VII. Pay It Back (TARP Developments)

A. Introduction

This development article is designed to explain the creation of the Troubled Asset Relief Program (“TARP”), its developments, and its implications in light of the introduction of the Dodd-Frank Act. Part II briefly describes the history and background of TARP. Part III explains TARP’s influence on current financial developments, and part IV analyzes the positive and negative impacts of TARP. Finally, part V postulates the future implications of the Dodd-Frank Act on TARP by focusing on expenditures, the unavoidability of future bailouts and the possible continuation of moral hazard problems.

B. TARP, Generally

President George W. Bush signed the Troubled Asset Relief Program into law as part of the Emergency Economic Stabilization Act (“EESA”) on October 3, 2008. The program endeavored to recapitalize the financial system, restart credit markets, restore confidence, and lower borrowing costs for businesses and families that were affected by the 2008 financial crisis. Through TARP, the U.S. Treasury is authorized to purchase from financial institutions up to $700 billion of residential or commercial mortgages, and any mortgage-related securities, obligations or other instruments (also referred to as “troubled assets”) that were originated or issued on or before March 14, 2008. The Treasury is allowed to use an initial $350 billion and an additional $350 billion with Congressional approval. Since the passing of the legislation, the government has

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provided TARP money to banks, insurers and automakers. Some firms have already repaid the money, and many firms intend to return the money in the near future.

The American Recovery and Reinvestment Act ("ARRA"), enacted on February 17, 2009, is a second major TARP-related law. ARRA contributes to TARP by limiting executive compensation and stipulating new corporate governance standards. ARRA also requires each TARP recipient to include in its proxy statement a nonbinding shareholder vote ("say on pay") on the company’s executive cash compensation program. It also limits payments to senior executives or highly compensated employees upon termination of employment ("golden parachute") as long as TARP obligations remain outstanding. With respect to corporate governance, public companies that are recipients of TARP funds are required to establish a compensation committee comprised of independent directors to discuss and evaluate employee compensation plans semiannually.

The last major development in TARP was the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act") that was signed into law by President Obama on July 21, 2010. The purpose of Title XIII ("Pay it Back Act") of the Dodd-Frank Act, according to Senator Michael Bennett, was to "rebuild the credibility of our financial system, save taxpayers billions of dollars,

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6 Id.


9 Id.


and finally move to end the TARP\(^{12}\) by “prevent[ing] further
government spending, recaptur[ing] taxpayers’ investment in
financial institutions, and ensur[ing] that repaid funds are used for
deficit reduction.”\(^{13}\) Under Title XIII, TARP funding authorized
under the EESA was reduced from $700 billion to $475 billion.\(^{14}\)
Also, no additional TARP funds can be spent on any program
initiated after June 25, 2010; any money repaid to the TARP fund
must be used for deficit reduction only.\(^{15}\)

Title XIII amends the Housing and Economic Recovery Act
of 2008. The Treasury must allocate the sale of obligations and
securities, as well as fees paid by Fannie Mae, Freddie Mac, and
Federal Home Loan Banks to the General Fund of the Treasury
(“General Fund”).\(^{16}\) The funds must be “dedicated for the sole
purpose of deficit reduction” and “prohibited from use as an offset
for other spending increases or revenue reductions.”\(^{17}\) Similarly,
TARP funds provided to a state under ARRA and rejected by the
Governor or by the State legislature, or funds withdrawn or
recaptured by the head of an executive agency not obligated by a
State or local government, will be rescinded and deposited in the
General Fund.\(^{18}\) Once in the General Fund, the money will be
“dedicated for the sole purpose of deficit reduction” and “prohibited
from use as an offset for other spending increases or revenue
reductions.”\(^{19}\) Section 1306 further provides that discretionary
ARRA appropriations that have not been obligated as of December
31, 2010 shall also be rescinded and deposited in the General Fund
for the sole purpose of deficit reduction. This money shall not be
used to offset other spending increases or revenue reductions.\(^{20}\) The
Secretary of the Treasury is in charge of reporting to Congress every

Bennet).

