Executive Summary*

In its December oversight report, the Panel reviewed the successes and failures of the Troubled Asset Relief Program in 2008 and 2009. This month, the Panel focuses on the road ahead as Treasury closes the TARP. Now that Treasury has acquired hundreds of billions of dollars in assets, how does it plan to unwind its stake in the financial markets? How will Treasury balance its desire to sell these assets quickly with its goals of promoting financial stability and strengthening the return to taxpayers? What steps will Treasury take to unwind the implicit guarantee that the federal government will always stand behind too big to fail banks? In short, what is Treasury's exit strategy?

Ending the TARP will involve several stages of exit. The first milestone will be on October 3, 2010, when Treasury's authority to make new commitments to purchase assets, commit funds, and establish guarantees using TARP funds will expire. The end of this authority will not, however, constitute the end of the TARP; Treasury will be authorized to continue making purchases using funds that were committed in advance of the October 3, 2010 deadline. Finally, after Treasury completes all of its TARP purchases, it will hold a massive pool of financial assets likely worth hundreds of billions of dollars, and the process of unwinding some of these holdings may continue for a number of years.

As of December 31, 2009, Treasury's largest TARP-related assets include $58 billion in preferred securities issued by banks, $25 billion in Citigroup common stock, $46.9 billion in AIG preferred stock, and $61 billion in shares and debt of GM and Chrysler. Treasury also holds significant assets under the Public-Private Investment Program, the Term Asset-Backed Loan Facility, and the Capital Purchase Program, and it has announced plans to purchase further assets under new programs such as the small business initiative.

The Emergency Economic Stabilization Act authorized Treasury to hold its TARP assets until maturity or to sell them earlier. Treasury has articulated three principles that guide its determination of when to sell assets: maintaining the stability of the financial system, preserving the stability of individual financial institutions, and maximizing the return on the taxpayers' investment.

These principles may sometimes be at odds with one another. For example, the most profitable moment to sell a TARP asset may not be the moment that best promotes systemic stability or the moment that best serves a particular institution. Furthermore, Treasury is only one department of a much larger federal government, and the broader government may have additional goals for the TARP, such as preserving jobs or satisfying a political constituency.

*The Panel adopted this report with a 5-0 vote on January 13, 2010.

The Panel is also concerned that, although Treasury has been consistent in articulating its principles, the principles as announced are so broad that they provide Treasury with a means of justifying almost any decision. This means that there is effectively no metric to determine whether Treasury's actions met its stated goals. Because any approach may alternatively be justified as maximizing profit, or maintaining the stability of significant institutions, or promoting systemic stability, almost any decision can be defended. Measuring Treasury's success against these metrics is problematic.

As Treasury enters the next stage of its administration of the TARP, it must learn from the mistakes it has made in the past – in particular, its failure to follow the money used to bail out large financial institutions. Because Treasury never required the institutions that received the first infusions of TARP funding to account for their use of these funds, taxpayers have not had a clear understanding of how their money has been used. As Treasury embarks on new programs, it must require that future recipients provide much greater disclosure of their use of TARP dollars.

Finally, and perhaps most significantly, the TARP has raised the long-term challenge of how best to eliminate implicit guarantees. Belief remains widespread in the marketplace that, if the economy once again approaches the brink of collapse, the federal government will inevitably rush in to rescue financial institutions deemed too big to fail. This belief distorts prices, giving large financial institutions an advantage in raising capital that mid-sized and smaller banks – those not too big to fail – do not enjoy. These implicit guarantees also encourage major financial institutions to take unreasonable risks out of the belief that, no matter what happens, taxpayers will not allow their failure. So long as markets continue to believe that an implicit guarantee exists, moral hazard will continue to distort prices and endanger the nation's economy, even after the last TARP program has been closed and the last TARP dollar has been repaid.