the intervention “reduc[ing] the incentives of bank managers to adopt best practices that improve asset quality” (Harris, Huerta and Ngo (2013) – pp. 98, 102). The authors largely believed that the CPP exacerbated behaviors consistent with moral hazard, as evidenced by the behavior of participating banks prior to and after the capital injections (Harris, Hurta and Ngo (2013) – pp. 102).

Thus, there is a mixed consensus on the CPP’s effects on bank lending, as well as loan riskiness after receiving capital. Scholars that found a negligible effect on bank lending suggested that the banks that received assistance merely originated riskier loans, without increasing the volume. In a discussion with the Financial Crisis Inquiry Commission (FCIC), Paulson even stated that “The whole reason for designing the program was so many banks would take it, would have the capital, and that would lead to lending. That was the whole purpose” (FCIC Report – pp. 375).

Bank Competition. In addition to the conclusions drawn about bank risk taking as a result of receiving CPP aid, there was also literature that centered on potential competitive advantages by CPP recipient banks. In a July 2010 report, the Congressional Oversight Panel (COP) cited the concern for consolidation in the “generally unhealthy” small bank sector. The COP reported that “the question of concentration was, however, a side issue in late 2008 when TARP was first developed”, though Paulson’s and Neel Kashkari’s remarks at the time indicate that they did not believe that this was a problem (COP 7/14/2010 – pp. 44 – 45). The Panel noted that, at the time of the report, there had been 860 bank-to-bank purchases and mergers since 2006, with the concentration in the financial system increasing and giving the remaining banks “a freer hand in setting terms for their depositors, possibly resulting in higher fees and more restrictions on account holders” (COP 7/14/2010 – pp. 46, 48).

Koetter and Noth (2014) explored these concerns by analyzing the likelihood of government intervention (in this case, the CPP) on interest rates as a measure of price competition. Specifically, they look at the expectations of receiving a bailout on the behavior of banks that were sound but did not receive capital. These unsupported banks could be at a competitive disadvantage in relation to those that received funding, and thus may be required to pay out “higher risk premiums....which reduced margins at given loan rates or could encourage higher risk taking by the banks in an attempt to increase expected returns and thus margins” (Koetter and Noth (2014) – pp. 995). By analyzing the probability of a bailout through

political factors such as “the voting behavior on TARP, party membership, and membership on the financial subcommittee...”, they were able to determine that, while bailout expectations were correlated with pricing behavior, the effect on loan rates was only about 4.5 basis points (Koetter and Noth (2014) – pp. 1018). Additionally, these small effects became insignificant after 2010, suggesting that potential of capital injections for sound banks did not have any lasting competitive effects (Koetter and Noth (2014) – pp. 1018 – 1020).

Berger and Roman (2014a) explored the potentially distortionary effects that the CPP had on recipient banks, rather than on the behavioral changes that unassisted-but-sound banks made due to bailout expectations. In their analysis, the authors found that both market share and market power, defined as local market share of assets and Lerner Index value, increased significantly for recipients of CPP capital. This effect was most pronounced for banks that repaid their capital quickly (Berger and Roman (2014a) – pp. 19 – 20). The authors concluded by saying that, to encourage lending, future CPP-like interventions should be targeted more to smaller banks to avoid distortionary effects. However, from a financial-stability perspective, they cautioned, larger banks would presumably see a larger benefit (Berger and Roman (2014a) – pp. 30).

Bank and Borrower Stock Market Valuations. Equity market valuations of participating banks were also affected by their participation in TARP, as evidenced by the findings in Ng, Vasvari, and Wittenberg-Moerman (2015). The authors analyzed the amount of negative media coverage that the program got throughout its inception to the end of 2009 to determine how media sentiment affected bank stock valuations. While both non-CPP and CPP banks were affected by the negative coverage, the effect was more pronounced for CPP banks, despite them performing better during the program (Ng, Vasvari, Wittenberg-Moerman (2015) – pp. 3 – 5).

Veronesi and Zingales (2009) analyzed the overall economic impact of the program on the original \$125 billion investment to the largest financial institutions and found that the total enterprise value increase was approximately \$132 billion (Veronesi and Zingales (2009) – pp. 3, 22). The cost of the plan, as estimated by the authors, was approximately \$25 billion to \$47 billion, depending on if the FDIC’s debt guarantee program and deadweight losses are included (Veronesi and Zingales (2009) – pp. 3). The authors, through DCF analysis, determined that the cost of government intervention was 2.5% of enterprise value, compared to that of going through a potential bankruptcy, at 22% (Veronesi and Zingales (2009) – pp. 25 – 28).

