

Section Two: Additional Views

A. Damon Silvers

This separate view does not reflect a disagreement with the Panel report in any respect. Rather I wish to say in a somewhat briefer and perhaps blunter way what I believe the Panel report as a whole says about TARP.

The Emergency Economic Stabilization Act of 2008 and the Troubled Asset Relief Program it created, in my opinion, were significant contributors to stabilizing a full blown financial panic in October 2008. It is clear to me that for that reason, we are better off as a nation for the existence of TARP than if we had done nothing. Of course this proposition is very hard to prove, but I am convinced it is true. Many people deserve credit for doing TARP rather than doing nothing, but three people who in particular deserve credit are Federal Reserve Chairman Ben Bernanke, Treasury Secretary Timothy Geithner, and in particular, former-Treasury Secretary Henry Paulson.

Further, we are better off that, in implementing TARP, then-Secretary Paulson and his colleagues chose to do capital infusions in the form of the Capital Purchase Program rather than the initial plan of asset purchases. The prospect of asset purchases did not calm the markets, the announcement of capital infusions did. Furthermore, asset purchases at the richly subsidized prices the banks had hoped for would have been profoundly unfair to the public. Any other kind of asset purchases would certainly have had little impact on the panic and could have worsened it.

The reason, however, for the success of the CPP infusions into the nine largest banks was, I believe, not that those infusions by themselves made those institutions adequately capitalized or resolved the toxic asset problem. It worked because it was a credible signal, together with other guarantees issued by Treasury and the FDIC, that the United States government was guaranteeing the solvency of the large banks.

The question then was, what price the Treasury would ask on behalf of the public for guaranteeing the large banks? Our February report showed that in purchasing preferred stock from the large banks the Treasury accepted significantly less in exchange for its investment than private commercial parties were demanding at the time.⁴⁴⁸ This mispricing was substantially driven by the decision to price the preferred stock purchased from the large banks as if each bank

⁴⁴⁸ Congressional Oversight Panel, *February Oversight Report: Valuing Treasury's Acquisitions* (Feb. 6, 2009) (online at cop.senate.gov/documents/cop-020609-report.pdf).

was equally healthy, a decision later criticized by the Special Inspector General for TARP as based on a manifestly false premise.⁴⁴⁹

This initial mispricing was followed by then-Secretary Paulson's decision to rescue first Citigroup and then Bank of America from imminent bankruptcy without subjecting their shareholders to the same levels of dilution that had been forced on AIG. This placed the public in the position of rescuing the stockholders of banks. For the previous seventy five years, it had been a fundamental premise of bank regulation that while a stable system required deposit insurance, and we might bail out other short term creditors and even bondholders in a crisis, no public purpose was served by rescuing stockholders. In fact the moral hazard issues created by such a wealth transfer were profoundly dangerous.

After an initial period of deliberation, the Obama Administration settled on an approach of trying to limit further capital infusions into the banks while effectively pursuing a time-buying strategy. This strategy led to improved transparency in some respects, such as the release of the stress test results and the recognition that some banks were stronger than others, opacity continued in other areas. For example, in our August report we found it was not possible to determine the value of toxic assets on the books of the large banks.⁴⁵⁰ It appeared in general that where transparency led to the conclusion that the banks were strong, the approach was transparency. Where transparency might have led to a different conclusion, opacity continued. This is of course completely consistent with a time buying strategy. The time buying strategy so far has worked in that so far there have been no further direct capital infusions into the major banks since President Obama took office.

However, though the consequences of the time buying strategy appear to be that while we have had no further capital infusions into the large banks, it is unclear whether the large banks are actually healthy. Citigroup, Wells Fargo and Bank of America were not allowed to return their TARP money after the stress tests. Those banks constitute approximately 40 percent of the nation's bank assets. Recently Bank of America announced its intention to return TARP money after completing a public offering, though questions have been raised by informed commentators like Andrew Ross Sorkin as to whether Bank of America is really strong enough to be allowed to return its TARP capital, and point to the lack of lending on the part of Bank of America.⁴⁵¹ Meanwhile, small banks that do not benefit from either implicit or explicit guarantees are failing at an alarming rate.

⁴⁴⁹ SIGTARP, *Emergency Capital Injections Provided to Support the Viability of Bank of America, Other Major Banks, and the U.S. Financial System*, at 17 (Oct. 5, 2009) (online at sigtarp.gov/reports/audit/2009/Emergency_Capital_Injections_Provided_to_Support_the_Viability_of_Bank_of_America..._100509.pdf).

⁴⁵⁰ August Oversight Report, *supra* note 100.

⁴⁵¹ Andrew Ross Sorkin, *Bailout Refund Is All About Pay, Pay, Pay*, New York Times (Dec. 7, 2009) (online at www.nytimes.com/2009/12/08/business/08sorkin.html).

As a result of the continuing underlying weakness in the banking system, banks appear reluctant to lend, particularly to small and medium sized businesses. This dynamic has been cited by Federal Reserve Chairman Bernanke as a key contributor to the high rate of unemployment.⁴⁵² In a parallel development, Treasury's foreclosure relief programs seem to be designed with the first principle of avoiding writedowns. This is again consistent with a goal of buying time for banks, but not consistent with a goal of stabilizing the housing market or keeping American families in their homes. These dynamics appear to have some resemblance to the forces that led in different circumstances to Japan in the 1990s having a decade long problem with bank weakness that contributed to prolonged economic weakness

So the verdict on TARP is that it was a success at stabilizing a serious financial crisis but that it has been characterized by a willingness to give public money to the banks at less than fair terms to the public, and by a refusal to resolve fundamental problems with the financial institutions it has rescued. These weaknesses in TARP were not necessary. In some cases these weaknesses have been addressed over time. Where these problems remain, and I believe they remain central to the nature of TARP today, they could still be addressed.

⁴⁵² Ben S. Bernanke, *Speech at the Economic Club of New York* (Nov. 16, 2009) (online at www.federalreserve.gov/newsevents/speech/bernanke20091116a.htm).