



Exiting TARP: Repayments by the Largest Financial Institutions

Special Inspector General for the Troubled Asset Relief Program



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September 29, 2011

MEMORANDUM FOR: The Honorable Timothy F. Geithner, Secretary of the Treasury

 The Honorable John Walsh, Acting Comptroller of the Currency

 The Honorable Martin J. Gruenberg, Acting Chairman, Board of Directors
 of the Federal Deposit Insurance Corporation

 The Honorable Ben S. Bernanke, Chairman, Board of Governors of the
 Federal Reserve System

FROM: Christy L. Romero, Acting Special Inspector General for the Troubled
 Asset Relief Program *Christy L. Romero*

SUBJECT: Exiting TARP: Repayments by the Largest Financial Institutions

We are providing this audit report for your information and use. It discusses the development and application of criteria by Treasury and Federal banking regulators for the largest banks to repay and exit CPP and other TARP programs.

The Office of the Special Inspector General for the Troubled Asset Relief Program conducted this audit under the authority of Public Law 110-343, as amended, which also incorporates the duties and responsibilities of inspectors general under the Inspector General Act of 1978, as amended.

We considered comments from the Department of the Treasury, the Federal Reserve Board, the Federal Deposit Insurance Corporation, and the Office of the Comptroller of the Currency when preparing the final report. The comments are addressed in the report, where applicable, and copies of agencies' responses to the audit are included in Appendix G of this report.

We appreciate the courtesies extended to the SIGTARP staff. For additional information on this report, please contact Mr. Kurt Hyde, Deputy Special Inspector General for Audit and Evaluation (Kurt.Hyde@treasury.gov / 202-622-4633), or Ms. Kimberley A. Caprio, Assistant Deputy Special Inspector General for Audit and Evaluation (Kimberley.Caprio@treasury.gov / 202-927-8978).



Summary

The first program under the Troubled Asset Relief Program (“TARP”) was the Capital Purchase Program (“CPP”), through which the U.S. Department of the Treasury (“Treasury”) invested in what Treasury described as healthy and viable financial institutions to promote financial stability and confidence in the financial system. Approximately 80% (\$163.5 billion) of all CPP funds went to the 17 CPP banks that were subject to the Supervisory Capital Assessment Program (“SCAP”), which stressed the nation’s 19 largest financial institutions and estimated future losses, revenues, and needed reserves.

Despite the dramatic efforts of the U.S. Government, in early 2009, the market still lacked confidence in some of the nation’s largest financial institutions and some TARP recipients complained of a stigma associated with their participation in the program. Generally, under the original terms of CPP, banks were not permitted to repay Treasury and exit TARP for three years. That changed with the enactment of the American Recovery and Reinvestment Act of 2009 (“ARRA”) on February 17, 2009, which eliminated the waiting period. In May 2009, the Federal Reserve Board (“FRB”) released the results of the stress test for SCAP banks and FRB subsequently issued guidance for TARP repayments. FRB’s guidance for TARP exit by SCAP institutions focused on capital – specifically the TARP recipient’s ability to meet SCAP capital targets and its ability to issue common stock in the market. Nine SCAP institutions quickly repaid Treasury’s investment and exited TARP in June 2009. The eight remaining SCAP institutions that received CPP funds were considered to be weaker by regulators than the nine that exited TARP in June 2009. These included some of the nation’s largest banks, such as Bank of America Corp. (“Bank of America”), Citigroup Inc. (“Citigroup”), and Wells Fargo & Company (“Wells Fargo”). Non-public guidance issued by FRB on November 3, 2009, and agreed to by the other regulators and Treasury, added a provision that would allow these SCAP banks to repay on an expedited basis.

As part of SIGTARP’s continuing oversight, we performed a review of the process that Treasury and Federal banking regulators established for the largest

banks to repay and exit CPP and other TARP programs in which the banks participated. SIGTARP’s reporting objectives for this audit were to determine to what extent: (1) Treasury maintained a consistent and transparent role in the TARP repayment process; and (2) Federal banking regulators consistently coordinated and evaluated the TARP repayment request. SIGTARP focused this review on repayments by the first 13 of the 17 SCAP institutions that participated in CPP to repay Treasury’s TARP investment.

What SIGTARP Found

In February 2009, when ARRA was enacted, Treasury and Federal banking regulators had not developed criteria or guidance to evaluate a bank’s proposal to exit TARP. Treasury published basic criteria in May, and on June 1, 2009, FRB issued guidance for those banks that were subject to the stress tests (SCAP institutions) to exit TARP. FRB’s guidance primarily focused on the banks’ capital levels. Institutions that met SCAP target capital ratios were allowed to repay after satisfying certain requirements, including issuing new common stock. In June 2009, nine out of the 17 SCAP banks exited CPP: JPMorgan Chase & Co., The Goldman Sachs Group, Inc., Morgan Stanley, U.S. Bancorp, Capital One Financial Corporation, American Express Company, BB&T Corporation, The Bank of New York Mellon, and State Street Corporation. The remaining eight were not yet eligible to repay. Regulators saw those institutions as weaker than the SCAP institutions that exited TARP and required them to meet additional criteria including raising additional capital.

After FRB issued new, non-public guidance on November 3, 2009, to the eight remaining SCAP institutions, some institutions immediately requested to exit TARP, under a provision in the revised guidance that permitted expedited repayment. These included Bank of America, Citigroup, Wells Fargo, and PNC Financial Services Group, Inc. (“PNC”). The November guidance provided that, subject to meeting criteria such as demonstrating access to long-term debt markets and satisfying SCAP requirements, the remaining institutions may be allowed to repay upon issuing at least \$1 in new common equity for every \$2 TARP repaid. An FRB official told SIGTARP that the 1-for-2 ratio was, in



part, based upon an assessment of the banks' capital levels from the recently completed stress tests.

SIGTARP found that interagency sharing of data, vigorous debate among regulators, and hard-won consensus increased the amount and improved the quality of the capital that SCAP institutions were required to raise to exit TARP. FRB agreed to consult with the Federal Deposit Insurance Corporation ("FDIC") and the Office of the Comptroller of the Currency, on repayment proposals. That consultation often generated both conflict and frustration because of varied and occasionally conflicting policy approaches as regulators pushed back at different times on repayment proposals. FDIC, exposed through its deposit insurance fund and its emergency lending program, was by far the most persistent in insisting that banks raise more common stock. The checks-and-balances that resulted from this interagency coordination helped to ensure that the nation's largest financial institutions were better capitalized upon exiting TARP than prior to TARP. However, three aspects of the TARP exit process serve as important lessons learned.

First, Federal banking regulators relaxed the November 2009 repayment criteria only weeks after they were established, bowing at least in part to a desire to ramp back the Government's stake in financial institutions and to pressure by institutions seeking a swift TARP exit to avoid executive compensation restrictions and the stigma associated with TARP participation. The large financial institutions seeking to exit TARP were notably persistent in their efforts to resist regulatory demands to issue common stock, seeking instead more creative, cheaper, and less sturdy alternatives that provide less short- or long-term loss protection than new common stock. Bank of America, Wells Fargo, and PNC, for example, requested expedited repayment, but each institution balked at issuing the amount of common stock required by regulators. When Bank of America, Citigroup, and Wells Fargo repaid Treasury in December 2009, only Citigroup met the 1-for-2 minimum established by the guidance, combining new common stock and other types of capital to meet a more stringent requirement. Because the regulators failed to adhere to FRB's clearly and recently established requirements, the process to review a TARP bank's exit proposal was ad hoc and inconsistent.

Second, by not waiting until the banks were in a position to meet the 1-for-2 provision entirely with new common stock, there was arguably a missed opportunity to further strengthen the quality of each institution's capital base to protect against future losses without selling sources of revenue. Although the 1-for-2 minimum was established as a capital buffer to allow each bank to absorb losses under adverse market conditions, the discussion quickly switched to analysis of how much common stock the market could absorb during a frenzied period in which each of these TARP banks wanted to exit at that time based in part on news that other large banks were exiting TARP. Concerned about executive compensation restrictions and a lack of market confidence that might result from being the last large TARP bank to exit, banks successfully convinced regulators that it was the right time to exit TARP, and that the market would not support a 1-for-2 common stock issuance. There was arguably a missed opportunity to wait until the market could absorb a 1-for-2 common stock issuance, which would have had long lasting consequences in further strengthening the quality of the banks' capital base.

Third, SIGTARP also found that Treasury encouraged TARP banks to expedite repayment, opening Treasury to criticism that it put accelerating TARP repayment ahead of ensuring that institutions exiting TARP were sufficiently strong to do so safely. Treasury Secretary Timothy F. Geithner told SIGTARP that putting pressure on firms to raise private capital was part of a "forceful strategy of raising capital early" and "We thought the American economy would be in a better position if [the firms] went out and raised capital." Treasury's involvement was also more extensive than previously understood publicly. While regulators negotiated the terms of repayment with individual institutions, Treasury hosted and participated in critical meetings about the repayment guidance, commented on individual TARP recipient's repayment proposals, and in at least one instance urged the bank (Wells Fargo) to expedite its repayment plan. The result was a nearly simultaneous exit by Bank of America, Wells Fargo, and Citigroup, involving offerings of a combined total of \$49.1 billion in new common stock in an already fragile market, despite warnings that large and contemporaneous equity offerings might be too much for the market to bear. While none of the offerings failed, Citigroup exercised only a portion of its overallotment option, and later complained that Wells



Fargo's simultaneous offering sapped demand for Citigroup's stock.

The lessons of the financial crisis and the events surrounding TARP repayments and exit demonstrate the importance of implementing strong capital requirements and holding institutions strictly accountable to those requirements. Some of the nation's largest financial institutions had too little capital before the last crisis, a fact that not only contributed to the crisis itself but also necessitated the subsequent bailouts. Regulators leveraged TARP repayment requirements to improve the quality of capital held by the nation's largest financial institutions in the wake of the financial crisis, but relaxed those requirements shortly after establishing them. Whether these institutions exited TARP with a strong and high quality capital structure sufficient to absorb their own losses and survive adverse market conditions without further affecting the broader financial system remains to be seen. There will always be tension between the protection of the greater financial system through robust capital requirements and the desire of individual financial institutions to maximize profits and shareholder returns. While striking the right balance is no easy task, regulators must remain vigilant against institutional demands to relax capital requirements while taking on ever more risk.



