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Testimony

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TROUBLED ASSET RELIEF PROGRAM

Status of Participants' Dividend Payments and Repurchases of Preferred Stock and Warrants

Statement of Gary T. Engel, Director,
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Mr. Chairman, Ranking Member Bachus, and Members of the Committee:

I am pleased to be here today to discuss certain of our work on the Troubled Asset Relief Program (TARP), under which the Department of the Treasury (Treasury) has the authority to purchase and insure through its Office of Financial Stability (OFS) up to almost \$700 billion in troubled assets held by financial institutions.¹ As you know, Treasury was granted this authority in response to the financial crisis that has threatened the stability of the U.S. banking system and the solvency of numerous financial institutions. The Emergency Economic Stabilization Act of 2008 (the act) that authorized TARP on October 3, 2008, requires us to report at least every 60 days on the findings resulting from our oversight of the actions taken under the program, which includes, among others things, outflows and inflows of funds.² We are also responsible for auditing TARP's annual financial statements.

My statement today is based primarily on certain information in our June 17, 2009, report—our fifth report under the act's mandate—which covers TARP activities as of June 12, 2009.³ Specifically, this statement includes information on (1) terms and rates for dividend payments from participants, (2) the dividend payments received through June 30, 2009, from participants, and (3) repurchases of preferred stock and warrants⁴ by participants. To do this work, we reviewed documents provided by OFS and conducted interviews with officials from OFS. In addition, we have updated the dollar amounts and numbers as of June 30, 2009.

¹The Emergency Economic Stabilization Act of 2008 (the act), Pub. L. No. 110-343, 122 Stat. 3765 (2008) originally authorized Treasury to buy or guarantee up to \$700 billion in troubled assets. The Helping Families Save Their Homes Act of 2009, Pub. L. No. 111-22, div. A, amended the act and reduced the maximum allowable amount of outstanding troubled assets under the act by almost \$1.3 billion, from \$700 billion to \$698.741 billion.

²Pub. L. No. 110-343, 122 Stat. 3765 (2008). The act requires the U.S. Comptroller General to report at least every 60 days, as appropriate, on findings resulting from oversight of TARP's performance in meeting the act's purposes; the financial condition and internal controls of TARP, its representatives, and agents; the characteristics of asset purchases and the disposition of acquired assets, including any related commitments entered into; TARP's efficiency in using the funds appropriated for its operations; its compliance with applicable laws and regulations; and its efforts to prevent, identify, and minimize conflicts of interest among those involved in its operations.

³GAO, *Troubled Asset Relief Program: June 2009 Status of Efforts to Address Transparency and Accountability Issues*, [GAO-09-658](#) (Washington, D.C.: June 17, 2009).

⁴A warrant is an option to buy shares of common stock or preferred stock at a predetermined price on or before a specified date.

We conducted the performance audit for our June 17, 2009, report between April 2009 and June 2009 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

In Summary

According to Treasury, as of June 30, 2009, Treasury had disbursed about \$339 billion in TARP funds. Although most of the disbursements have been for the Capital Purchase Program (CPP), Treasury has utilized other programs as well. The agreements entered into under the various programs for the purchase of preferred stock entitled Treasury to receive dividends on varying terms and at varying rates. For example, according to the CPP terms for publicly held institutions, participating institutions pay Treasury quarterly dividends at a rate of 5 percent per year for the first 5 years on the preferred stock acquired by Treasury.

According to Treasury, from TARP's inception through June 30, 2009, Treasury received approximately \$6.7 billion in dividend payments on preferred stock acquired through the CPP,⁵ Targeted Investment Program (TIP), Automotive Industry Financing Program (AIFP), and Asset Guarantee Program (AGP). The dividend payments received are generally deposited into the General Fund of the U.S. Treasury and are not to be used to reduce the outstanding balance under the almost \$700 billion TARP limit.

According to Treasury records, as of June 30, 2009, 32 institutions, including 10 of the largest bank holding companies participating in TARP, had repurchased their preferred stock from Treasury for a total of about

⁵For some of the CPP participants, Treasury acquired cumulative preferred stock while for others it acquired noncumulative preferred stock. If an institution does not declare a dividend for noncumulative preferred stock during the dividend period, the noncumulative preferred shareholders generally have no right to receive any dividend for the period, and the institution has no obligation to pay a dividend for the period, whether or not dividends are declared for any subsequent dividend period. Generally, if an institution does not declare a dividend for cumulative preferred stock during the dividend period the unpaid dividends accumulate and the institution must pay the cumulative accrued dividends before making dividend payments to other classes of shareholders.