\(^{13}\) Id.

\(^{14}\) Legal Alert, Taft Stettinius & Hollister LLP, The Dodd-Frank Act Ushers
in a New Era of Regulation in the Finance Industry and Beyond (Jul. 27,
the-dodd-frank-act-ushers-in-a-new-era-of-regulation-in-the-finance-
industry-and-beyond.

\(^{15}\) Id.

\(^{16}\) Dodd-Frank Act § 1304 (2010).

\(^{17}\) Id.

\(^{18}\) Dodd-Frank Act § 1306 (2010).

\(^{19}\) Id.

\(^{20}\) Id.
six months on the amount transferred to the General Fund. 21 Meanwhile, the Federal Housing Finance Agency shall report to Congress on its plans to “continue to support and maintain the Nation’s vital housing industry while at the same time guaranteeing that the American taxpayer will not suffer unnecessary losses.” 22

C. Relevance to Current Financial Developments

TARP funding was provided to over 600 institutions including banks, automakers, American International Group (“AIG”), and housing funds. 23 As of October 3, 2010, $474.8 billion had been obligated to TARP programs. 24 As stipulated by Dodd-Frank, no new obligations may be made to new programs or institutions with TARP funds. 25 From the $474.8 billion available to be spent, $389.8 billion was already spent by December 31, 2010. 26 The government now has an additional $80 billion, which can be spent only in current TARP programs. Currently, TARP funds have been assigned to 13 programs: Capital Purchase Program (“CPP”); Systematically Significant Failing Institutions (“SSFI”); Targeted Investment Program (TIP); Public-Private Investment Program (“PPIP”); Term Asset-Backed Securities Loan Facility (“TALF”); Automotive Industry Financing Program (“AIFP”); Auto Supplier Support Program (“ASSP”); Auto Warranty Commitment Program (“AWCP”); Unlocking Credit for Small Businesses (“UCSB”); Community Development Capital Initiative (“CDCI”); Making Home Affordable (“MHA”); Housing Finance Agency Hardest-Hit Fund (“HFA”); and FHA Short Refinance Program. 27

Major TARP fund programs include CPP, PPIP and the Automotive Industry Support Programs. First, CPP is the largest and most significant program under EESA. 28 CPP was designed “to

21 Dodd-Frank Act § 1303 (2010).
22 Dodd-Frank Act § 1305 (2010).
25 Id.
26 Id.
27 Id.
28 See Trouble Asset Relief Program: Two Year Retrospective, supra note 23.
bolster the capital position of viable financial institutions of all sizes and, in doing so, to build confidence in these institutions and the financial system as a whole."\textsuperscript{29} The Treasury provided $205 billion to 707 institutions, including $125 billion to the eight largest financial institutions, and the rest to 450 small and community banks and 22 certified community development financial institutions ("CDFIs").\textsuperscript{30} The Treasury invests money in these institutions and receives either preferred stock or debt securities in exchange for the investments.\textsuperscript{31} There is no fixed date on which the institutions must redeem the stock or repay the debt.\textsuperscript{32} However, institutions have incentives to repay in a timely fashion since they must pay dividends or interest rates, and subject themselves to additional TARP-related regulation, until payment is completed.\textsuperscript{33} As of now, the Treasury has received around $10 billion in dividends and interest, and $3 billion in other income from the sale of Citigroup common stock.\textsuperscript{34}

Second, PPIP is a large program implemented to purchase troubled securities, such as residential mortgage-backed securities ("RMBS") and commercial mortgage-backed securities ("CMBS").\textsuperscript{35} The Treasury aimed to remove the troubled assets from institutions’ balance sheets in order to increase credit availability to consumers.\textsuperscript{36} The Treasury has committed $22 billion to eight different funds.\textsuperscript{37}

