Section Two: Additional Views

A. Damon Silvers

The Panel's January Report is an extraordinarily detailed survey of many issues associated with the windup of the programs created under the Emergency Economic Stabilization Act of 2008. Because of the breadth of the Report, I think it is important to express in one place clearly what I see as the problem with the direction the TARP has taken in recent weeks.

In the course of several weeks in December 2009, the Board of Governors of the Federal Reserve announced it was allowing three of the nation's largest banks to return their TARP monies – allowing Bank of America and Wells Fargo to escape TARP's limitations on executive pay, and allowing Citigroup to escape the extraordinary limits on executive pay associated with institutions receiving extraordinary aid, even though Citigroup continued to be the beneficiary of tens of billions of TARP funds in the form of common stock. Citigroup is now the only company in which the TARP holds common stock that is not subject to the rulings of the Special Master on Executive Pay.

But despite the intense interest that the executives of Citigroup, Bank of America and Wells Fargo appeared to have in the executive pay issue, that issue is a secondary one in relation to the repayment decision. The real issues are about systemic stability and moral hazard.

In relation to systemic stability the question is – are these banks really sound after repayment? Given their enormous size, if they are not sound after repayment allowing them to repay would be a profoundly irresponsible act, making another systemic financial crisis far more likely. Then there is the question of these large banks' ability to withstand future economic and financial turmoil. It would not be good for the country if it turned out that these repayment transactions were high stakes bets on continued economic and financial stability.

It is very important that the public and Congress understand that the Congressional Oversight Panel has no ability to answer this critical question because (1) we have never received, despite repeated requests, the algorithms at the heart of the stress tests (see our earlier hearings and our correspondence with Secretary Geithner); (2) we were unable to determine the extent of or the value of the toxic assets that continue to be held by the major banks (see our August 2009 report) and (3) because the bank regulators have never disclosed the criteria for allowing repayment.

Following the stress tests, each of these three banks began to press to be allowed to repay their TARP funds. Because we do not know what the criteria were for being allowed to repay, it is impossible to know when they met them. But it is puzzling to note that in the case of Wells Fargo and Bank of America, the result of bank regulators allowing repayment transactions not entirely funded by new equity was to reduce those banks' Pro forma Tier 1 capital ratios, a basic measure of bank capital strength, to below the level that it had been at these banks at the end of the second quarter of 2009, when the Treasury steadfastly refused to permit them to repay TARP funds. One explanation for the regulator opposing transactions that weakened Tier I capital is that the regulators were exclusively focused on measures of common equity capital strength. But an approach focused on common stock is odd in the context of the fact that all of TARP's efforts to strengthen bank capital have involved preferred stock infusions.

Then there is Citigroup. While our conversations with Treasury and others on this matter are ongoing, we have yet to receive a satisfactory explanation for how it is possible that Citigroup, which had a Tier 1 capital ratio of 11.92 percent at the end of 2008, and was generally understood to be the walking dead, is now healthy enough to be let out of TARP with a Pro forma Tier 1 capital ratio post-repayment of 11.0 percent. Citigroup gets more puzzling in light of several other facts: Citigroup posted net losses available to common shareholders in the first and third quarters of 2009, and most analysts believe it will lose money in the fourth quarter; its equity offering ran into trouble; its stock price post-repayment is just over $3 per share; and its total preferred and common equity market capitalization is the same as it was at the beginning of 2009. Of course, by converting the majority of its TARP preferred to common, then selling common to replace preferred at the close to option value price of $3.25, Citigroup has been able to raise its common equity ratios significantly. But does trading government preferred stock for government common stock transform a sick bank into a healthy bank?

As to moral hazard, repayment converts what had been a time-buying strategy into a fait accompli. We now know for certain that, barring another systemic crisis requiring revisiting these issues, the public has definitely rescued the shareholders, bondholders and executives of these large banks from the consequences of their actions. What is far less clear is whether as a result we have strong, stable banks able to play their proper role as provider of credit to the real economy.

Note on Recusal:

In July, 2009, I recused myself from participation in any Panel discussions about and votes on matters pertaining to General Motors, Chrysler or their financial affiliates, including but not limited to GMAC. I did not vote on or participate in discussions related to the Panel's September Report, *The Use of TARP Funds in Support and Reorganization of the Domestic Automotive Industry*. My vote in favor of this Report and the Panel's December Report, entitled *Taking Stock: What Has the Troubled Asset Relief Program Achieved?* should not be taken as an expression of opinion on sections of the report dealing with General Motors, Chrysler, or their financial affiliates. Lastly, my votes in favor of this report and the December Report were addressed only to those portions of the reports that did not relate to General Motors, Chrysler, or their financial affiliates.