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Introduction

The first use of Troubled Asset Relief Program (“TARP”) funds was the Capital Purchase Program (“CPP”), through which the U.S. Department of the Treasury (“Treasury”) made investments in qualifying banks, bank holding companies, and other financial institutions in exchange for preferred stock¹ (or certain debt instruments)² and warrants.³ Through CPP, Treasury sought to invest funds in “healthy, viable institutions” as a way of promoting financial stability, maintaining confidence in the financial system, and permitting lenders to meet the nation’s credit needs. From October 2008 through December 2009, when CPP closed to new investments, Treasury invested \$204.9 billion in 707 institutions. Approximately 80% of all CPP investments – \$163.5 billion – went to the 17 CPP banks that were subject to the Supervisory Capital Assessment Program (“SCAP”), a joint Treasury and regulator program that stress-tested the nation’s 19 largest financial institutions.⁴

Despite the dramatic efforts of the U.S. Government, in early 2009, the market still lacked confidence in some of the nation’s largest financial institutions and some TARP recipients complained of a stigma associated with their participation in the program. Under the original terms agreed to by each CPP recipient, banks and other financial institutions were not permitted to repay Treasury’s TARP investment and exit TARP for three years, unless certain exceptions applied.⁵ When asked about the rationale for establishing a repayment waiting period, Treasury referred the Office of the Special Inspector General for the Troubled Asset Relief Program (“SIGTARP”) to language published by former Treasury Secretary Henry Paulson, citing the important role that CPP funds played in calming markets and restoring confidence in the banking industry. On February 17, 2009, the American Recovery and Reinvestment Act of 2009 (“ARRA”) changed the timing and conditions under which CPP recipients could repay Treasury’s TARP investment. ARRA provided that “subject to consultation

¹ Preferred stock is equity ownership that usually pays a fixed dividend prior to distributions for common stock owners but only after payments due to holders of debt and depositors. It typically confers no voting rights. Preferred stock also has priority over common stock in the distribution of assets when a bankrupt company is liquidated.

² The debt instruments were subordinated debt, which ranks below senior debt but above equity with regard to investors’ claims on company assets or earnings. Senior debt holders are paid in full before subordinated debt holders are paid. There may be additional distinctions of priority among subordinated debt holders.

³ The Emergency Economic Stabilization Act of 2008 (“EESA”) mandated, with limited exceptions, that Treasury receive warrants granting it the right to purchase at a previously determined price shares of common stock for certain publicly traded institutions or preferred stock or debt for certain non-publicly traded institutions for which it provided assistance.

⁴ The SCAP stress tests were a forward-looking exercise designed to estimate losses, revenues, and reserve needs. The tests were conducted between February 2009 and April 2009, with results announced in May 2009. Of the 19 institutions that participated in SCAP, 17 were CPP participants. See the Background for further discussion of SCAP.

⁵ For the purposes of this report, “exit” from TARP refers to the removal of restrictions placed on TARP recipients by EESA, either through the repurchase of securities held by Treasury or through other means of ending Treasury’s TARP investment in the institution.

with the appropriate Federal banking agency...[Treasury] shall permit a TARP recipient to repay...[TARP funds] without regard to whether the financial institution has replaced such funds from any other source or to any waiting period.”

In February 2009, at the time ARRA was enacted, Treasury and the Federal banking regulators had not developed criteria or guidance to evaluate a bank’s proposal to repay Treasury’s TARP investment by repurchasing its preferred shares held by Treasury and exit TARP. In May, the Federal Reserve Board (“FRB”) released the results of the SCAP stress tests and some SCAP banks immediately requested to repay Treasury and exit TARP. That month, Treasury published basic criteria for CPP institutions seeking to exit TARP, and on June 1, 2009, FRB issued a press release with guidance specific to SCAP banks that wanted to repay Treasury and exit TARP. Institutions that met the target capital ratios established by SCAP were allowed to repay after satisfying certain requirements, including raising common stock through a public issuance. Those that did not meet the SCAP targets were required to wait. That month, nine out of the 17 SCAP banks that participated in CPP exited the program: JPMorgan Chase & Co. (“JPMorgan”), The Goldman Sachs Group, Inc. (“Goldman Sachs”), Morgan Stanley, U.S. Bancorp, Capital One Financial Corporation (“Capital One”), American Express Company (“American Express”), BB&T Corporation (“BB&T”), The Bank of New York Mellon (“BNY Mellon”), and State Street Corporation (“State Street”).

In the fall of 2009, some of the SCAP banks remaining in TARP began communicating to Treasury and the Federal banking regulators their desire to repay and exit TARP. These included some of the nation’s largest banks, such as Bank of America Corp. (“Bank of America”), Citigroup Inc. (“Citigroup”), Wells Fargo & Company (“Wells Fargo”), and the PNC Financial Services Group, Inc. (“PNC”). Some of these institutions expressed concern about the perceived stigma associated with their participation in TARP as well as being subject to TARP executive compensation restrictions. Treasury and the Federal banking regulators engaged in discussions about revising the June criteria to provide additional guidance for these SCAP banks to repay and exit TARP. The result was new non-public guidance issued by FRB on November 3, 2009, which added an option for remaining SCAP banks to issue a certain amount of common equity to be considered for TARP repayment on an expedited basis.

SIGTARP focused its review on repayments by the largest CPP recipients; specifically, the first 13 (of the 17 SCAP institutions that participated in CPP) to repay Treasury’s CPP investment and exit TARP, with additional detail on those occurring after FRB issued revised repayment guidance in November 2009.⁶

⁶ In response to a draft of this report, FRB strenuously objected to the inclusion of a significant amount of text on the grounds that it was confidential and that disclosure would violate the bank supervision privilege. In doing so, FRB expressed concern that SIGTARP’s inclusion of certain discussion among regulators about specific repayment requests

Though they represent less than 2% of the number of institutions receiving CPP funds, the repayments by the 13 institutions reviewed in this report comprise approximately 81.5% of the total principal amount repaid to Treasury under CPP as of August 31, 2011. According to Treasury, as of that date, 219 banks and financial institutions have fully repaid Treasury's CPP investment and exited the program. Treasury had received a total of \$183.3 billion (or 89.4%) in principal repayments of its \$204.9 billion CPP investment, and had collected an additional \$25.6 billion in proceeds through dividends, interest, the sale of warrants, and gains on common stock investments.

This report examines the development of TARP repayment guidance and its application by Treasury and the Federal banking regulators to the first 13 SCAP institutions to exit the program.⁷ Specifically, the objectives of the audit were to determine the extent to which:

- Treasury maintained a consistent and transparent role in the TARP repayment process; and
- Federal banking regulators consistently coordinated and evaluated TARP repayment requests.

For discussion of the audit scope and methodology, see Appendix A. For additional information and comments from responding agencies, see Appendix G.

might, among other things, affect FRB's ability to maintain open communication with supervised financial institutions. SIGTARP respectfully disagrees with FRB's prediction of harm and believes that the exclusion of such information unnecessarily inhibits transparency, and is a missed opportunity to shed additional light on transactions that involved billions of dollars in taxpayer money. Nevertheless, out of an abundance of caution, SIGTARP has removed some of the text, while reaching agreement with FRB on the inclusion of other portions.

⁷ SIGTARP included in its review any SCAP institution that had repaid TARP as of December 31, 2010. Since that date, three more SCAP institutions have repaid and exited TARP.

Background

By September 2008, financial markets suffered from a severe loss of investor confidence. During that month, a succession of major U.S. financial institutions either collapsed or approached the brink of failure, there was historic turmoil in financial markets, and the Government stepped in to provide unprecedented Federal assistance through TARP. On October 13, 2008, in a meeting with then-Treasury Secretary Henry Paulson and other senior Government leaders, nine large and systemically important institutions⁸ agreed to accept \$125 billion in TARP capital funding. These nine institutions were chosen for their perceived importance to the broader financial system. The next day, Treasury announced the establishment of CPP, making up to \$250 billion in capital funding – including the \$125 billion accepted by the original nine banks the day before – available to a broad array of qualifying financial institutions⁹ that were deemed to be healthy and viable by Federal regulators¹⁰ and Treasury.

On October 28, 2008, the original nine financial institutions became the first recipients of TARP funds disbursed through CPP. Through the program, Treasury sought, in part, to “encourage U.S. financial institutions to build capital to increase the flow of financing to U.S. business and consumers and to support the U.S. economy.” The terms of CPP limited the amount of funding that qualifying institutions could receive to between 1% and 3% of their risk-weighted assets,¹¹ up to a maximum of \$25 billion.¹² The original terms also generally restricted institutions from repaying CPP funds within three years of Treasury making the investment.¹³ In exchange for its investment, Treasury received

⁸ The nine institutions were: Bank of America, BNY Mellon, Citigroup, Goldman Sachs, JPMorgan, Merrill Lynch, Morgan Stanley, State Street, and Wells Fargo. Bank of America acquired Merrill Lynch in January 2009. For details on the selection of these nine institutions and Bank of America’s acquisition of Merrill Lynch, see SIGTARP report “Emergency Capital Injections Provided to Support the Viability of Bank of America, Other Major Banks, and the U.S. Financial System,” October 5, 2009.

⁹ Pursuant to EESA, qualifying financial institutions were allowed to participate in TARP “without discrimination based on size, geography, or form of organization.”

¹⁰ The institutions participating in CPP are currently regulated by FRB, the Federal Deposit Insurance Corporation (“FDIC”), and the Office of the Comptroller of the Currency (“OCC”). Pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act, the Office of Thrift Supervision (“OTS”) will be eliminated 90 days after its powers and functions were transferred to the other Federal banking agencies on July 21, 2011. Appendix B identifies and explains the role of each Federal banking regulator.

¹¹ The risk-weighting of assets is the classification of assets according to the risk of loss from investment in the asset. A bank’s assets are weighted according to credit risk, and some assets, such as debentures, are assigned a higher risk than others, such as cash or government bonds. This asset calculation is used in determining the capital requirement for a financial institution.

¹² In May 2009, Treasury increased the maximum amount of CPP funding that small institutions could receive 3% to 5% of risk-weighted assets. Small institutions were defined as those with total assets less than \$500 million.

¹³ Institutions that sold qualifying perpetual preferred stock or common stock for cash proceeds worth at least 25% of Treasury’s CPP investment to repay were excepted from this restriction. OCC determined whether equity offerings qualified an institution for this exception.

dividend-paying preferred stock (or certain debt instruments) and warrants to purchase common stock.

Treasury had invested \$204.9 billion in 707 financial institutions by the time CPP closed to new investments in December 2009. While the 707 CPP participants reflected a diverse array of financial institutions, nearly half of the \$204.9 billion in CPP funds were concentrated in four of the largest banks – Bank of America, Citigroup, JPMorgan, and Wells Fargo – each of which received the maximum \$25 billion investment permitted under the program.¹⁴

Bank of America and Citigroup Received Additional Government Support

Despite a public statement by Treasury and Federal banking regulators that CPP was limited to healthy institutions, within months of receiving \$25 billion each in CPP funds, two SCAP banks – Bank of America and Citigroup – each received additional TARP funds under the Targeted Investment Program (“TIP”),¹⁵ as well as agreements for protection on losses of certain assets on those institutions’ books and records under the Asset Guarantee Program (“AGP”).¹⁶

In November 2008, Citigroup teetered on the brink of failure. The company would lose \$27.7 billion in 2008, and by November 19, 2008, its stock price had dropped precipitously. With Citigroup’s survival in doubt, the Government, through TARP and other means, stepped in to save it. The Government provided Citigroup with an additional \$20 billion of TARP funds in exchange for preferred stock under TIP and a Federal guarantee of a portion of losses on a designated pool of \$306 billion in Citigroup assets under AGP.