Norden, Roosenboom and Wang (2013) looked at market performance of borrowers that had significant relationships with participants in the CPP. According to the authors, firms that had lenders that obtained CPP capital “significantly benefit[ted] from the CPP infusions in their banks” (Norden, Roosenboom and Wang (2013) – pp. 1636). They found that firms that were more leveraged, bank dependent, and more vulnerable to the effects of the crisis benefitted even more from having a bank that received government capital (Norden, Roosenboom and Wang (2013) – pp. 1636 - 1637). Finally, the authors showed that firms that were more financially distressed (measured by factors such as leverage ratio, profitability, etc) and bank-dependent experienced significant positive increases in stock

market valuations as a result of the CPP (Norden, Roosenboom and Wang (2013) – pp. 1654 – 1655).

Recovery. Berger and Roman (2014b) conducted an analysis on the influence of CPP on the performance of local market conditions, defined using variables such as net job creation per capita, bankruptcies (business and personal) per capita, and net hiring establishments per capita. The authors found that job creation and hiring establishments increased, while personal bankruptcies decreased after the injections had taken place (Berger and Roman (2014b) – pp. 20). In the four years after TARP was established (Q1 2009 to Q4 2012), the authors found that, “for every 1,000 people, 19.48 jobs were created, 3.57 more establishments created jobs, and 1.29 personal bankruptcies were eliminated due to TARP” (Berger and Roman (2014b) – pp. 20).

Calomiris and Khan (2015) discussed alternative implementation strategies to TARP, especially with respect to its more controversial elements, such as the use of warrants, use of common dividends for users of the CPP, and executive compensation limits (Calomiris and Khan (2015) – pp. 73 - 74). The use of warrants, the authors felt, were counterproductive to TARP’s primary role of stabilizing the banking system, as they “discouraged private stock issuance by taking away some of the upside available to stockholders” A reward system that benefitted banks that raised new private capital would have been more suitable (Calomiris and Khan (2015) – pp. 73). Additionally, the authors explained that common stock dividends should have been completely restricted, despite Treasury assertions that, had they done so, the largest banks (such as JP Morgan and Citi) might not have participated (Calomiris and Khan (2015) – pp. 73 - 74). Finally, executive compensation restrictions, despite being incorporated into TARP to help it pass, were associated with both less willingness on the part of banks to accept TARP funds as well as lower likelihood of acceptance into the CPP if they had a higher number of highly paid CEO’s (Calomiris and Khan (2015) – pp. 74).

Liu et al. (2014) discussed the impact of the CPP on the recovery participant banks through their change in common stock prices. In the period where they held CPP capital, participating banks that repaid the government’s investment by the end of 2010 obtained “significant abnormal returns of about 4.7 percent...” In the quarter after repayment, these institutions experienced significant wealth increases of \$329 billion (Liu et al. (2014) – pp. 5049). Additionally, the authors found that increasing executive compensation restrictions played a significant role in increasing the probability of repayment (Liu et al. (2014) – pp. 5059). The authors linked these results with those from a dynamic recovery model which stated that “recovering CPP banks that repaid TARP obligations tended to have stronger overall financial condition, as reflected in higher capital, asset quality, dividends, liquidity, and size, than nonrecovering CPP banks”, leading them to conclude that “TARP was instrumental in fostering the financial and stock price recoveries of CPP banks” (Liu et al. (2014) – pp. 5049).

The overall impact of the Capital Purchase Program, after analyzing the literature, suggests that the immediate stabilizing impact of the program was clear. In a report published a year after TARP was passed, SIGTARP explained that, after reaching its highest point of 341 basis points on October 13, 2008, “the LIBOR-OIS spread [fell] sharply, indicating that credit markets, although still not at normal levels, are now working better than before the government capital injections” (SIGTARP 10/5/2009 – pp. 10). The decision to use capital injections was informed by the fact that the government would not have had time to value

the troubled assets and, even if they did, \$700 billion would not have been enough to stabilize the market ([SIGTARP 10/5/2009](#)) – pp. 12).