\$70.1 billion.⁶ Also, as of June 30, 2009, 11 financial institutions had repurchased their warrants and 3 institutions had repurchased their warrant preferred stock from Treasury at an aggregate cost of about \$20.3 million.⁷ Funds received from the repurchases of initial preferred stock are deposited into the General Fund of the U.S. Treasury and reduce the outstanding balance under the almost \$700 billion TARP limit. Treasury may then issue new debt to purchase new financial instruments if it so chooses until December 31, 2009, or a later date determined by the Secretary of the Treasury under the sunset provision of the act. However, like the dividend payments, any amounts received from the repurchases of warrants and warrant preferred stock are deposited in the General Fund of the U.S. Treasury and are not to be used to reduce the outstanding balance under the almost \$700 billion TARP limit.

As of June 30, 2009, Treasury had disbursed approximately \$339 billion in TARP funds, had approximately \$102 billion outstanding in additional obligations to purchase or insure troubled assets, and had received approximately \$70 billion from preferred stock repurchased by CPP participants.⁸ As a result, Treasury has approximately \$328 billion remaining under the almost \$700 billion limit on the amount of purchased or insured troubled assets that Treasury may have outstanding at any time (the almost \$700 billion TARP limit reduced for \$339 billion in

⁶Our use of the term repurchases in this testimony is general and does not differentiate between repurchases and redemptions of senior preferred stock. A redemption of senior preferred stock occurs when an institution completes a qualified equity offering per the standard terms of the preferred stock and subsequently exchanges cash for its senior preferred stock previously issued to Treasury. A repurchase occurs when the institution buys back its senior preferred shares without having completed a qualified equity offering, as permitted by the American Recovery and Reinvestment Act (ARRA), Pub. L. No. 111-5, div. B, § 7001, 123 Stat. 115, 516 (2009), or another authority.

⁷In addition to preferred stock, Treasury also received from the privately held institutions warrants to purchase a specified number of shares of preferred stock, called warrant preferred stock, that pay quarterly dividends at a rate of 9 percent per year. The exercise price for the warrant preferred stock is \$0.01 per share unless the financial institution's charter requires otherwise. Unlike for publicly held institutions, Treasury exercised these warrants immediately for warrant preferred stock.

⁸The additional obligations outstanding include approximately \$29 billion in the undisbursed portion of an equity facility under the Systemically Significant Failing Institutions Program (SSFI), \$30 billion relating to AIFP, \$20 billion relating to Term Asset-Backed Securities Loan Facility (TALF), \$18 billion relating to Making Home Affordable, and \$5 billion in obligations under AGP. These amounts do not include a subtraction from the outstanding guarantee amount to reflect the balance in the Troubled Asset Insurance Financing Fund as stipulated in section 102 of the act.

disbursements and \$102 billion in obligations, and increased by \$70 billion in preferred stock repurchases).

Agreements under Certain TARP Programs Entitle Treasury to Receive Dividend Payments on Varying Terms and at Varying Rates

The agreements under the various TARP programs—CPP, TIP, AIFP, AGP, and the Systemically Significant Failing Institutions Program (SSFI)—for the purchase of preferred stock entitle Treasury to receive dividend payments. However, the terms and rates vary by program and type of institution. For example:

- According to the CPP terms for publicly held institutions, participating institutions pay quarterly dividends at a rate of 5 percent per year for the first 5 years on the preferred stock acquired by Treasury. After the first 5 years, the preferred stock pays quarterly dividends at a rate of 9 percent per year.⁹
- According to the CPP terms for privately held institutions, participating institutions pay quarterly dividends at a rate of 5 percent per year for the first 5 years on the initial preferred stock acquired by Treasury.¹⁰ After the first 5 years, the preferred stock pays quarterly dividends at a rate of 9 percent per year. Any preferred stock of privately held institutions acquired through Treasury's exercise of warrants pays quarterly dividends at a rate of 9 percent per year.
- Under the terms of the TIP agreements, Citigroup and Bank of America pay quarterly dividends on preferred stock acquired by Treasury at a rate of 8 percent per year.
- Under the terms of the AGP agreement, Citigroup pays quarterly dividends at a rate of 8 percent per year on the preferred stock issued as a premium for the guarantee provided by Treasury in accordance with section 102 of the act.

⁹Treasury also received from each publicly held institution a warrant to purchase a specified number of shares of common stock.

¹⁰The term initial preferred stock refers to the preferred stock acquired by Treasury from privately held CPP institutions as a result of the initial investment amount.

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- Under the terms of the restructured SSFI agreement, American International Group Inc. (AIG) pays quarterly dividends on preferred stock issued to Treasury at a rate of 10 percent per year.¹¹

Importantly, each dividend payment to Treasury is contingent on each institution declaring dividends. The dividend payments received under CPP, TIP, SSFI, and AIFP are deposited into the General Fund of the U.S. Treasury. The dividend payments received under AGP are deposited into the Troubled Assets Insurance Financing Fund to fulfill obligations of any guarantees provided to financial institutions pursuant to section 102 of the act. Dividend payments from TARP participants—other than AGP participants—to Treasury are not available to be used to reduce the outstanding balance under the almost \$700 billion TARP limit.