The third major TARP initiative includes the Automotive Industry Support Programs—AIFP, ASSP, and AWCP. These programs were designed to prevent significant disruption in the U.S. automotive industry.\textsuperscript{38} The Treasury provided approximately $80 billion as temporary loans and equity investments to General Motors ("GM"), GMAC, Chrysler, and Chrysler Financial, conditioned on restrictions such as limiting executive compensation and complying with corporate governance requirements.\textsuperscript{39} As a result, GM filed for bankruptcy on June 1, 2009 and the New GM filed a registration
statement with the Securities and Exchange Commission in August 2010.\textsuperscript{40} Also, a newly-formed entity, Chrysler Group LLC, purchased most of the assets of the Old Chrysler in June 2009.\textsuperscript{41}

\textbf{D. Analysis of TARP’s Impact}

\textbf{1. Accomplishments of TARP}

The Treasury Department’s Office of Financial Stability lists four key accomplishments of TARP.\textsuperscript{42} First, TARP was “remarkably effective in helping to unfreeze the markets for credit and capital, bringing down the cost of borrowing, restoring confidence in the financial system, and restarting economic growth.”\textsuperscript{43} TARP achieved its purpose of injecting capital to financial markets, preventing the collapse of spending and restoring confidence.\textsuperscript{44}

Second, the projected costs of TARP have fallen by about $300 billion, far lower than the originally projected amount.\textsuperscript{45} With the rapid financial recovery, as of February 2011, total program repayments and other income have reached more than $274 billion out of the $410 billion disbursed.\textsuperscript{46} Initially, the Congressional Budget Office (“CBO”) estimated that TARP would cost $350 billion or more.\textsuperscript{47} In August 2010, the CBO had revised its projection of total TARP costs to $66 billion.\textsuperscript{48} Now, the CBO estimates that TARP will cost only $25 billion.\textsuperscript{49} The CBO explains that the dramatic change in the estimate is a result of “additional repurchases

\textsuperscript{40} Id. at 46.
\textsuperscript{41} Id.
\textsuperscript{42} Id. at 2-7.
\textsuperscript{43} Id. at 2.
\textsuperscript{45} \textit{See Trouble Asset Relief Program: Two Year Retrospective}, supra note 23, at 3.
\textsuperscript{46} Press Release, U.S. Department of the Treasury, TARP Bank Programs Nearing Profitability after Fifth Third Bancorp Repays $3.4 Billion (Feb. 2, 2011).
\textsuperscript{47} \textit{See Trouble Asset Relief Program: Two Year Retrospective}, supra note 23, at 3.
\textsuperscript{49} Id.
of preferred stock by recipients of TARP funds; a lower estimated cost for assistance to AIG and to the automotive industry; lower expected participation in mortgage programs; and the elimination of the opportunity to use TARP funds for new purposes” as restricted by the Dodd-Frank Act.\(^50\)

Third, the financial system is showing signs of recovery.\(^51\) At the end of 2008, TARP preferred stock investment held 88% of the total assets of the American banking system.\(^52\) Now, TARP holds only 10% of total assets of financial institutions.\(^53\) In May 2010, Chrysler Financial was released from TARP obligations after it and its parent company, CGI Holding LLC, together repaid $3.4 billion in loans outstanding to the Treasury.\(^54\) In December 2010, Citigroup was released from TARP obligations after Treasury completed its sale.\(^55\) Now, as of December 2010, only AIG, Chrysler, GM and Ally Financial are considered exceptional assistance recipients.\(^56\)

Fourth, the Obama Administration introduced the “stress test”\(^57\) to force banks to raise private capital and developed a series of innovative programs\(^58\) to provide easy access to loans. For instance, the U.S. Federal Reserve Board with support from the Treasury created TALF to increase credit availability and support the issuance of CMBS and “asset-backed securities (“ABS”) collateralized by student loans, auto loans, credit card loans, and loans guaranteed by the Small Business Administration (SBA).”\(^59\) The Federal Reserve Bank of New York would lend up to $1 trillion on a non-recourse