In December 2008, Bank of America was considering terminating a planned acquisition of Merrill Lynch, another CPP recipient that incurred significant losses in the fourth quarter of 2008. Because Treasury and FRB officials believed termination of the acquisition could potentially weaken Bank of America and destabilize the financial system, they pressured Bank of America to complete the acquisition and provided Bank of America with \$20 billion in additional TARP funds through TIP, as well as an agreement for a Federal guarantee of a portion of losses on a pool of up to \$118 billion in assets.¹⁷

¹⁴ Wells Fargo was in the process of acquiring Wachovia when the institutions agreed to accept CPP capital on October 13, 2008. After the acquisition was completed, Wells Fargo became the fourth-largest financial institution in the United States by total assets.

¹⁵ The objective of TIP was to invest funds on a case-by-case basis to strengthen the economy and protect American jobs, savings, and retirement security where the loss of confidence in a financial institution could result in significant market disruptions that threaten the financial strength of similarly situated financial institutions. The only institutions to receive funds under TIP were Citigroup and Bank of America.

¹⁶ AGP was created to provide guarantees for assets held by systemically significant financial institutions that faced a high risk of losing market confidence due in part to a portfolio of distressed or illiquid assets.

¹⁷ Although Bank of America’s loss sharing term sheet was negotiated in January 2009, a final agreement was never reached. On May 6, 2009, Bank of America requested termination of the agreement, which was terminated on

Treasury and Regulators Announced and Implemented the Supervisory Capital Assessment Program

Despite the dramatic efforts undertaken by the Government to bolster the capital adequacy of financial institutions in late 2008 and early 2009, a Treasury report prepared at the time concluded that the market still lacked confidence in some of the nation's largest financial institutions, impairing the ability of the overall financial system to lend. On February 10, 2009, Treasury and regulators jointly announced a Financial Stability Plan. Among other

elements, the plan established a Financial Stability Trust, which was intended to strengthen confidence in financial institutions through, along with other initiatives, comprehensive stress tests of all banking institutions with 2008 year-end assets in excess of \$100 billion, later named SCAP.¹⁸

Supervisory Capital Assessment Program

SCAP was a stress test of the nation's 19 largest financial institutions conducted in early 2009 by FRB in coordination with other regulators and Treasury. FRB designed SCAP to estimate losses, revenues, and reserve needs for these 19 institutions under two macroeconomic scenarios – one that reflected a baseline projection and another that reflected a more severe recession than the baseline projections.

Applying the asset threshold, regulators identified the nation's 19 largest bank holding companies for participation in SCAP. SCAP was designed to identify the potential losses, resources available to absorb losses, and the additional capital needed, if any, for each of the participating institutions.¹⁹ According to FRB, the 19 institutions subject to SCAP collectively held two-thirds of the assets and more than half of the loans in the U.S. banking system. Of the 19 SCAP institutions, 18 participated in one or more TARP programs.²⁰ Seventeen SCAP institutions were CPP recipients, and one SCAP institution, GMAC, now known as Ally Financial Inc., received funding through TARP's Automotive Industry Financing Program.

Between February 2009 and April 2009, regulators performed stress tests on each of the 19 SCAP institutions. On April 24, 2009, FRB published details on the design and implementation of the SCAP process. According to the FRB

September 21, 2009. Bank of America agreed to pay \$276 million to Treasury, \$57 million to FRB, and \$92 million to FDIC in exchange for the costs incurred by the Government and the benefits received by Bank of America through the announcement of its participation in the agreement.

¹⁸ In addition to establishing a Financial Stability Trust, the Financial Stability Plan also called for the establishment of a new Public-Private Investment Fund, a Consumer and Business Lending Initiative, new governance provisions and restrictions, Housing Support and Foreclosure Prevention, and a Small Business Community Lending Initiative.

¹⁹ The 19 SCAP institutions were: American Express Company, Bank of America, BB&T, BNY Mellon, Capital One, Citigroup, Fifth Third Bancorp ("Fifth Third"), GMAC LLC ("GMAC"), Goldman Sachs, JP Morgan, KeyCorp, MetLife Inc. ("MetLife"), Morgan Stanley, PNC, Regions Financial Corporation ("Regions"), State Street, SunTrust Banks, Inc. ("SunTrust"), U.S. Bancorp, and Wells Fargo.

²⁰ MetLife was the only SCAP institution to receive no direct support through TARP. However, on November 1, 2010, MetLife purchased the American Life Insurance Company from the American International Group, Inc., which received money from TARP's Systemically Significant Failing Institutions Program.

description, between February and April, institutions were asked to project their credit losses and revenues for 2009 and 2010, as well as reserves necessary to cover expected losses in 2011, under two economic scenarios: baseline and more adverse. SCAP's baseline economic scenario reflected a consensus expectation among professional forecasters on the depth and duration of the recession. FRB constructed the more adverse scenario from the baseline scenario, taking into account the historical track record of forecasters as well as their current assessments of uncertainty for unemployment and gross domestic product. By using a common set of economic scenarios and conceptual framework, regulators sought to apply a consistent and systematic approach across all 19 institutions.

The more adverse economic scenario projected a recession that would be longer and more severe than the expectations of professional forecasters. SCAP institutions were required to have enough capital to meet target capital adequacy ratios under the more adverse scenario. The stress tests included a common equity component. By including this, Treasury and regulators acknowledged that markets had heavily discounted other types of capital and emphasized the importance of common equity to a bank's capital base. A joint statement issued in May 2009 by Treasury, FRB, FDIC, and the Office of the Comptroller of the Currency ("OCC") explained, "Common equity is the first element of the capital structure to absorb loss and offers protection to more senior parts of the capital structure. All else equal, more Tier 1 Common Capital gives a [bank holding company]²¹ greater permanent loss absorption capacity and a greater ability to conserve resources under stress by changing the amount and timing of dividends and other distributions."

SCAP established target capital ratios of at least 6% of risk-weighted assets in Tier 1 Capital and at least 4% in Tier 1 Common under the more adverse scenario projected through December 31, 2010. Tier 1 Capital is a measure used by regulators to identify an institution's stable and readily available capital, and includes common equity and preferred equity elements. Tier 1 Common, a subset of Tier 1 Capital, includes only the common equity elements of Tier 1 Capital. According to regulators, for the purposes of SCAP, Tier 1 Common was calculated by subtracting preferred stock, qualifying trust preferred securities, and minority interests in an institution's subsidiaries from the calculation of its Tier 1 Capital.²²

²¹ A bank holding company is a company that owns and/or controls one or more U.S. banks.

²² In support of the stress tests, regulators asked SCAP institutions to provide documentation for their projected losses and resources, including projected income and expenses by major category, domestic and international portfolio characteristics, forecasting methods, and important assumptions. According to the terms of the program, institutions that did not meet the target capital adequacy ratios described above would have to submit a plan to raise sufficient capital by early November 2009 or accept additional capital through the Capital Assistance Program ("CAP"). CAP was created to give financial institutions access to additional capital as needed. However, on November 9, 2009, Treasury announced that CAP had been closed without making any investments under the program.

On May 7, 2009, FRB publicly released the results of the SCAP stress tests, announcing that the unprecedented nature of the program and the conditions that precipitated it led to the “unusual step of publicly reporting the findings of this supervisory exercise.” Nine of the 19 SCAP institutions, including eight CPP participants, were found to have sufficient capital to maintain target capital ratios.²³ Ten SCAP institutions, of which nine were CPP recipients, were required to raise additional capital to meet SCAP requirements.²⁴ Collectively, these 10 firms were \$74.6 billion short of the capital requirements, with the vast majority of the shortfall pertaining to the institutions’ Tier 1 Common reserves.²⁵ According to FRB, these results indicated that the institutions’ capital structures were too strongly tilted away from common equity,²⁶ and the institutions would therefore need to augment their capital base by raising additional common equity.

FRB gave each of the 10 institutions that did not meet SCAP requirements 30 days to submit a detailed capital plan for reaching target capital ratios, advising that wherever possible the institutions should actively seek to raise new capital from private sources. In addition to issuing common stock, capital actions such as converting preferred stock to common stock, selling assets, and limiting dividends and stock repurchases were also permitted means of meeting the target ratios. After submitting their plans, the remaining SCAP institutions had until November 9, 2009, to implement their plans and meet the target capital ratios. Table 1 on the following page shows the results of the SCAP stress tests.

²³ The nine institutions that were not required to raise additional capital to meet SCAP requirements were American Express, BB&T, BNY Mellon, Capital One, Goldman Sachs, JPMorgan, MetLife, State Street, and US Bancorp.

²⁴ The 10 institutions required to raise additional capital to meet SCAP requirements were Bank of America, Citigroup, Fifth Third Bancorp, GMAC, KeyCorp, Morgan Stanley, PNC, Regions Financial, SunTrust, and Wells Fargo. With the exception of GMAC, which did not participate in CPP, each of the 10 SCAP institutions required to raise additional capital met the SCAP requirements by the November 9, 2009, deadline. Rather than accessing CAP to address the shortfall, GMAC received capital through the Automotive Industry Financing Program.

²⁵ After taking into account completed or contracted capital actions and the effects of first quarter 2009 operating results.

²⁶ The capital structure of some SCAP institutions relied heavily on preferred equity, which have debt-like characteristics and do not provide the same level of protection provided by common equity.

TABLE 1

SCAP RESULTS		
Institution	TARP Program Participation	Capital Raise Required by SCAP (\$ bn)
Bank of America	CPP, TIP	\$33.9
Wells Fargo	CPP	13.7
GMAC	AIFP	11.5
Citigroup	CPP, TIP, AGP	5.5
Regions	CPP	2.5
SunTrust	CPP	2.2
KeyCorp	CPP	1.8
Morgan Stanley	CPP	1.8
Fifth Third	CPP	1.1
PNC	CPP	0.6
American Express	CPP	0.0
BB&T	CPP	0.0
BNY Mellon	CPP	0.0
Capital One	CPP	0.0
Goldman Sachs	CPP	0.0
JPMorgan	CPP	0.0
State Street	CPP	0.0
U.S. Bancorp	CPP	0.0
MetLife	Did not participate	0.0
TOTAL		\$74.6

Sources: FRB and Treasury.

Note: In stress testing Citigroup, regulators counted as common stock the amount of private and Government preferred stock that Citigroup announced it would convert to common stock, though the conversion was not finalized until after the SCAP results were announced.

June 2009 Guidance and Subsequent Repayments

This section describes the development and the issuance by regulators in June 2009 of guidance for SCAP institutions seeking to exit TARP, as well as the repayments by certain SCAP institutions in June 2009. The eight institutions that met SCAP capital targets at the time of the stress tests, and a ninth that met the targets shortly thereafter, applied to repay Treasury and exit TARP. All nine were approved by FRB after issuing sufficient common equity and meeting the other requirements outlined in the June 2009 guidance.

