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What's Under the TARP?

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"An Act to provide authority for the Federal Government to purchase and insure certain types of troubled assets for the purposes of providing stability to and preventing disruption in the economy and financial system and protecting taxpayers…"

—Public Law 110-343, 110th Congress

The Emergency Economic Stabilization Act was signed into law on October 3, 2008, and granted the U.S. Treasury broad powers to ensure financial market stability through the Troubled Asset Relief Program (TARP). The TARP authorized the purchase and insurance of up to $700 billion of troubled assets from banks and was passed with three goals: to stabilize financial markets, to support housing markets by preventing foreclosures and supporting mortgage finance, and to minimize potential losses to taxpayers.

The TARP was originally conceived to purchase troubled assets directly from banks. However, as quickly became apparent, properly valuing these assets was extremely difficult as a result of ongoing home mortgage foreclosures, defaults, and falling house prices. The financial turmoil intensified in the weeks following the bill's passage, and to move quickly, the U.S. Treasury established the Capital Purchase Program (CPP), which became the centerpiece of TARP. The goal of the CPP was to recapitalize healthy banks by purchasing preferred shares of stock in banks instead of purchasing their troubled assets.[1] The Treasury hoped to stabilize the financial markets and limit downside financial risks to taxpayers via such recapitalization. Later, the TARP included investments in American International Group (under the Systemically Significantly Failing Institutions provision of TARP), the automotive industry (General Motors, Chrysler, and their respective financing arms), and targeted investments in Citigroup and Bank of America. The left column of the table below summarizes the first half of TARP allocations through February 25, 2009.

TARP Allocations and Financial Stability Proposals

Troubled Asset Relief Program (*allocated*)	Amount ($ billion)	Financial Stability Plan (*proposed*)	Amount ($ billion)
Capital Purchase Program	196.4	Capital Assistance Program	Unknown
American International Group	40.0	Homeowner Affordability and Stability Plan	75.0
Citigroup		Public-Private Investment Fund	Unknown
Targeted investment	20.0	Term Asset-Backed Securities Lending Facility	100.0
Asset guarantee	5.0		
Bank of America	20.0		
Automotive industry financing*	24.8		
Total	306.2	Total	175.0

NOTE: *Includes General Motors, Chrysler, and their respective financing divisions.

[1] Holders of preferred shares are paid before common stockholders. Preferred shares pay a cumulative dividend of 5 percent for the first 5 years and 9 percent thereafter. These dividends are established by the CPP and are greater than dividends paid to common shareholders.

The Emergency Economic Stabilization Act also created a Congressional Oversight Panel (COP) to evaluate the effectiveness of the TARP. In their January 9, 2009, report, the COP highlighted four areas that they believe warranted special attention. First, they asked the Treasury to report how banks are using their TARP funds. Second, the panel called for greater transparency and asset evaluation. Third, the panel suggested greater Treasury emphasis on preventing foreclosures, and finally, they asked for better communication of the overall TARP strategy.

On February 10, 2009, Treasury Secretary Geithner released details for the new Financial Stability Plan, which attempts to address some of the COP concerns by reallocating the remaining TARP funds and combining the funds with larger, more comprehensive lending facilities. The Financial Stability Plan, initiated under the belief that "[t]here is more risk and greater cost in gradualism than in aggressive action," has several features.[2]

First, the Financial Stability Plan established the Capital Assistance Program (CAP). This program will work in a manner similar to the original Capital Purchase Program but addresses the issue of transparency by requiring more stringent reporting and accounting measures. The plan also requires participating firms to submit a detailed plan for how the proposed funds will be used. After receiving funds, firms must also provide monthly reports on the number and type of loans issued and securities purchased; these reports will be publicly available at www.financialstability.gov. Any institution that accepts funds must commit to a series of restrictions, such as limits to executive pay, and participate in mortgage foreclosure mitigation programs. To be eligible for a CAP investment, banks must first undergo a stress test. This test determines whether a bank has enough money to withstand a severe economic downturn. The stress test is required for all U.S. bank holding companies with more than $100 billion in assets, but smaller U.S. banking organizations seeking funds must opt to take a stress test before receiving any funds.

