



What's Really Hidden Under the TARP?

There has been a lot of question and doubt over the effectiveness of the U.S. Treasury's TARP (Troubled Assets Relief Program). TARP is the enactment of the Emergency Economic Stabilization Act of 2008, commonly referred to as the bailout of the U.S. financial system. It was approved on October 3 2008 and allows the U.S. Department of the Treasury to purchase or insure up to \$700 billion of "troubled" assets – non-liquid, difficult-to-value assets from banks and other financial institutions. The intention of TARP was to bring financial stability to the markets, mitigate the effect of foreclosures on homeowners and protect the well-being of tax-payers. The original plan was to use the bulk of the money to buy illiquid assets from the struggling banks, thereby freeing up their balance sheets to start issuing new loans again and jump start the credit market. Just a week after the bill was passed, the then Treasury Secretary Henry Paulson had a change of mind and suggested the funds would instead be injected directly into banks – a notion he was initially opposed to.

Under the Bush regime, the U.S. Treasury has spent nearly US\$300 billion to help stabilize struggling financial sector firms including Citigroup Inc., Bank of America Corp., General Motors, Chrysler, GMAC, Chrysler Financial and American International Group. But getting help from TARP does not come free of charge. When institutions seek help from TARP, there are strings attached and disadvantages to shareholders. Institutions get TARP relief only by giving the federal government preferred shares, which gives federal policymakers power over bank operations. There is the concern that when common equity is no longer the dominant form of capital, political pressures may force actions that may not be in the best interest of common shareholders. The size of dividend payments due to the government each year from these shares will leave little remaining for regular shareholders, since preference shareholders get paid first. Finally, the TARP program's investments must eventually be paid back and to repay the money, banks may need to issue new public shares, which would greatly dilute current shareholders' stakes.

The Act also sets some new limits on the compensation of the five highest-paid executives at companies that elect to participate significantly in TARP. Companies who sell more than US\$300 million in assets through an auction process are prohibited from signing new "golden parachute" contracts (employment contracts that provide for large payments upon termination) with any future executives. There is also a US\$500,000 limit on annual tax deductions for payment of each executive, as well as a deduction limit on severance benefits for any golden parachutes already in place. Companies in which the Treasury acquires equity through direct purchases must meet tougher standards. These standards will require the companies to eliminate compensation structures that encourage "unnecessary and excessive" risk-taking by executives, provide for repayment of bonuses already paid to senior executives based on financial statements later proven to be inaccurate, and prohibit payment of previously established golden parachutes.

In exchange for its help, the U.S. Treasury department has received US\$279.2 billion in preferred shares from 319 financial

institutions. Though there may be a small paper gain for taxpayers (US\$271 million in dividends), the plan has done little to unlock the frozen credit markets. One of the major reasons for this is that these institutions are hoarding the money they receive or using the money to rebuild reserves in the face of huge write-downs. Banks are not lending to the public or even to other financial intuitions due to fear of never seeing those funds again, thereby defeating the primary goal of TARP to thrust the credit markets back into motion. Treasury has been criticized for their hands-off approach to keeping track of the hundreds of billions of dollars already committed through TARP and the continued high levels of compensation to executives of TARP-aided firms. There is no disclosure about what these companies did or are doing with these funds and what effect, if any, has the injection of funds had on the market to date. Nothing was put in place to measure the success of the program or establish an overall strategy on what would be done with the acquired assets and how to manage the portfolio. The plan also did nothing to assist struggling homeowners on foreclosures as it was intended to do. To make matters worse, the Congressional Oversight Panel put the federal overpayments in the first half of TARP in the range of US\$64 billion to US\$78 billion, saying that Treasury has paid substantially more for investments than they appear to have been worth at the time of the transaction.

So what now? How do President Obama and new Treasury Secretary Timothy Geithner make it work this time? One of the ideas being considered include creating a "bad bank" that could purchase toxic assets off the balance sheets of banks in the hope of reviving lending – sounds familiar? The idea supporting this is that banks won't be able to lend aggressively and support economic growth until troubled assets are removed from their balance sheets. Treasury could also employ a program that would provide government guarantees of troubled assets by leveraging a small amount of bank bailout funds. The Obama administration plans to mandate stricter executive-pay regulations on TARP recipients and use policies to reduce foreclosures. President Obama has already said that going forward, senior executives at banks receiving "exceptional" assistance be limited to US\$500,000 in total compensation, other than restricted stock or other similar long-term incentive arrangements. Top executives at financial firms receiving "generally available" assistance can exceed \$500,000 with public disclosure and a non-binding shareholder resolution if requested by investors. Geithner is expected to issue a report on Monday 9 February 2009 (this article was written on 6 February 2009) describing plans to spend the remaining \$350 billion as well as other new programs to shock the system out of recession. Officials said the goals of the new plan will include bringing new transparency and accountability standards to the TARP program, keeping people in their existing homes, and increasing lending to consumers and small businesses. To aid transparency, investment contracts, both existing and future, will now be posted to the Department's website. At the end of the day, bad assets must be segregated, identified and isolated from the financial system in order to improve institutional counter-party confidence and transparency and the credit crisis remains alive until this primary objective is tackled.

Table 1: Regional Market Performance (as at 5 February 2009)

Index	Closing Value	Weekly Change (%)	Monthly Change (%)	YTD Change (%)	1 Year Change (%)
TTSE Composite	847.64	-0.07	0.55	0.56	-13.91
All Trinidad	1,151.31	0.96	-0.30	-0.30	-3.47
JSE Index	85,743.74	-2.01	-0.35	6.98	-21.44
JSE Select	1,962.50	-5.87	-1.58	-1.12	-34.02
All Jamaica	73,038.15	-4.27	-1.79	-1.29	-32.81
BSE Composite	916.42	-0.24	-0.45	-0.37	-10.44

Table 2: International Market Performance (as at 5 February 2009)

Index	Closing Value	Weekly Change (%)	Monthly Change (%)	YTD Change (%)	1 Year Change (%)
S&P 500	845.85	0.08	-8.80	-6.35	-36.72
Nasdaq Composite	1,546.24	2.55	-5.02	-1.95	-33.05
Dow Jones Industrial	8,063.07	-1.05	-9.94	-8.13	-34.26
German Dax	4,510.49	1.86	-9.50	-6.23	-33.33
FTSE 100	4,228.93	0.93	-7.66	-4.63	-27.93
Nikkei 225	7,949.65	-3.66	-12.09	-9.12	-42.17
Hang Seng	13,178.90	0.19	-15.32	-8.40	-46.88
DJ Eurostoxx	2,293.23	1.05	-10.19	-6.46	-38.31

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