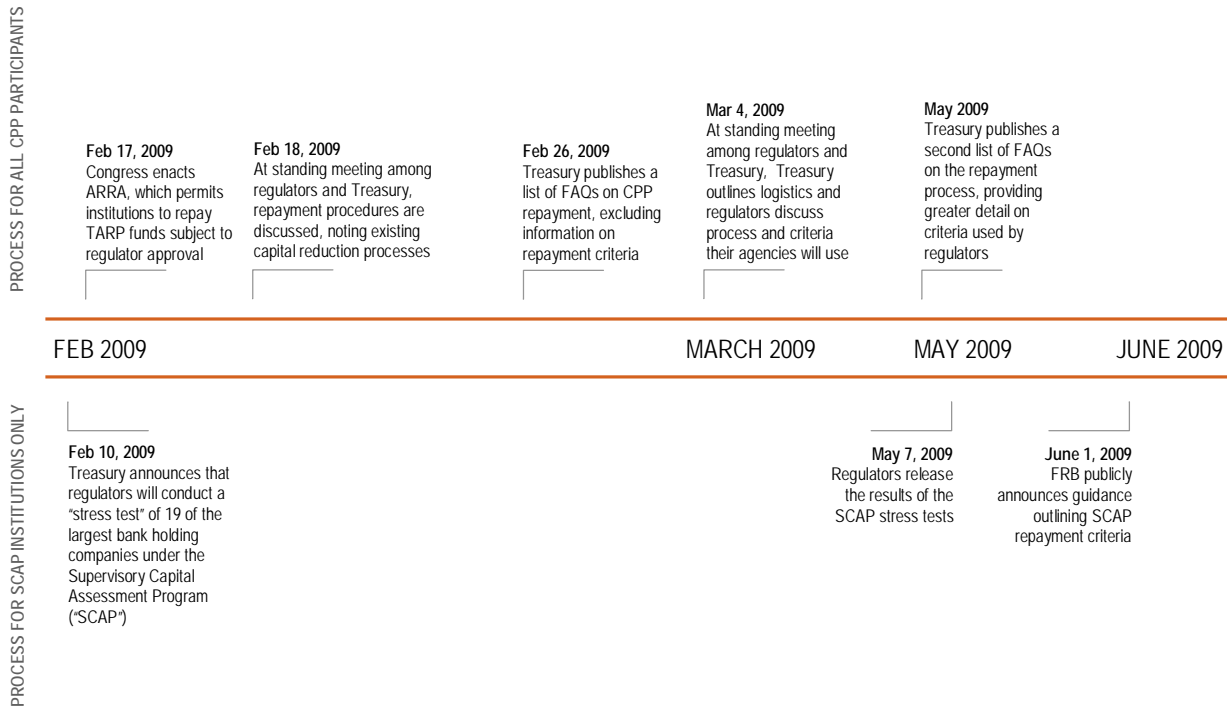
In early 2009, while Treasury was making additional TARP investments in some institutions, ARRA removed the three-year repayment waiting period governing CPP investments.²⁷ A few TARP recipients sought to repay in the weeks following ARRA's enactment, and during this time Treasury published basic guidance advising institutions to notify their primary regulator of their desire to repay TARP. Treasury also began meeting with regulators to discuss criteria and procedures for evaluating applications to repay and exit TARP.

Between February 2009 and June 2009, Treasury and FRB issued general guidance on TARP repayment, developed in coordination with FDIC, OCC, and OTS. In May 2009, Treasury published answers to frequently asked questions outlining the requirements and criteria that applied broadly to all 707 institutions that would participate in the program, and specified that additional requirements would apply only to SCAP institutions. FRB later elaborated on repayment guidance pertaining to SCAP institutions in June 2009 through guidance specifying that only institutions that met the SCAP target capital ratios and other criteria were eligible to repay and that each institution applying to do so would also have to demonstrate access to equity markets. Figure 1 on the following page is a timeline of key events related to the development of the repayment guidance.

²⁷ ARRA, enacted on February 17, 2009, provided, "subject to consultation with the appropriate federal banking agency, if any, [Treasury] shall permit a TARP recipient to repay [the CPP investment] without regard to whether the financial institution has replaced such funds from any other source or to any waiting period."

FIGURE 1

**DEVELOPMENT OF TARP REPAYMENT PROCEDURES AND GUIDANCE
(FEBRUARY 2009 - JUNE 2009)**



Sources: Treasury, Public Law 111-5, FRB, and OCC.

Treasury and Regulators Developed Repayment Guidance

As the primary Federal regulator for all bank holding companies, FRB is responsible for supervising approximately 82% of all the institutions that participated in CPP,²⁸ including each of the 17 SCAP institutions that participated. In this role, after coordinating with other regulators to evaluate repayment applications, FRB issues a recommendation to Treasury on whether or not each bank holding company should be allowed to repay. In doing so, FRB seeks consensus with other Federal regulators – FDIC, OCC, or previously OTS – if one or more of the regulators has a significant connection to the holding company’s largest subsidiary banks or thrifts, either through regulating a subsidiary or by insuring deposits.

²⁸ FRB supervises all bank and financial holding companies and state member banks, which collectively comprise 82% of the 707 institutions that participated in CPP. The remaining institutions are not subsidiaries of a bank or financial holding company and are not state member banks. Among those, responsibility for supervising and issuing a recommendation on CPP repayment to Treasury lies with FDIC for all non-member banks (9% of CPP participants); OTS for all thrifts and savings and loan institutions (8% of CPP participants); and OCC for all national banks (1% of CPP participants).

On March 17, 2009, FRB disseminated a template of a decision memorandum developed to summarize evaluations of CPP repayment requests. The template specifically instructs Federal Reserve Banks to consult with the regulators of the institution's subsidiary banks. Other criteria listed in FRB's decision memo template include the institution's current capital ratios and summary financial ratings; its forecasted condition once funds are repaid; and the appropriateness of the institution's capital planning processes.²⁹

In May 2009, as FRB announced the results of the SCAP stress tests, some SCAP institutions requested to repay Treasury's CPP investment. Treasury's repayment guidance published that month stated that all SCAP institutions "must have a post-repayment capital base at least consistent with the SCAP buffer,³⁰ and must be able to demonstrate its financial strength by issuing senior unsecured debt for a term greater than five years not backed by FDIC guarantees, in amounts sufficient to demonstrate a capacity to meet funding needs independent of government guarantees." These requirements prohibited institutions from using FDIC's Temporary Liquidity Guarantee Program ("TLGP")³¹ to demonstrate their ability to issue long-term debt.

On March 4, 2010, Treasury told the Congressional Oversight Panel ("COP"), "After the stress test results were announced on May 7, 2009, Treasury officials encouraged [FRB, FDIC, and OCC] to develop and articulate the conditions that a bank would have to satisfy in order to be permitted to repay TARP assistance. Treasury urged the regulators to develop and communicate any such conditions or standards, so that banks wishing to repay could decide whether, how and when they could meet the standards." According to Treasury Secretary Timothy F. Geithner, he told colleagues at Treasury and FRB "that it was important that they lay out a clear set of criteria for repayment as soon as possible and that we maximize incentives for the firms to go out and raise private capital on as large a scale as possible." Treasury, however, also told COP that while it "was asked for and offered its opinions on proposed standards, the standards were determined by the regulators and Treasury deferred to their judgment as to what should be

²⁹ See Appendix E for a template of the FRB Redemption Request Decision Memo for CPP repayment evaluations.

³⁰ The term "SCAP buffer" is shorthand for the requirement that SCAP institutions be able to maintain capital ratios of at least 6% of risk-weighted assets in Tier 1 Capital and at least 4% in Tier 1 Common Capital under the more adverse scenario projected through December 31, 2010.

³¹ The Temporary Liquidity Guarantee Program ("TLGP") was established in October 2008 to address "disruptions in the credit market, particularly the interbank lending market, which reduced banks' liquidity and impaired their ability to lend. The goal of TLGP is to decrease the cost of bank funding so that bank lending to consumers and businesses will normalize." The program does not rely on the taxpayer or the deposit insurance fund, but is entirely funded by industry fees. Participating institutions may issue debt under TLGP's Debt Guarantee Program, which provided an FDIC guarantee of newly issued senior unsecured debt of participating insured depository institutions and other eligible entities. New guarantees were issued until October 31, 2009, with the debt being guaranteed until "the earliest of the opt-out date, the maturity of the debt, the mandatory conversion date for mandatory convertible debt, or December 31, 2012."

required.” Secretary Geithner similarly told SIGTARP that Treasury “left the principal verdict with [FRB].”

FRB Issued Guidance to SCAP Institutions in June 2009

On June 1, 2009, FRB issued a press release outlining the criteria for SCAP institutions to redeem Treasury’s TARP investment. FRB’s release stated that any SCAP institution “seeking to redeem U.S. Treasury capital must demonstrate an ability to access the long-term debt markets without reliance on [TLGP] and must successfully demonstrate access to public equity markets.” The release set forth other factors that would be considered by FRB, including whether the SCAP institutions would be able to maintain capital levels consistent with supervisory expectations. Finally, the release provided that SCAP institutions must have a robust longer-term capital assessment and management process geared toward achieving and maintaining a prudent level and composition of capital commensurate with the company’s business activities and firm-wide risk profile.

A senior FRB official told SIGTARP that the requirement to demonstrate access to equity markets meant that the institution had to issue additional common stock prior to repaying and exiting TARP. According to the official, this requirement was an essential condition of CPP repayment and a market test of each firm’s viability. In determining the appropriate size of the common stock issuance required for each institution, FRB considered whether the issuance would generate enough capital for the institution to remain above SCAP target capital ratios after removing TARP capital.

FDIC and OCC played a minor role in reviewing the June 2009 repayments, in part because regulators viewed these repayments as less controversial and less complicated than later repayments. Senior-level OCC officials said that they were given a chance to object to repayment proposals, but had no conversations concerning the size of the common stock issuances required by FRB and voiced no objections to them. A senior-level FDIC official said that his agency provided input to FRB on the repayments, but that the input was informal. Additionally, FRB did not consult with OTS at all on the repayment application submitted by American Express, though OTS regulated the company’s largest subsidiary. According to an OTS official, this was an oversight on the part of FRB, and representatives from the two agencies later met to ensure it did not happen with future repayment applications. American Express is the only SCAP institution with a large subsidiary that was regulated by OTS.

Repayments by SCAP Institutions in June 2009

The eight CPP institutions found to have met the SCAP stress test requirements became eligible to repay TARP immediately after the June 2009 guidance was issued. Each institution applied to do so in the month leading up to the issuance of the guidance. These eight institutions – American Express, BB&T, BNY Mellon, Capital One, Goldman Sachs, JPMorgan, State Street, and U.S. Bancorp

– were soon joined by a ninth – Morgan Stanley – which raised enough capital to become eligible shortly after the SCAP results were announced and also applied to repay.

All nine of these institutions were approved for TARP repayment and exited TARP on June 17, 2009, repaying a combined total of \$66.7 billion to Treasury.³² The remaining eight institutions were required to wait, at a minimum, until they raised enough capital to meet SCAP requirements and met the other criteria set forth in the June 2009 guidance before they could apply to repay and exit TARP.³³ Then-FDIC Chairman Sheila Bair told SIGTARP that the stronger institutions, in terms of capital adequacy, exited in the first round of SCAP repayments.