The Financial Stability Plan increases Treasury participation in the Term Asset-Backed Securities Lending Facility (TALF); at the same time, the Federal Reserve Board has expanded the TALF to lend up to $1 trillion.[3] The TALF is designed to lend money and accept assets backed by student loans, small business loans, and credit card payments, thereby increasing the availability of loans to consumers and small businesses. The TALF will use approximately $100 billion of the remaining TARP funds.

Finally, the Financial Stability Plan contains two new features. First, the plan will purchase troubled or illiquid assets from banks through the Public-Private Investment Fund. Inclusion of the private sector is designed to avoid overpricing assets and creating taxpayer losses. However, details for this plan remain vague. Second, the plan includes language directed solely at stemming home foreclosures. The new Homeowner Affordability and Stability Plan will use up to $75 billion of the $700 billion TARP allocation to refinance or modify qualifying mortgages so that monthly payments are never more than 38 percent of a borrower's gross income. The plan also includes financial incentives for lenders that would lower the borrower's monthly payments to 31 percent of gross income. These modified payments will be in force for a minimum of five years, after which they can gradually be increased to the conforming loan rate.

The Financial Stability Plan is just one piece of a comprehensive government response to the current financial market turmoil. It is meant to complement the fiscal stimulus legislation signed into law in February and build on ongoing actions by the Federal Reserve. The plan also attempts to address some of the concerns of the Congressional Oversight Panel. Time will tell whether these actions will produce their intended effects.

—By Craig P. Aubuchon, Senior Research Associate, Federal Reserve Bank of St. Louis.

[2] Remarks by Treasury Secretary Timothy Geithner on February 10, 2009.

[3] See Aubuchon, Craig P. "The Fed's Response to the Credit Crunch." Federal Reserve Bank of St. Louis *Economic Synopses* No. 6, 2009.

Recent Articles and Further Reading on the TARP

"Secretary Geithner Introduces Financial Stability Plan" by Treasury Secretary Timothy Geithner, United States Department of the Treasury, TG-18, Tuesday, February 10, 2009.

This official press release introduces the terms of the Financial Stability Plan and establishment of the Public-Private Investment Fund. The link at the end of the press statement provides a fact sheet for the Financial Stability Plan.

"Fighting the Financial Crisis, One Challenge at a Time" by former Treasury Secretary Henry M. Paulson, Jr., op-ed article published in *The New York Times*, November 18, 2008; also available at http://www.treas.gov/press/releases/hp1280.htm.

Links in the *Times* version of this article provide background information for some of the major "players" in the financial crisis: Bear Stearns, Lehman Brothers, Washington Mutual, Fannie Mae and Freddie Mac, and AIG. Paulson provides in-depth comments on the root causes of the global market and credit crisis.

"Accountability for the Troubled Asset Relief Program" by Congressional Oversight Panel (*The Second Report of the Congressional Oversight Panel*), January 9, 2009.

This is the second official oversight report, including answers to ten specific questions about the initial $700 billion in bailout funds.

Free Data Sources and Reports

Data: "Troubled Asset Relief Program Transactions Report"
Description: Most recent list of banks and other institutions that have received funds under the CPP, including data and amounts received
Published by: United States Department of the Treasury
Location: http://www.treasury.gov/initiatives/eesa/transactions.shtml

Data: "Tracking Capital Purchase Program Investments Across the Country"
Description: A map of capital purchase program investments
Published by: United States Department of the Treasury
Location: http://www.treas.gov/initiatives/eesa/map/

Data: "Troubled Asset Relief Program: Additional Actions Needed to Better Ensure Integrity, Accountability, and Transparency"
Description: Detailed report of steps taken to stabilize the financial markets and banking system
Published by: United States Government Accountability Office, *GAO-09-161, Report to Congressional Committees*, December 2008
Location: http://www.gao.gov/new.items/d09161.pdf

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