TARP Developments

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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
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