Treasury Has Received Approximately \$6.7 Billion in Dividend Payments

From TARP's inception through June 30, 2009, Treasury received approximately \$6.7 billion in dividend payments on preferred stock acquired through CPP, TIP, AIFP, and AGP (table 1).

¹¹AIG is the sole participant in SSFI. On April 17, 2009, AIG and Treasury restructured their November 25, 2008, agreement. Under the restructuring, Treasury exchanged \$40 billion of cumulative Series D preferred shares for \$41.6 billion of noncumulative Series E preferred shares. The amount of Series E preferred shares is equal to the original \$40 billion, plus approximately \$733 million in undeclared dividends as of the February 1, 2009, scheduled quarterly dividend payment date, \$15 million in dividends compounded on the undeclared dividends, and an additional \$855 million in dividends accrued from February 1, 2009, but not paid as of April 17, 2009. AIG's restructured agreement kept the quarterly dividend payment dates of every May 1, August 1, November 1, and February 1, established by the original November 25, 2008, agreement. However, the restructured agreement also specified that dividends were payable beginning with the first dividend payment date to occur at least 20 calendar days after the restructuring date. Accordingly, in compliance with these dividend payment terms, the dividend payment for the period from April 17, 2009, through May 1, 2009, which amounts to approximately \$150.2 million, is to be included in the August 1, 2009, scheduled quarterly dividend payment.

Table 1: TARP Dividend Payments Received as of June 30, 2009

Dollars in thousands

Program	Dividend payments received	Cumulative dividends not declared and not paid	Noncumulative dividends not declared and not paid
Capital Purchase Program (CPP)	\$5,254,685	\$5,962	\$802
Targeted Investment Program (TIP)	1,128,889	-	-
Automotive Industry Financing Program ^a (AIFP)	159,611	-	-
Asset Guarantee Program (AGP)	107,573	-	-
Systemically Significant Failing Institutions Program (SSFI)	-	-	- ^b
Total	\$6,650,758	\$5,962	\$802

Source: Treasury OFS, unaudited.

^aDividend information for AIFP only relates to GMAC LLC.

^bSee footnote 11.

According to Treasury records, from March 21, 2009, through June 30, 2009, 17 CPP participants had not declared or paid dividends of approximately \$6.6 million. Specifically, 7 institutions did not declare and pay their cumulative dividends of approximately \$6 million and 10 institutions did not declare and pay their noncumulative dividends of approximately \$666,000. OFS said it received notification from the 17 institutions that they did not intend to declare or pay their May 15, 2009, quarterly dividends. According to OFS officials, of the 17 institutions, 13 informed Treasury that state or federal banking regulations or policies restricted them from declaring dividends, 1 indicated concern about its profitability, and 3 did not provide an explanation as to why they did not declare dividends. According to the standard terms of CPP, after six nonpayments by a CPP institution—whether or not consecutive—Treasury and other holders of preferred securities equivalent to Treasury’s can exercise their right to appoint two members to the board of directors for that institution at the institution’s first annual meeting of stockholders subsequent to the sixth nonpayment.

As reported in our March 2009 report, from TARP’s inception through March 20, 2009, eight participants did not declare or pay approximately \$150,000 in noncumulative dividends.¹² Five of the eight were among the 17 institutions that did not declare or pay dividends during the period from March 21, 2009, through June 30, 2009, noted above. Two of the eight paid their most recent dividend payments for the May 15, 2009, quarterly dividend payment date. The other participant subsequently declared and paid the approximately \$14,000 in noncumulative dividends previously not paid and its most recent May 15, 2009, quarterly dividend.

Financial Institutions Have Begun to Repurchase Their CPP Preferred Stock and Warrants from Treasury but the Process Lacks Adequate Transparency

As permitted by the act—as amended by the American Recovery and Reinvestment Act of 2009 (ARRA)—participants may repurchase or buy back their preferred stock and warrants issued to Treasury under CPP at any time, subject to consultation with the primary federal banking regulator.¹³ According to Treasury records, as of June 30, 2009, 32 institutions had repurchased their preferred stock from Treasury for a total of about \$70.1 billion, including 10 of the largest bank holding companies participating in CPP. Table 2 provides additional information about the repurchases. Under the terms of the CPP and ARRA, after all the preferred stock is repurchased, the financial institution may repurchase all or part of the warrants held by Treasury. As of June 30, 2009, 11 of the 32 financial institutions that repurchased their preferred shares from Treasury had repurchased their warrants and 3 others had repurchased their warrant preferred stock from Treasury at an aggregate cost of about \$20.3 million. None of the 10 largest bank holding companies that repurchased its preferred stock had repurchased its warrants as of June 30, 2009. In addition, certain financial institutions had informed Treasury that they did not plan to repurchase their warrants. For those institutions that informed Treasury that they did not intend to repurchase their warrants, Treasury may attempt to sell the warrants in the financial

¹²GAO, *Troubled Asset Relief Program: March 2009 Status of Efforts to Address Transparency and Accountability Issues*, [GAO-09-504](#) (Washington, D.C.: Mar. 31, 2009).