Prior to exiting TARP, each institution that repaid in June 2009 issued new common equity in response to the requirement that they demonstrate access to equity markets. Table 2 below shows the amount of common stock issued in connection with TARP repayment by each institution that repaid on June 17, 2009.

TABLE 2

COMMON STOCK ISSUED IN CONNECTION WITH TARP EXIT IN JUNE 2009

Institution	Common Stock Issued (\$bn)	TARP Repayment (\$bn)
Morgan Stanley	7.0	10.0
JPMorgan	5.8	25.0
Goldman Sachs	5.8	10.0
U.S. Bancorp	2.8	6.6
State Street	2.3	2.0
BB&T	1.7	3.1
Capital One	1.5	3.6
BNY Mellon	1.4	3.0
American Express	0.5	3.4

Sources: Treasury, FRB, and the Securities and Exchange Commission.

Treasury, as well as FRB, emphasized the importance of replacing TARP capital with some amount of private capital. Secretary Geithner told SIGTARP that putting pressure on firms to raise private capital was part of “a forceful strategy of raising capital early.” According to the Secretary, “You can’t force private capital to come in, but you can go to firms and ask them to raise it... We thought the

³² Northern Trust Corporation, a large financial institution that did not participate in SCAP, also exited TARP on June 17, 2009.

³³ These eight were Bank of America, Citigroup, Fifth Third Bancorp, KeyCorp, PNC Financial Services, Regions Financial, SunTrust, and Wells Fargo.

American economy would be in a better position if [the firms] went out and raised capital... It doesn't matter whether [the firms] thought it was in their interest. We thought it was in our interest." FRB Governor Daniel Tarullo³⁴ told SIGTARP that FRB would not have allowed the institutions to "repay TARP without them having enough capital to absorb losses." He added that the common stock the institutions were required to issue resulted in "a big upgrade in their capital position."

According to FRB analysis of the June 2009 repayments, the projected capital ratios of each institution remained above SCAP targets after CPP funds were removed from their capital structure. FRB officials explained to SIGTARP that, using data collected through the recently completed stress tests, they would "back up" each institution's projected capital ratios by subtracting TARP capital to aid in estimating the amount each would have to raise through common equity issuance. An FRB official also noted that some institutions may have elected to issue additional common stock to take advantage of more receptive equity markets.

TARP funds added to the preferred capital base of each recipient, and therefore, TARP repayment altered the recipient's capital structure. Generally, the repayments replaced TARP preferred capital with a smaller amount of higher quality common capital. For most institutions, the repayments resulted in a reduction in Tier 1 Capital – which includes both preferred and common equity elements – because when an institution exits TARP, it redeems the TARP preferred stock from Treasury and removes it from its capital structure. However, because regulators required banks to raise some amount of new common stock to exit TARP, the repayments generally increased the amount of Tier 1 Common – which includes only common equity elements – held by the institutions.

For SCAP institutions repaying in June 2009, TARP repayment lowered an institution's Tier 1 Capital ratio by an average of 114 basis points³⁵ (from 11.06% to 9.91%) as projected by FRB through 2010. However, FRB also projected that Tier 1 Common ratios increased by an average of 133 basis points (from 6.57% to 7.90%) due to the new common stock each repaying institution was required to issue.³⁶ According to FRB's projections, two institutions – State Street and BB&T – would see an increase of 300 basis points in their Tier 1 Common ratios from issuing common stock and exiting TARP. Figure 2 shows the net change in projected Tier 1 Capital and Tier 1 Common ratios for the nine SCAP institutions that repaid in June 2009.

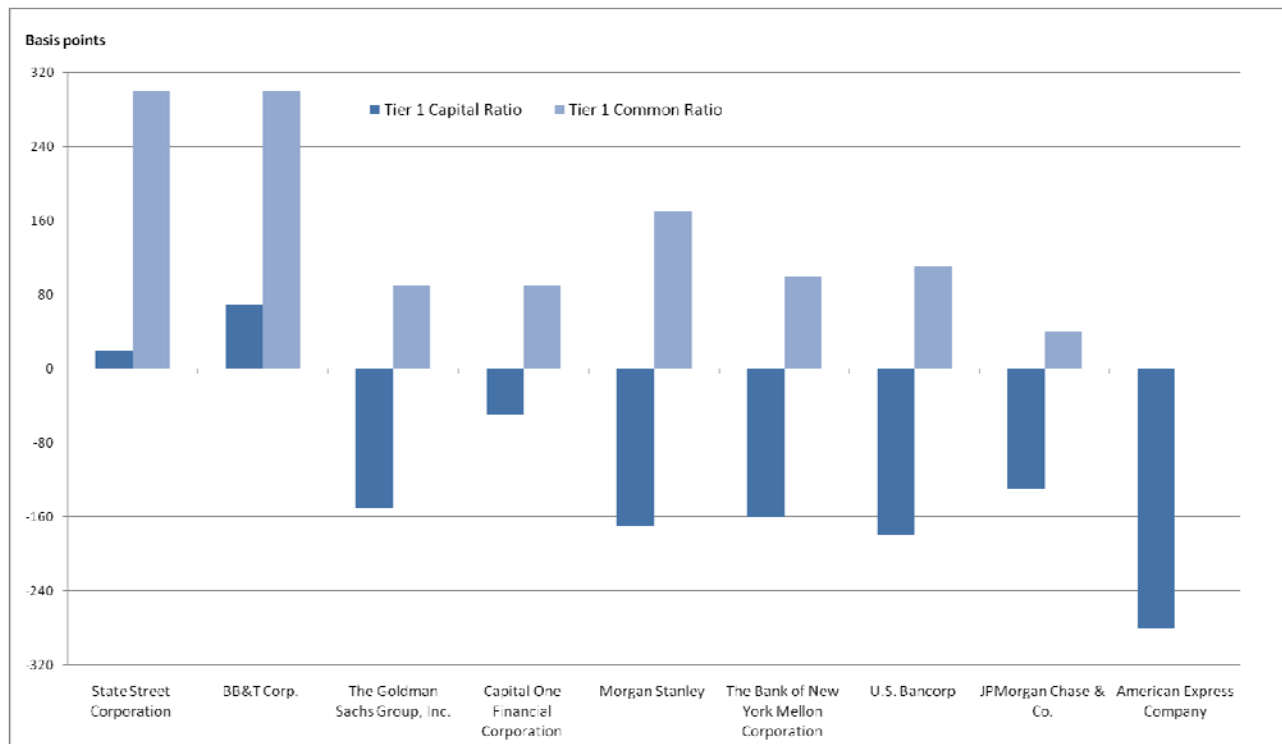
³⁴ Upon taking office on January 28, 2009, Governor Tarullo became Chairman of FRB's Committee on Bank Supervision.

³⁵ A basis point represents 1/100 of a percent. For example, an increase from 5.25% to 5.50% would be an increase of 25 basis points.

³⁶ The average change in FRB's projected Tier 1 Capital and Tier 1 Common ratios for institutions that repaid in June 2009 was determined by calculating a simple average of the institutions' projected ratios.

FIGURE 2

NET CHANGE IN PROJECTED CAPITAL RATIOS FROM TARP REPAYMENT BY SCAP INSTITUTIONS REPAYING IN JUNE 2009



Source: SIGTARP analysis of FRB data.

Note: American Express' projected Tier 1 Common ratio under SCAP conditions remained unchanged after TARP repayment.

November 2009 Clarifying Guidance

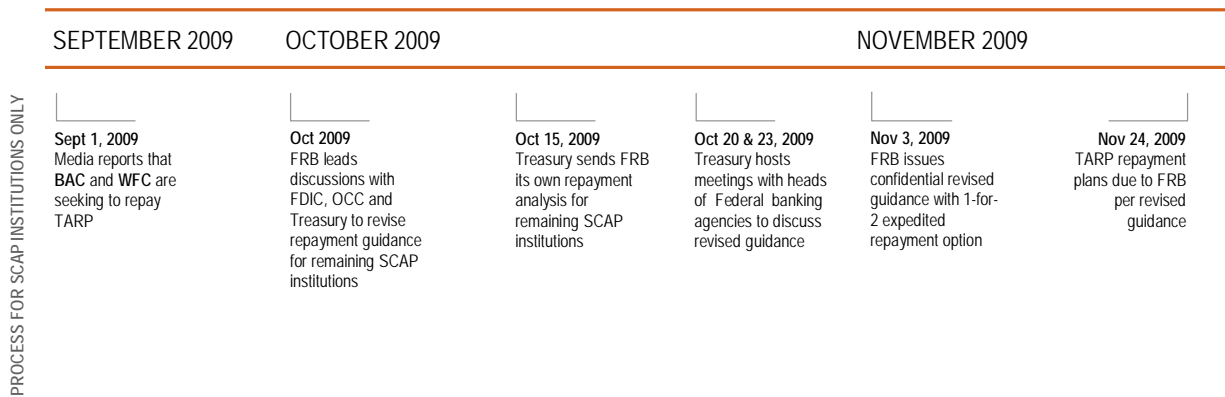
This section details the events leading to the revision of the TARP repayment guidance for remaining SCAP institutions by FRB on November 3, 2009.

Figure 3 shows the timeline of key events related to the development of revised TARP repayment guidance for SCAP institutions.

In the months following the SCAP stress tests and the June 2009 repayments, each of the eight SCAP institutions that remained in CPP brought their capital ratios into compliance with the SCAP capital requirements through common stock issuance and conversion, asset sales, and other capital actions. Bank of America and Wells Fargo began talking to the press in early September 2009 about their plans to repay TARP. Over the following weeks, Federal banking regulators and Treasury began to discuss revising the criteria for remaining SCAP institutions to repay and exit TARP, culminating in FRB’s issuance of revised guidance on November 3, 2009.

FIGURE 3

DEVELOPMENT OF REVISED TARP REPAYMENT GUIDANCE FOR SCAP INSTITUTIONS (SEPTEMBER 2009 – NOVEMBER 2009)



Sources: Treasury, FRB, FDIC, *The Wall Street Journal*, and Bloomberg.

Regulators Discussed Revising the Repayment Guidance; Treasury Weighed in on the Criteria

In October 2009, FRB led discussions with FDIC, OCC, and Treasury to revise the repayment guidance for the eight SCAP institutions that remained in TARP. With the support of Secretary Geithner, who said that part of Treasury’s job “was to make sure there was more consistency and consensus” regarding the repayment guidance, regulators discussed specifying the minimum amount of common equity that remaining institutions would have to raise before being allowed to repay TARP immediately. In addition to seeking consistency, Treasury was also concerned that to avoid diluting the holdings of common shareholders, some

institutions might decide to hold on to TARP capital and repay slowly through earnings, rather than issue new common equity.³⁷ Secretary Geithner told SIGTARP, “We did sometimes go to the firms themselves and told them they needed to go raise as much as capital and as soon as possible, to prove to people that they were able to repay the government and to put the institutions back in private hands.”