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\(^{50}\) Id.
\(^{51}\) \textit{See Trouble Asset Relief Program: Two Year Retrospective}, supra note 23, at 7.
\(^{52}\) Id. at 5.
\(^{53}\) Id.
\(^{54}\) \textit{See Quarterly Report to Congress}, supra note 24, at 50.
\(^{55}\) Id. at 121.
\(^{56}\) Id. at 170.
\(^{57}\) Id.
\(^{58}\) Id. at 39, 49-50 (providing general information on TALF, PPIP, and MHA). Innovative programs include: Term Asset-Backed Securities Loan Facility (TALF), Public Private Investment Program (PPIP), SBA 7(a) Securities Purchase Program—which helped to make credit more available; and Making Home Affordable Program (MHA)—which helped to reduce the mortgage payments to more affordable levels.
basis to holders of certain AAA-rated ABS, and the Treasury would provide $20 billion of credit protection to the loans.\textsuperscript{60} As a result, since the introduction of TALF, issuance of ABS backed by consumer and small business loans averaged $12 billion per month, compared to less than $2 billion before the program started.\textsuperscript{61}

2. **Drawbacks of TARP**

TARP has its criticisms and drawbacks. The Congressional Oversight Panel alleged that foreign companies benefited from the U.S. bailout program more than U.S. companies did.\textsuperscript{62} In fact, major financial institutions included in the program, such as Bank of America, Morgan Stanley, Goldman Sachs and Citigroup, have overseas branches located in countries such as Canada, France, and Germany.\textsuperscript{63} According to the Oversight Panel, out of the 87 financial institutions which have indirectly benefited from the bailout of AIG alone, 43 are foreign.\textsuperscript{64} Another significant legacy of TARP is moral hazard and the potentially disastrous consequences associated with the continued existence of institutions considered “too big to fail.” The persistence of an implicit government guarantee of very large financial institutions may sow the seeds for the next financial crisis.\textsuperscript{65} The Dodd-Frank Act falls short of ending government bailouts, and large institutions continue to enjoy access to cheap credit.\textsuperscript{66} Moreover, providing funding to non-financial sectors such as the automotive industry creates a perception that big companies in risk of failure will receive taxpayer funding no matter what, and puts other, more competently-managed automotive companies at a disadvantage.\textsuperscript{67} A final significant criticism of TARP focused on the largest recipient of TARP funds, AIG. AIG received $185 billion

\begin{footnotesize}
\begin{itemize}
  \item See \textit{Trouble Asset Relief Program: Two Year Retrospective}, supra note 23, at 19.
  \item Id.
  \item Id.
  \item Id.
  \item Id.
\end{itemize}
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without any sacrifice on the part of the company or its creditors,\textsuperscript{68} although the company helped create the bubble in mortgage-backed securities that in turn brought on the financial turmoil in 2008.\textsuperscript{69} Even after AIG received TARP money, it paid its executives over $180 million in bonuses, exacerbating public outrage.\textsuperscript{70}

**E. Implications on Future Practice**

1. **Implications on Expenditure**

Two years after the 2008 financial crisis, the American financial markets have, to some degree, stabilized. Dodd-Frank changed many of the rules governing the way in which Treasury can spend TARP funds. First, the Treasury is authorized to use only $475 billion, and it would have to reduce the budget from the $535.5 billion it had committed before the passage of the legislation.\textsuperscript{71} The Treasury was in compliance with the $475 billion cap as of October 3, 2010 because it allocated $474.8 billion to TARP’s thirteen programs.\textsuperscript{72} Also, the likelihood that the economy would require additional TARP funds decreased because financial markets regained strength and the automobile and insurance industries suffered lower-than-expected losses.\textsuperscript{73} Second, with the introduction of Dodd-Frank, no new TARP expenditures may be spent on new programs.\textsuperscript{74} As of now, the Treasury can no longer spend on eight out of the thirteen TARP programs because all allocated funds have already been spent on each.\textsuperscript{75} Money not spent on the remaining five TARP programs is available to be spent; this spending must remain within the amount allocated to each program since no extra money will be transferred to TARP.\textsuperscript{76}


\textsuperscript{69} Id.