¹³Pub. L. No. 111-5, 123 Stat. 115 (2009). Section 7001 provides, in part, that “Subject to consultation with the appropriate Federal banking agency, if any, ... Treasury *shall* permit a TARP recipient to repay any assistance previously provided under the TARP to such financial institution, without regard to whether the financial institution has replaced the funds from any other source or to any waiting period.” (Emphasis added.) ARRA also required that Treasury liquidate the warrants when the assistance was repaid. This requirement was amended by the Helping Families Save Their Homes Act of 2009, Pub. L. No. 111-22, which removed the requirement that Treasury liquidate the warrants when the assistance is repaid.

markets. According to a Treasury official, as of June 30, 2009, Treasury has not yet liquidated any CPP warrants in the financial markets.

Table 2: Capital Purchase Program Repurchases as of June 30, 2009

Dollars in thousands

Institution Type	Repurchase amount for preferred stock initially issued to Treasury	Repurchase amount for preferred stock issued through exercise of warrants	Repurchase amount for warrants
Private Institutions	\$31,900	\$1,595	N/A
Public Institutions	70,092,689	N/A	18,690
Total	\$70,124,589	\$1,595	\$18,690

Source: Treasury OFS, unaudited.
N/A = not applicable.

Although institutions have repurchased their preferred stock, the regulators' repurchase approval criteria have lacked adequate transparency. The Federal Reserve has provided criteria for the 19 largest bank holding companies, but the other regulators have not consistently provided details about how they have made repurchase determinations and how they will make future determinations. Clearly articulated and consistently applied criteria are indicative of a robust decision-making process, and without them Treasury will face an increased risk that institutions requesting repurchase of their stock may not be treated equitably. In this regard, we recommended in our June 17, 2009, report that Treasury, in consultation with the Chairmen of the Federal Deposit Insurance Corporation and the Federal Reserve, the Comptroller of the Currency, and the Acting Director of the Office of Thrift Supervision, ensure consideration of generally consistent criteria by the primary federal regulators when considering repurchase decisions under TARP.¹⁴ We have begun to receive the criteria from the federal banking regulators and will evaluate their consistency as part of our ongoing TARP work.

Treasury has provided limited information about the warrant repurchase process on its www.financialstability.gov Web site. We recognize the challenges associated with valuing warrants in the absence of readily available markets for these instruments. For this reason, and because the

¹⁴[GAO-09-658](#).

valuation process can be assumption driven, a well-designed, fully vetted transparent process becomes critical to defusing questions about the warrant valuation process and whether the resulting prices paid by the institutions reflect the taxpayers' best interests. While Treasury has provided some limited information about the valuation process, it has yet to provide the level of transparency at the transaction level that would begin to address such questions. In this regard, we recommended in our June 17, 2009, report that Treasury ensure that the warrant valuation process maximizes benefits to taxpayers and consider publicly disclosing additional details regarding the warrant repurchase process, such as the initial price offered by the issuing entity and Treasury's independent valuations, to demonstrate Treasury's attempts to maximize the benefit received for the warrants on behalf of the taxpayer.¹⁵ On June 26, 2009, Treasury issued a press release detailing certain information about the warrant repurchase process and indicating that Treasury plans to begin publishing additional information on each repurchased warrant. We will evaluate Treasury's disclosure of warrant information as part of our ongoing TARP work.

Closing Comments

Treasury has received billions of dollars from TARP recipients in dividend payments and participants' repurchases of the preferred stock and warrants. While Treasury has been receiving such payments, it also has continued to disburse funds. As of June 30, 2009, Treasury had disbursed almost \$339 billion among five programs—CPP, SSFI, TIP, AIFP, and the Term Asset-Backed Securities Loan Facility (TALF). Specifically, according to Treasury records, it has disbursed just about \$203 billion under CPP, about \$41 billion to AIG under SSFI, \$40 billion under TIP, over \$54 billion to participants under AIFP, and \$100 million under TALF. As of June 30, 2009, Treasury's projected use of TARP funds totaled about \$643 billion, without taking into account any repayments.

Mr. Chairman and Ranking Member Bachus, this concludes my prepared statement. I would be pleased to respond to any questions that you or other members of the committee may have at this time.

¹⁵ [GAO-09-658](#).

GAO Contact

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