Regulators sought to establish guidance that would help them to gain comfort with expedited repayments. FRB Governor Tarullo told SIGTARP that since the stress tests judged the remaining institutions to be unable to maintain sufficient capital in adverse conditions, it was necessary to revise the June guidance to provide additional assurance that they would be viable after TARP repayment. By October 15, 2009, FRB arrived at such a framework, proposing to offer remaining SCAP institutions two paths to full repayment: 1) repay upon completion of supervisory review of the firm’s internal capital assessment and planning process (or longer-term capital plans);³⁸ or 2) expedite repayment by raising at least 50% of outstanding TARP funds in common equity. The latter is referred to as the 1-for-2 provision because the final version of the provision required firms seeking immediate repayment to raise at least \$1 in common stock for every \$2 they repaid in TARP funds.³⁹ Former FRB Vice Chairman Donald Kohn told SIGTARP that there were sound public policy reasons for including the 1-for-2 provision, noting that “the sooner the banks demonstrated they could go out to the market and get out from under TARP, the sooner confidence could be restored.”

Regulators developed the 1-for-2 provision based on their estimate that it would align the Tier 1 Capital and Tier 1 Common ratios of the remaining institutions with those of the institutions that exited TARP in June 2009. FRB Governor Tarullo told SIGTARP that during the financial crisis, it became clear that the markets cared about common equity, not Tier 1, and that the 1-for-2 provision provided the “right order of magnitude” to position the remaining banks to absorb potential future losses. An FRB official noted the similarity between the proposed guidelines and the requirements of earlier SCAP repayments, writing that it was “consistent with what we did for the first nine.” FRB officials discussed how to measure common equity raised toward meeting the 1-for-2 provision. They considered crediting common equity raised in response to the SCAP stress tests that exceeded minimum capital targets, crediting earnings to

³⁷ Issuing new common equity dilutes the holdings of existing common shareholders by increasing the number of shares outstanding and reducing the ownership stake of each share of common stock.

³⁸ While firms that exited in June were also required to submit their longer-term capital plans to FRB, supervisory review and acceptance of the plans was not a prerequisite for repayment approval for those firms.

³⁹ Regulators sometimes also referred to the 1-for-2 provision as a “safe harbor” for exiting TARP. However, it was not a safe harbor in that it did not guarantee that an institution would be allowed to repay TARP.

absorb losses in excess of expectations,⁴⁰ or crediting the sale of assets. Treasury developed its own repayment analysis for the remaining SCAP institutions around that time. Treasury's analysis also envisioned a common equity raise of approximately 50%, or 1-for-2, of the amount the institution would repay, with certain institutions required to raise additional capital above that minimum. Despite the similarities between the proposals developed by FRB and Treasury, regulators had yet to agree on revised repayment guidance for the remaining SCAP institutions. At issue was whether to count capital that was not raised through equity issuances, as well as the amount of capital above the 1-for-2 minimum that certain institutions would have to raise.

Treasury Facilitated Meetings with Regulators to Finalize the Revised Guidance

A senior Treasury official told SIGTARP that during this time, some remaining SCAP institutions were receiving conflicting messages from regulators about the new repayment requirements, and the conflicting messages were beginning to sow uncertainty in the markets. According to Secretary Geithner, "there had to be clarity on the guidance that could be applied evenly to firms and that was quickly understandable." To that end, Secretary Geithner hosted at least two meetings with the heads of Federal banking agencies in late October 2009 to discuss the repayment guidance. Secretary Geithner told SIGTARP that the meetings were part of a "constant conversation" about the repayment guidance.

During the meetings, FDIC pushed for strict wording that would require institutions seeking expedited repayment to meet the 1-for-2 ratio entirely by issuing new common stock. FDIC and other regulators also acknowledged early on that certain institutions would be required to raise additional capital beyond that minimum. Citigroup, for example, might need to raise 100% of Treasury's preferred stock investment, or 1-for-1, to justify an expedited repayment of TIP funds. Then-Chairman Bair told SIGTARP that FDIC reluctantly agreed to the 1-for-2 ratio as a minimum requirement for most remaining institutions, but would have preferred the more stringent 1-for-1 ratio to apply to all remaining institutions. She added that FDIC ultimately found the 1-for-2 provision reasonable because institutions that met it would increase the quality of their capital, and in the process, receive market validation of their common stock. According to then-Chairman Bair and a senior FDIC official, there was specific agreement among regulators that all capital raised toward the 1-for-2 provision would consist entirely of newly issued common stock, and not asset sales or employee stock issuances.

⁴⁰ Specifically, excess pre-provision net revenue ("PPNR"). PPNR is net interest income, fees and other non-interest income, net of non-credit-related expenses. It represents the earnings capacity that can be applied to capital or loan losses and therefore, is a resource available to a firm to absorb some of its estimated losses under the SCAP scenarios.

However, according to then-Comptroller of the Currency John Dugan, there was no formal agreement to a firm 1-for-2 requirement or that it be composed entirely of newly issued common stock, and that OCC expressed concerns about such a rigid requirement. A senior OCC official told SIGTARP that applying such a requirement to all remaining institutions ignored other considerations, such as earnings accrued in the interim, equity already raised in excess of SCAP requirements, and “the reality of the bank’s balance sheet.” Further, according to then-Comptroller Dugan, he “was very worried about the prospect of a capital raise that failed to achieve an unduly high number and what that would do to confidence in particular banks and the banking system.” He explained to SIGTARP that given the fragile state of the markets at the time, he was concerned that the 1-for-2 provision in particular was too high a bar for institutions to meet if it consisted only of new equity issuance and did not credit other forms of equity raising, including asset sales. He thought the goal should be to maximize the amount of equity that could be raised, while not setting the bar so high that it could not be achieved successfully. The difficulty in a 1-for-2 issuance would become an important concern as regulators deliberated over Bank of America’s repayment proposals the following month. Former FRB Vice Chairman Kohn summed up each regulator’s perspective, telling SIGTARP that while FDIC wanted the 1-for-2 to be met entirely with new common stock, “the OCC was much more relaxed than that, and [FRB] was a little more relaxed than the FDIC.”

While OCC, FDIC, and Treasury were all given an opportunity to weigh in on the revisions, FRB, as the primary Federal regulator of each SCAP institution, was ultimately responsible for issuing the guidance. According to FRB Governor Tarullo, this arrangement was beneficial from a public administration perspective because there were multiple, sometimes conflicting, policy goals associated with the repayment of TARP funds, and FRB was best suited to account for all policy considerations. He told SIGTARP that FDIC was understandably concerned about its exposure to institutions through TLGP and the deposit insurance fund, and that OCC tends to look more narrowly at specific national banks with less of a macro perspective. Treasury’s policy goal, according to Governor Tarullo, was to get Government ownership ramped back. Governor Tarullo added that “you want the decision maker to be someone who has an interest in all of the conflicting policy aims.” With respect to TARP repayment, that entity was FRB. He explained that it was a two-key process. First, FRB had to agree to let the bank repay, and second, Treasury had to agree to be repaid, but the second key would turn automatically if FRB turned the first key. Former FRB Vice Chairman Kohn, who acted as a liaison to Treasury on repayment discussions, told SIGTARP that he kept Treasury apprised of repayment discussions because as the supplier of TARP capital, Treasury wanted to know the terms under which it would be repaid.

FRB Issued November 2009 Guidance with a “1-for-2” Repayment Option

On November 3, 2009, FRB issued the guidance non-publicly to the eight SCAP institutions that had yet to exit TARP. In doing so, FRB included the strict 1-for-2 provision for expedited repayment developed by FRB and advocated by FDIC, and required each remaining institution to submit a detailed TARP exit plan within 21 days. Specifically, the guidance allowed institutions to either expedite repayment by issuing \$1 of new common equity for every \$2 of TARP repaid⁴¹ or to wait until supervisors completed their review of the institution’s longer-term capital plan. The expedited option allowed firms to apply the 1-for-2 provision toward a partial repayment, but did not address the use of asset sales or other means of generating capital beyond issuing new common stock. According to one FRB official, “We designed the [1-for-2] with an option for a partial [repayment] specifically to allow a firm to begin getting out while we do the capital assessment work that needs to be done.” The guidance also provided that institutions *may* be allowed to repay subject to the 1-for-2 provision. According to regulators, the caveat was included to suggest that some of the remaining SCAP institutions would need to raise additional capital. Similar to the guidance issued in June 2009, the November 2009 guidance also addressed the institutions’ ability to lend, their access to equity markets, their ability to issue debt, their capital adequacy, and their ability to serve as a source of financial and managerial strength to subsidiaries.

Figure 4 summarizes the SCAP-specific repayment guidance issued by Treasury and FRB from May 2009 through November 2009, which are reproduced in full in Appendix C and Appendix D, respectively.

⁴¹Issuing new common equity typically refers to offering new common stock in equity markets.

FIGURE 4
SUMMARY OF TARP REPAYMENT GUIDANCE TO SCAP INSTITUTIONS

May 2009 – Treasury FAQs on CPP Repayment

In addition to demonstrating to regulators their overall soundness, capital adequacy, and ability to lend, the 19 institutions that were subject to the SCAP stress tests must meet the following criteria in order to repay CPP:

1. Maintain a post-repayment capital base at least consistent with the SCAP buffer; and
2. Demonstrate their financial strength by issuing senior unsecured debt for a term greater than five years not backed by FDIC guarantees.

June 1, 2009 – FRB Guidance for Repayment by SCAP Institutions

A SCAP institution will become eligible to repay TARP only once it has met the SCAP capital requirements and submitted a description of its internal capital assessment, planning, and management processes. The following will inform the decision-making process for the 19 institutions that participated in SCAP:

1. Whether the institution can repay and remain in a position to fulfill its role as an intermediary that facilitates lending to creditworthy households and businesses;
2. Whether, after repayment, the institution will be able to maintain capital levels consistent with the SCAP buffer, supervisory expectations, industry norms and historical levels for the firm, including its own internal capital targets;
3. Whether the institution has demonstrated access to common equity through public issuance in equity capital markets and demonstrated the ability to raise a significant amount of unsecured senior debt without reliance on Government guarantees;
4. Whether the institution and its bank subsidiaries will be able to meet obligations to counterparties, as well as ongoing funding requirements; and
5. Whether the institution will be able to continue to serve as a source of financial and managerial strength and support to its subsidiary bank(s) after repayment.

November 3, 2009 – FRB Clarifying Guidance for Repayment by SCAP Institutions

In addition to the requirements outlined in the June guidance, remaining SCAP institutions may be permitted to redeem TARP capital subject to:

1. Submitting a plan detailing how the institution plans to repay TARP capital; and
2. Satisfying one of the following conditions. Either:
 - a. Issue new common equity worth 50% of the amount of TARP capital the institution is seeking to repay; or
 - b. Wait until supervisors have completed a review of the institution's longer-term capital planning processes.

Sources: Office of Financial Stability ("OFS") and FRB.

