TARP Developments

J.W. Verret
Assistant Professor, GMU Law School
Senior Scholar, Mercatus Center
337-280-8066
jayverret@gmail.com

TARP Commitments

- 5 dominant methods:
- $250 billion in Bank Injections, $100 billion on the way
- $100 billion to Public/Private Partnerships
- $70 billion AIG
- $55 billion to Federal Reserve TALF
- $25 billion Auto Industry

Capital Assistance Program

- Preferred shares issued to Treasury can be converted to voting common equity
- Explanation is to promote TCE ratio over Tier One, but distinction is artificial

Consequences of Government Stock in Banks

- International evidence on government ownership in banks is overwhelming
- Correlates with low economic development & GDP growth
- Greater risk of subsequent bailout
- Subsidized lending to politically important groups and regions
- Preferential regulatory treatment to government banks

AIG Trust and Citigroup Trust

- AIG Trust executed by Geithner at FED
- 3 trustees
- "A Trustee shall have no liability hereunder…provided that such Trustee acted in good faith in a manner…in or not opposed to ***the best interests of the Treasury***."!!!!!!
- No good faith limit on indemnification
- Compensation is flat $100,000
- Citigroup trust documentation not available, alluded to in Conversion term sheet

Public Private Investment Partnership

- Leverage $75-100 billion TARP $ into 375-500 billion purchasing power
- Purchase legacy (toxic) assets
- Plans to expand to $1 trillion
- Private Sector Discovery, prevent overpayment but have govt. aid
- Legacy Securities Program & Legacy Loans Program

Legacy Securities Program

- Treasury & Private sector 50/50 investments into Legacy Funds
- 5 private sector funds manage, over 10 billion, & they charge fees
- Leveraged with TALF and/or Treasury non-recourse loans
- Treasury loans one-to-one, subordinated to TALF debt

Legacy Securities Program Cont'd

- 3 year withdrawal limit
- Purchase MBOs and CDOs, issued pre-2009 with AAA rating at origination
- Governance Structures unclear, managers have control but prohibited from "waste"

What is TALF?

- Federal Reserve Loans secured by legacy assets at 5-16% haircut, $55 billion TARP
- Begins as $200 billion, will reach $1 trillion
- 3 year term =Inflation concerns, Fed won't be able to sell TALF loans to soak up liquidity
- $1 trillion effort, but March demand was $4.7 billion, in April…$1.7 billion
- TALF will be used in PPIP legacy securities program
- TALF loans exempt from mark-to-market

Legacy Loans Program

- Legacy Loan Funds capitalized similar to Securities Program, after an auction
- Bids on residential & commercial loans
- Loan Fund issues FDIC guaranteed debt to selling bank, which can resell
- FDIC deems assets eligible, then conducts appraisal before guarantee
- Leverage cannot exceed 6/1 per fund

Legacy Loans Program Cont'd

- Investors in Loan Fund bid on bank loans, bank discretion to accept bid
- No mention of whether asset managers involved
- No investors may purchase loans from an affiliate of investor, but TARP participants may be affiliates

Public Private Investment Program Challenges

- Political Uncertainty, e.g. a future windfall profits tax
- H-1b Visa Program limitation in Stimulus Bill
- Treasury's inability to fund loan commitments
- Adverse Selection Problems

Public Private Program Challenges

- Will TARP Inspector General have authority to inspect passive investors?
- Geithner and Bair say executive comp restrictions won't apply to undefined "passive investors"
- Mark-to-Market changes limit bank incentives to sell, FDIC & Treasury still have twisted incentives

Recommendations

- Global Sunset Provision for TARP
- Capital Assistance Trustees liability
- H1-b visa restriction exemption for passive investors
- Confidentiality rights for SPV investors
- Ex Post Facto Tax Restrictions
- Another advisor for Treasury to manage interest & determines Treasury's Securities Fund investment
- Mandatory high bid acceptance in Loan Fund