\textsuperscript{70} Id.

\textsuperscript{71} Rebecca Christie, *TARP Dividend Payments, Interest Total $16 Billion, Treasury Figures Show*, BLOOMBERG, Sept. 9, 2010.

\textsuperscript{72} See Quarterly Report to Congress, supra note 24, at 39.

\textsuperscript{73} Rebecca Christie, *TARP Didn’t Bust the Bank*, BLOOMBERG BUSINESS WEEK, Sept. 30, 2010.

\textsuperscript{74} See Quarterly Report to Congress, supra note 24, at 39.

\textsuperscript{75} Id. (the eight TARP programs without available funds to spend are: CPP, CAP, TIP, AGP, ASSP, AWCP, UCSB, and CDCI).

\textsuperscript{76} Id. at 40 (the five TARP programs with available funds to spend are: MHA, SSFI, TALF, PPIP and AIFP).
2. Unavoidability of Future Bailouts

When signing the Dodd-Frank bill, President Obama stated that "there will be no more taxpayer-funded bailouts—period."77 The Dodd-Frank Act prohibits the use of TARP funds in new programs. However, it allows the Federal Deposit Insurance Corporation ("FDIC"), as a receiver, to liquidate a failing company that creates risk to the financial system.78 The FDIC may take control of the company and move forward with liquidation procedures in accordance with "Orderly Liquidation Authority."79 Section 214 of the Dodd-Frank Act provides that "no taxpayer funds shall be used to prevent the liquidation of any financial company."80 However, the FDIC is allowed to borrow from the Treasury up to 90 percent of covered financial company assets to finance the operations of the receivership.81 This means that the FDIC has leeway to indirectly use taxpayer money. In other words, the Dodd-Frank Act’s "orderly resolutions" may be just another term for "bailout."82

3. Moral Hazard

As long as the option of a bailout remains open in the Dodd-Frank Act, the law creates the risk of moral hazard. Title I of the Dodd-Frank Act establishes the Financial Stability Oversight Council ("FSOC") to indentify risks and threats to financial stability, and to promote market discipline.83 There is concern that the FSOC might

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79 Id.
80 Dodd-Frank Act § 214.
give the impression that the government is vigilantly supervising the financial system, which might lead to a lack of caution on the part of financial institutions. People may place the blame for a failing financial institution on the FSOC and not on the private sector actor. “Too big to fail” firms will continue to receive funding, which discourages competition and encourages moral hazard such as failure to manage operations properly and excessive executive compensation. Even the Office of the Special Inspector General for the Troubled Asset Relief Program agrees that unless big firms like Citigroup can be left to suffer the consequences of their own folly, TARP will potentially fuel more bad behavior than discipline.

F. Conclusion

The implementation of TARP through ESSA, ARRA, and subsequently through the Dodd-Frank Act had positive and negative effects. One role of TARP was to provide inflow of money to big and mid-size financial institutions, the auto industry and mortgage industry during the height of the 2008 financial crisis. Also, despite the public concerns that TARP would be too expensive and ultimately cost taxpayers more than $700 billion, recent estimates confirm that the net cost of the TARP program is well below $25 billion. Compared to its role in stabilizing the financial industry and big companies in trouble, the cost of implementing TARP was worth spending. One of the major drawbacks of TARP, which was not resolved by the Dodd-Frank Act, is that it created a perception that in the event of next financial crisis, the government will be ready to back failing financial giants, and that “too big to fail” companies will never be subject to market disciple. As such, Dodd-Frank did not end the era of the government bailout.

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