The 1-for-2 provision placed stricter repayment standards on the remaining SCAP institutions compared to those that exited in June 2009. Former FRB Vice Chairman Kohn told SIGTARP that regulators "wanted to toughen it up a little because the next set of banks were almost by definition less strong than the first set. Otherwise, they would've repaid right away," noting that the remaining

banks “demonstrated that they needed more oversight.” An FRB official also noted that 1-for-2 was not an arbitrarily selected ratio, and that the stress tests conducted earlier in the year provided FRB with insight on the amount of capital required to secure the remaining SCAP institutions in worse-than-expected market conditions. These assertions are supported by FRB analysis conducted as the guidance was being developed. The analysis showed that the remaining SCAP institutions’ Tier 1 Common ratios – the indicator markets and regulators were primarily concerned with – were significantly lower than those of the institutions that exited in June 2009.

Although the November 2009 guidance specified that the remaining SCAP institutions were required to issue at least half (1-for-2) of the amount they sought to repay in common stock, regulators later approved repayments under terms that included somewhat smaller offerings, supplemented with capital raised through a combination of proceeds from other sources, such as asset sales. Senior FDIC officials told SIGTARP that the terms of some repayments ran contrary to language specifying that the required capital raise would consist only of new common stock. Then-Chairman Bair expressed frustration over the reliance on asset sales and employee stock issuances to meet the 1-for-2, referring to those sources of capital as “gimmicks,” in part because unlike new common stock they did not provide market validation of the firm’s strength. Regulators ultimately decided to relax the terms of the existing guidance to allow asset sales and other forms of capital count toward the 1-for-2, but to count those types of capital less than new common stock.

As of June 30, 2011, seven institutions had repaid TARP funds pursuant to the November 2009 guidance: Bank of America repaid CPP and TIP in December 2009; Citigroup repaid TIP in December 2009; Wells Fargo repaid CPP in December 2009; PNC repaid CPP in February 2010; Fifth Third repaid CPP in February 2011; and both KeyCorp and SunTrust repaid CPP in March 2011.

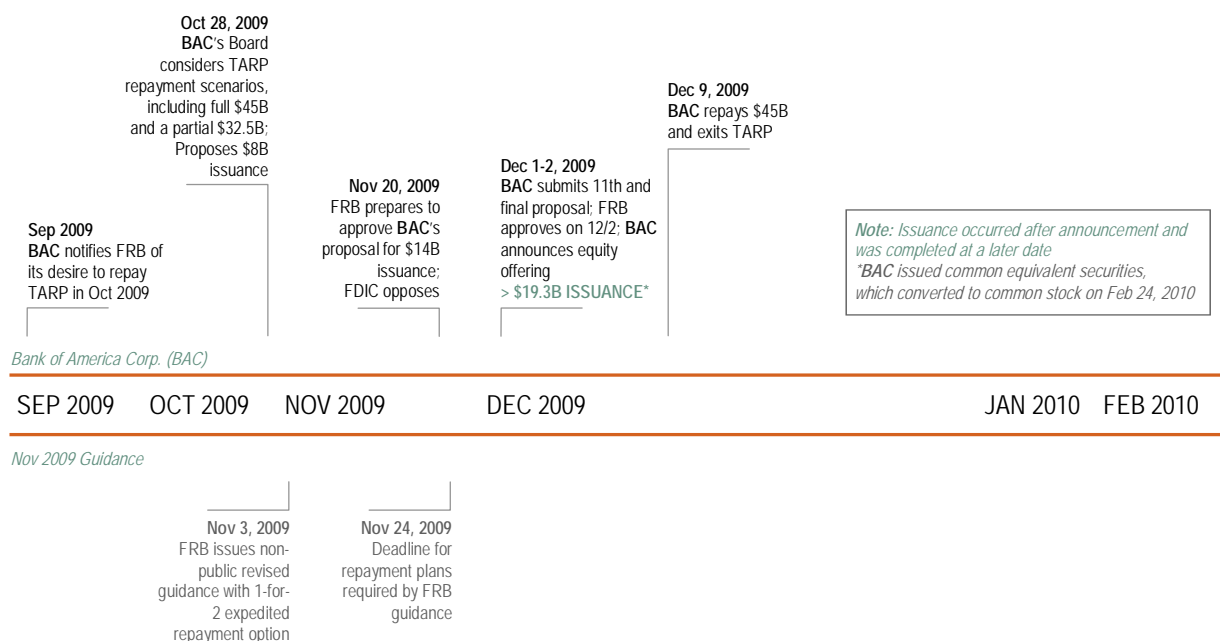
Bank of America's TARP Exit

To exit TARP immediately in compliance with the 1-for-2 provision outlined in the November 2009 guidance, Bank of America was required to issue \$22.5 billion in new common equity before being allowed to repay its \$45 billion TARP preferred stock.

Despite the plain terms of the repayment guidance, from November 4, 2009, through December 1, 2009, Bank of America submitted 11 repayment proposals (10 for full repayment and one for partial repayment), with each falling short of the 1-for-2 provision and including other sources of capital in place of newly issued common stock. There was considerable discussion among the regulators and Treasury regarding how much common stock Bank of America could successfully issue and whether partial repayments and an exit from TARP in multiple stages could be a viable alternative to a full repayment and an immediate exit. Bank of America was adamant that it needed to repay in full and immediately exit TARP, citing concerns including market perception and restrictions established by the Special Master for TARP Executive Compensation. As the negotiations progressed, FRB, OCC, and Treasury became increasingly more comfortable with permitting other sources of capital as a substitute for meeting the 1-for-2 provision in the repayment guidance, while FDIC pushed hard to maintain the strict requirement, as originally established, that the 1-for-2 provision apply only to new common stock. Figure 5 shows the timeline of key events related to Bank of America's repayment and exit from TARP.

FIGURE 5

KEY TARP REPAYMENT EVENTS FOR BANK OF AMERICA (BAC)



Sources: SIGTARP, OFS, FRB, OCC, and Bank of America.

Bank of America approached FRB and Treasury early in fall 2009, before the November 2009 guidance was issued, to inquire about repaying Treasury’s investment and exiting TARP. On September 11, 2009, then-CEO Kenneth Lewis met with Secretary Geithner in Washington at the CEO’s request. According to Mr. Lewis, he told Secretary Geithner that Bank of America wanted to begin repayment discussions, and the Secretary replied that Bank of America would need to “raise a lot of equity” to exit TARP.

On October 28, 2009, senior executives at Bank of America presented three potential TARP repayment scenarios to its board of directors. Two of the three scenarios envisioned a partial TARP repayment during the fourth quarter of 2009 and a phased exit from TARP. The third scenario envisioned repaying the full \$45 billion in preferred stock and immediately exiting TARP during the fourth quarter of 2009. To provide some

of the capital for the full repayment, Bank of America proposed to issue \$8 billion in new common stock and \$4 billion in trust preferred securities. During this

Trust Preferred Securities

Securities with both equity and debt characteristics, created by establishing a trust and issuing debt to it.

Pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act, trust preferred securities issued after May 19, 2010, by a bank or thrift holding company with more than \$500 million in assets will no longer count as Tier 1 Capital.

meeting, Bank of America's board formally authorized senior executives to hold discussions with the Government about repaying Treasury and exiting TARP.

Bank of America Submitted Proposals to Exit TARP Immediately After FRB Issued Revised Guidance in November 2009

The guidance FRB issued on November 3, 2009, required Bank of America to issue \$22.5 billion in new common stock to be eligible for full and immediate TARP repayment under the 1-for-2 provision.⁴² Through this provision, Bank of America could also repay in part and exit TARP in multiple stages. Alternatively, the institution could wait and repay TARP once supervisors completed a satisfactory review of the bank's longer-term capital plans.

On November 4, 2009, the day after FRB issued the revised guidance, Bank of America indicated its preference to repay TARP in full and immediately exit. A former Bank of America executive told SIGTARP that repaying in full and exiting TARP immediately was preferable because a partial repayment would not address the uncertainty in the market associated with the bank's continued participation in TARP.

Bank of America Proposal 1 (Nov. 4, 2009)

- \$9.25 billion common issuance
- \$4.0 billion trust preferred securities

Rather than seek approval through the 1-for-2 provision, however, Bank of America asked FRB to expedite its review of Bank of America's longer-term capital plan and, subject to satisfactory completion of that review, allow the bank to repay its full TARP investment (including warrants) and exit TARP immediately. To fund the repayment, Bank of America proposed to issue \$9.25 billion in new common stock, \$4 billion in trust preferred securities, and use \$33.75 billion in existing liquidity. However, because Bank of America's initial repayment proposal failed to improve the bank's capital position, FRB rejected it.

During the week of November 9, 2009, FRB and OCC examiners conducted an abridged review to gauge Bank of America's internal capital assessment and planning processes. Examiners concluded that while the bank had improved these processes, any TARP repayment proposal outside of the 1-for-2 provision would need to be

Bank of America Proposal 2 (Nov. 12, 2009)

- \$12.7 billion common issuance
- \$5.0 billion trust preferred securities

⁴² A \$22.5 billion public issuance and repayment of \$45 billion in TARP funds represents \$1 of new common stock for every \$2 repaid, the minimum ratio required by the guidance. Then-Chairman Bair told SIGTARP that although it was not discussed during meetings about the guidance, FDIC's view was that Bank of America would be required to raise somewhere between 1-for-2 and 1-for-1.

accompanied by a more complete review by FRB. According to Bank of America, regulators indicated that a complete review of the bank's longer-term capital plans could take up to four months. Instead, Bank of America prepared a second repayment proposal, which sought expedited repayment through the 1-for-2 provision. On November 12, 2009, Bank of America submitted the proposal to FRB, requesting to fully repay the \$45 billion in TARP funds and immediately exit by issuing \$12.7 billion in common stock, \$5 billion in trust preferred securities, and using existing liquidity. The terms proposed still fell short of the requirements established under the 1-for-2 provision.

On November 13, 2009, FRB received two new repayment proposals from Bank of America – one requesting a full \$45 billion repayment and immediate TARP exit, and the other proposing a partial repayment of \$35 billion followed by an exit from TARP in stages. The latter proposal hinged on Treasury committing to remove Bank of America's exceptional assistance designation⁴³ after the partial repayment. The exceptional assistance designation imposed additional

Bank of America Proposals (Nov. 13, 2009)	
<p>Proposal 3 (\$45B repayment)</p> <ul style="list-style-type: none"> • \$12.7 billion common issuance • \$5.0 billion trust preferred securities • \$1.5 billion asset sales 	<p>Proposal 4 (\$35B repayment)</p> <ul style="list-style-type: none"> • \$7.7 billion common issuance • \$5.0 billion trust preferred securities • \$1.5 billion asset sales

restrictions on the bank, including subjecting it to heightened executive compensation restrictions under the purview of the Special Master for TARP Executive Compensation. Bank of America executives told SIGTARP that removal of this designation, and the accompanying executive compensation restrictions, was just one of many factors influencing their decision to seek repayment. FRB viewed both proposals as insufficient because they failed to meet the 1-for-2 provision.