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VI. Appendix

Appendix A: Timeline of events

- July 30, 2008: The Housing and Economic Recovery Act of 2008 (HERA) is passed, which established the Federal Housing Finance Agency (FHFA) and gave Treasury the authority to place the government-sponsored enterprises Fannie Mae and Freddie Mac into conservatorship.
- September 7, 2008: Fannie Mae and Freddie Mac are placed into conservatorship. Treasury announces 1) preferred stock purchase agreements to ensure that the GSEs “maintain a positive net worth” and to support market stability, 2) a secured lending facility for the GSE’s and Federal Home Loan Banks to act as a liquidity backstop, and 3) a program to temporarily purchase mortgage-backed securities issued by GSEs.
- September 15, 2008: Lehman Brothers files for bankruptcy. Bank of America purchases Merrill Lynch for \$50 billion.
- September 21, 2008: The Federal Reserve Board approves the applications of investment banks Goldman Sachs and Morgan Stanley to become bank holding companies, allowing them to access Federal Reserve liquidity facilities.
- September 29, 2008: The first vote on the Emergency Economic Stabilization Act (EESA) fails in the House of Representatives, with a vote of 205-228.
- October 3, 2008: EESA is signed into law. Work on the Troubled Assets Relief Program (TARP) begins, with the government having access to the first of two \$350 billion tranches of appropriated funds. Wells Fargo announces proposal to acquire Wachovia.
- October 14, 2008: Treasury announces proposal to use TARP funds to purchase preferred equity in financial institutions through the \$250 billion Capital Purchase Program (CPP). Nine large, systemically significant financial institutions pledged to subscribe to the program for \$125 billion. Deadline to apply was November 14, 2008.

- November 17, 2008: Treasury announces CPP terms for non-publicly traded banks and trusts. Deadline to apply was December 8, 2008.
- January 12, 2009: President Bush submits report to Congress requesting disbursement of the remaining \$350 billion in TARP funds to be used by the incoming Obama administration.
- January 14, 2009: Treasury announces CPP terms for S-Corporations. Deadline to apply was February 13, 2009.
- February 17, 2009: February 17, 2009 – The American Recovery and Reinvestment Act of 2009 (ARRA) is passed. In addition to large amounts of stimulus spending and tax cuts, ARRA also broadened the original executive compensation restrictions for TARP recipients that came with EESA.
- February 25, 2009: Federal bank regulators, such as the FDIC, OCC, and Federal Reserve Board announce intent to begin stress testing U.S. bank holding companies with assets exceeding \$100 billion.
- April 14, 2009: Treasury announces CPP terms for Mutual Banks. Deadline to apply was April 7, 2009.
- May 7, 2009: Results of the series of stress tests for 19 large financial institutions announced on February 25, called the Supervisory Capital Assessment Program (SCAP), are released, which show a \$75 billion capital shortfall in 10 institutions. The 9 SCAP institutions that did not need more capital and also participated in the CPP repaid the government’s investment.
- June 10, 2009: Treasury releases its Interim Final Rule on TARP Standards for Compensation and Corporate Governance. The rule implemented and further expanded the restrictions laid out in ARRA, as well as appointed a Special Master for TARP Executive Compensation, which was responsible for reviewing compensation plans for institutions receiving “exceptional assistance”, among other things.
- December 9, 2009: In a letter to Congress, Treasury Secretary Tim Geithner outlines Treasury’s exit strategy for TARP, as well as its areas of focus for the following year. Additionally, the program’s authority would be extended from December 31, 2009 to October 3, 2010.

- February 3, 2010: Community Development Capital Initiative (CDCI) is created with the goal of providing financing to institutions that service low-income, minority, and underserved communities. CPP institutions were able to refinance their investment into CDCI capital.
- July 21, 2010: The Dodd Frank Wall Street Reform and Consumer Protection Act of 2010 is passed. The Act included the “Pay it Back Act”, which decreased the maximum TARP authorization, removed Treasury’s ability to reuse TARP funds, and prevented TARP funds from being used on programs that were created after June 25, 2010.
- September 27, 2010: Small Business Jobs Act of 2010 is passed, establishing the Small Business Lending Fund (SBLF), which provided capital injections to financial institutions with assets of less than \$10 billion to increase the availability of credit to small businesses.
- October 3, 2010: Purchasing authority under TARP officially expires, signaling the beginning of the wind-down phase of the program.
- December 10, 2010: Citigroup repays its \$25 billion in CPP capital, making it the last of the nine systemically important financial institutions that received \$125 billion in CPP capital to repay the government’s investment.