U.S. DEPARTMENT OF THE TREASURY

Treasury Notes

Winding Down TARP's Bank Programs

By: Tim Massad 5/3/2012

Just a few weeks ago, Regions Financial repaid the $3.5 billion it received through the Troubled Asset Relief Program at the height of the 2008 financial crisis.

Regions was one of the last large banks to repay its TARP investments – with interest. So this marks a good time to reflect on where we are with the program.

When TARP was launched, some doubted whether it would work. And many Americans assumed taxpayers would never get the money we invested back.

The facts are that TARP, as well as the other emergency actions taken by the government to combat the financial crisis, helped stabilize an economy in free fall and prevent a second Great Depression. And once we put out the immediate financial fire, we began moving to wind down that temporary support and recover taxpayer dollars.

Indeed, while cost is not the measure of success, it's important to note that TARP's bank programs have already yielded a significant positive return for taxpayers. All told, we invested $245 billion and have already recovered $264 billion through repayments and other income – representing a $19 billion positive return.

Today, however, there are still 343 banks remaining in TARP's Capital Purchase Program. Most of them are smaller, community lenders.

Of course, that's not because smaller banks have any less desire to repay taxpayers than larger banks.

Rather, smaller banks generally aren't household names outside the communities they serve and therefore find it harder to raise funds from private investors in the capital markets to repay taxpayers.

And smaller banks – like all financial institutions – have faced significant challenges in the aftermath of the financial crisis. Many community banks have been particularly hard hit by troubled commercial and residential real estate loans.

Given those realities, some have asked how Treasury plans to exit its remaining bank investments. After all, the government shouldn't be in the business of owning stakes in private companies for an indefinite period of time. And replacing temporary government support with private capital is an important part of continuing to restore financial stability.

Today, we wanted to provide additional details on our exit strategy for winding down our remaining bank investments in a way that protects taxpayer interests, promotes financial stability, and preserves the strength of our nation's community banks.[1]

Treasury has three basic options: We can wait for the banks to repay Treasury, restructure the investments, or sell the investments. We plan to wind down the portfolio, as we have done to date, using a mix of all three.

Repayments

Treasury's bank investments are primarily in the form of preferred stock, which is high-quality capital that can be used to make new loans and absorb unexpected losses. 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. Similar to a share of stock you might purchase on the stock exchange, there is no obligation for a company to buy it back.

Over the course of the last three years, however, many banks – with the approval of their regulators – have chosen to repurchase their preferred shares in full. Based on our ongoing analysis and discussions with the banks still in TARP, we expect a number of additional banks to have the ability to do so over the next 12 to 18 months. We'll continue to hold onto those investments. And we'll communicate regularly with the banks about our expectations regarding which ones are able to repay, which may change periodically based on changes in market and other conditions.

A majority of the remaining banks do not fall in this category today, however. And we do not expect them to be able to repay Treasury in the foreseeable future. For those banks, we'll move forward with other strategies to wind down the portfolio.

Restructurings

A handful of banks have proposed restructuring their investments – typically in connection with a merger or plan to raise new capital. Treasury agrees to receive cash (sometimes at a discount to the original "par" value of the investment) or other securities, which can be more easily sold. Treasury has participated in approximately 20 such transactions, and we'll continue to do so going forward in limited cases. But only if the terms represent the best deal for taxpayers under the circumstances.

Sales

In March, Treasury sold its preferred stock investments in six banks through public auctions. We used the same procedures that we previously developed for auctioning the bank warrants we received through TARP. Those bank warrant auctions have already produced nearly $4 billion in income for taxpayers.

The preferred stock auctions we conducted in March received very strong interest from a broad base of investors. They generated more than $362 million in income for taxpayers and were significantly oversubscribed – with eight times as many bids as the number of securities offered. While Treasury received less than the original par value of the investments, we received what we estimated in our budget projections (and the market determined) they were worth.

We also believe that selling these investments can be beneficial for community banks that don't have easy access to the capital markets – because it attracts new, private capital to replace the temporary government support they received through TARP. That means that the government is able to exit its stake, while the bank is still able to keep the capital on its books. The bank can then continue to use that capital to help them lend to families and businesses in their local communities.

We expect that the sale of existing investments will be an ongoing component of the wind down of TARP's bank programs. We'll sell some investments individually, and we may combine others, particularly smaller ones, into pools. We will conduct these sales over time, in stages, and evaluate our strategies as we proceed.

The sale prices may be less than the original par value. But we have already estimated that the value of these investments is less than par in our budget projections, and we'll only sell above a pre-set reserve price in order to best protect taxpayer value. Moreover, these auctions will not change the fact that the TARP bank programs in total will generate a significant positive gain to the taxpayer.   Since we've already locked in a $19 billion positive return to date on TARP bank investments, every additional dollar we recover from these investments is an additional return for taxpayers.

As with all of our TARP investments, the extent to which Treasury employs each of the individual options we've outlined – repayments, restructurings, and sales – will ultimately depend on market conditions. But the exit strategy we've detailed today represents a path forward for winding down our remaining bank investments in a way that's good for community banks, preserves financial stability, and protects taxpayer interests.

Timothy G. Massad is Assistant Secretary for Financial Stability at the U.S. Department of the Treasury

---

[1] These actions do not apply to investments through TARP's Community Development Capital Initiative (CDCI), which was announced in 2010 – two years after the launch of CPP. Additionally, many of these firms are non-profits and serve particularly hard-hit communities. Treasury will continue to hold onto its CDCI investments and make disposition decisions regarding that program at a later date.

Posted in: Financial Stability, CPP