⁴³ Institutions deemed by Treasury to have received exceptional financial assistance are those that participated in the Systemically Significant Failing Institutions Program, Targeted Investment Program, Automotive Industry Financing Program, or any future Treasury program designated by the Secretary as providing exceptional assistance. This designation subjects institutions to additional reporting requirements and certain restrictions, including restrictions on executive compensation. For more detail, see SIGTARP's June 2010 audit report, "Treasury's Monitoring of Compliance with TARP Requirements by Companies Receiving Exceptional Assistance."

As Bank of America Submitted Additional Proposals, OCC and Treasury Indicated Support for Proposals that Fell Short of the 1-for-2 Provision

On November 16, 2009, Bank of America submitted a fifth repayment proposal, seeking to repay the full \$45 billion and immediately exit by issuing \$13 billion in new common stock equivalent,⁴⁴ \$5 billion in trust preferred securities, \$1.7 billion in stock to employees in lieu of paying cash bonuses, applying proceeds from \$5.3 billion in asset sales, and using existing liquidity. Because Bank of America shareholders would need to authorize additional shares to permit the institution to issue the \$13 billion in common stock, the bank proposed issuing a common stock equivalent and incentivizing shareholders to later vote for its conversion to common stock. While the proposal would significantly increase Bank of America's Tier 1 Common ratio, it was still inconsistent with the 1-for-2 provision, and regulators considered whether its approval would set a precedent for the remaining SCAP institutions.

Bank of America Proposal 5 (Nov. 16, 2009)

- \$13.0 billion common issuance
- \$5.0 billion trust preferred securities
- \$5.3 billion asset sales
- \$1.7 billion employee stock compensation

Nevertheless, Bank of America submitted a sixth full repayment and immediate exit proposal to FRB on November 17, 2009, increasing the common stock it proposed to issue to \$14 billion, the proceeds from asset sales to \$6.8 billion, and removing the trust preferred securities altogether. Although the 1-for-2 provision was designed to apply only to new common stock, after receiving this proposal, FRB considered relaxing the guidance to allow for the inclusion of other sources of capital. Regulators discussed how to count asset sales in the 1-for-2 guidance, but did not accept this proposal.

Bank of America Proposal 6 (Nov. 17, 2009)

- \$14.0 billion common issuance
- \$6.8 billion asset sales
- \$1.7 billion employee stock compensation

⁴⁴ Common stock equivalent is an interim security that converts to common stock upon shareholder approval. The terms of Bank of America's common stock equivalent also provided that, if sufficient shares of common stock had not been authorized within 105 days of the issuance of the common stock equivalent, the dividend on the common stock equivalent would have increased from the rate on common stock to 10%, and continued to increase by 2% each quarter thereafter until the rate reached 16%.

Bank of America submitted another full repayment proposal the following day. Without increasing the amount of common stock the bank proposed to issue, the proposal submitted on November 18, 2009, added back \$2.5 billion of the trust preferred securities and increased the proposed proceeds from asset sales to \$8.8 billion.⁴⁵ Later that day,

**Bank of America Proposal 7
(Nov. 18, 2009)**

- \$14.0 billion common issuance
- \$2.5 billion trust preferred securities
- \$8.8 billion asset sales
- \$1.7 billion employee stock compensation

OCC cited the proposed repayment's positive impact on the institution's capital and liquidity, additional savings from no longer paying TARP dividends, increased managerial flexibility, and client stabilization. OCC internally stated that the proposal "meets all technical requirements" established by regulators. Former Comptroller Dugan explained that OCC viewed the 1-for-2 provision as "a fine benchmark, but not an ironclad requirement," and was concerned that institutions might miss a window of strong investor demand for financial stocks if regulators held the line on repayment requirements that were, in his view, "too rigid." After reviewing the proposal, Treasury also advised FRB to move forward on Bank of America's TARP repayment. FRB and FDIC continued discussions about whether to allow asset sales into the 1-for-2 provision. According to FRB, Treasury provided input that asset sales should count at a 1-for-1 ratio, meaning that a bank could redeem \$1 of TARP for every \$1 generated by an asset sale up to a predetermined cap.

FDIC Maintained Its Opposition as Bank of America Submitted Its Eighth and Ninth Proposals, While Regulators Debated the Feasibility of a \$22.5 Billion Common Stock Issuance

Bank of America submitted an eighth proposal to FRB on November 20, 2009, that offered to issue an additional \$1 billion in trust preferred securities beyond the terms previously proposed. FDIC learned that FRB was prepared to approve this most recent TARP repayment request. Then-Chairman Bair wrote, "Well, we will have to oppose this and so notify the bank." She told SIGTARP she was frustrated that the proposal did not meet the expedited repayment terms that regulators had agreed to.

**Bank of America Proposal 8
(Nov. 20, 2009)**

- \$14.0 billion common issuance
- \$3.5 billion trust preferred securities
- \$8.8 billion asset sales
- \$1.7 billion employee stock compensation

FRB and FDIC then engaged in conversations about how much capital the market could absorb. Bank of America asserted that it would not be able to successfully fill a \$22.5 billion common stock offering, and that a partial repayment would

⁴⁵ Bank of America also proposed to reduce the amount of assets sold by twice the amount of any common stock issued in excess of \$14 billion.

also not be feasible. According to the bank, it was concerned that a partial repayment might lead investors to suspect that regulators had additional credit concerns or that additional repayments would require another equity offering. While some within FRB remained unconvinced, according to an FRB governor, Treasury was also inclined to believe that issuing \$22.5 billion was “out of reach or that it risks a failed offering – a very bad outcome.” When asked about this concern, a senior Treasury official told SIGTARP that a determination on what the market could bear was “always a judgment call” because “there were lots of moving parts, and it wasn’t black and white.”

On November 21, 2009, then-Chairman Bair acknowledged that Bank of America might have to accept dilution and sell its stock at a discount to augment the size of the proposed offering, but noted “that should not be our concern.” She further stated, at that time, that if Bank of America could not meet the 1-for-2 minimum, “then that reflects market weakness which just validates the view that they aren’t yet strong enough to exit.” She later told SIGTARP that “the argument [FRB and OCC] used against us – which frustrated me to no end – is that [Bank of America] can’t use the 2-for-1 because they’re not strong enough to raise 2-for-1. That just mystified me. The point was if they’re not strong enough, they shouldn’t have been exiting TARP.” She added that “with TARP being over, Treasury couldn’t come back in,”⁴⁶ and FDIC was concerned about its exposure to Bank of America through its deposit insurance fund and the institution’s participation in TLGP. Then-Chairman Bair was also concerned in late November 2009 that acceptance of the proposal would have repercussions with other TARP banks seeing the Government as loosening its repayment standards and expecting a similar deal. She added, at the time, that “none of us liked the TARP program but let’s not compound the error now by allowing a weak institution to prematurely exit.”

FRB Governor Tarullo told SIGTARP that the issue was not about the strength of Bank of America, but was really about “how much could the market absorb.” Regulators sought the input of Wall Street advisors. Governor Tarullo told SIGTARP that despite bringing in these advisors, “nobody could be certain” how much Bank of America could successfully issue and that FRB “had to make a judgment as to some amount, which would be difficult to pull off.” FRB Governor Kohn told SIGTARP that FRB wanted to push Bank of America to issue as much new common stock as the market would allow, but there was a feeling “that if they went out for something and didn’t get it, it would be a vote of no confidence.” He added that “it was better to go out for a little less and top it off” by exercising the overallotment option. Officials from OCC and Treasury also told SIGTARP that requiring Bank of America to issue \$22.5 billion in new common stock – the largest ever common stock offering in the U.S. – would have risked a failed equity offering, potentially destabilizing the firm and threatening

⁴⁶ On December 9, 2009, one week after FRB approved Bank of America’s final repayment proposal, Secretary Geithner extended Treasury’s authority to commit TARP funds until October 3, 2010, pursuant to section 120 of EESA. Without the extension, Treasury’s authority would have terminated on December 31, 2009.

confidence in the broader financial system. FRB Governor Tarullo added that “it was not in anyone’s interest, not the firms, not Treasury, or the financial system to have one firm go out and fail to get the amount in question.”

Meanwhile, on November 23, 2009, Bank of America submitted its ninth proposal to FRB to repay TARP in full and immediately exit, increasing the size of the proposed common stock offering to \$15 billion, and adjusting the amount of trust preferred securities and the proceeds it proposed to generate through asset sales. On

November 25, 2009, two Bank of America directors met with then-Chairman Bair to discuss exiting

TARP. Former Bank of America CEO Kenneth Lewis told SIGTARP that it was important to receive FDIC’s approval to exit TARP. Mr. Lewis said that the understanding within Bank of America was that “for all practical purposes” Bank of America’s TARP exit “wouldn’t go forward without [FDIC’s] support.” Then-Chairman Bair told SIGTARP that while FDIC “had no legal standing on this,” the regulator had “implicit leverage...to weigh into the process” that is built into agency relationships.

**Bank of America Proposal 9
(Nov. 23, 2009)**

- \$15.0 billion common issuance
- \$4.0 billion trust preferred securities
- \$7.6 billion asset sales
- \$1.7 billion employee stock compensation

At the meeting, the two Bank of America directors briefed then-Chairman Bair on the bank’s operating condition, including its need to repay TARP in order to complete a successful CEO search. She reaffirmed FDIC’s position that 1-for-2 was the minimum requirement. According to Bank of America, she also offered as an alternative to arrange an interagency agreement to allow for a partial TARP repayment and the bank’s removal from the exceptional assistance designation. FDIC told SIGTARP that partial repayment and limited relief from employment restrictions for the purpose of recruiting a new CEO would have been preferable to a TARP repayment that was inconsistent with the 1-for-2 provision.

Regulators Sought Advice and Consensus on the Amount of Common Stock Bank of America Could Issue

On November 25, 2009, all three regulators held a conference call with the outside advisors to Bank of America and FRB to discuss differing views of the amount of common stock that Bank of America would be able to successfully issue in the market. That same day, financial markets were rattled by an announcement that the Government of Dubai’s flagship holding company would seek to postpone debt payments. The resulting uncertainty further complicated discussions about the timing and size of Bank of America’s proposed raise.

Because no one could predict how the market would react to various issuance targets, on November 29, 2009, regulators began to discuss a “best efforts” plan in which Bank of America would try to raise as much common stock as possible

such that any remaining TARP capital would be repaid through other means. Regulators would push for as much issuance of common stock as the market would bear, and any shortfall could be replaced with trust preferred securities and asset sales through an agreed-upon path to exit over time.

On November 30, 2009, Bank of America reasserted that only a plan that would get it out of TARP entirely through one lump sum repayment was feasible. An FRB official noted to SIGTARP that the option built into the November 2009 guidance that allowed for a partial repayment and multi-staged exit from TARP turned out to be impractical for some firms, in part because customers and investors believed that TARP participation carried a stigma. FRB Governor Tarullo reiterated this point, telling SIGTARP, “It was a binary situation where markets were going to view firms as out of the Government embrace or not.”

FRB Approved Bank of America’s 11th and Final Proposal After Reaching Agreement with FDIC on the Terms

On December 1, 2009, Bank of America submitted its 10th proposal to FRB, this time to repay TARP in full and immediately exit by issuing \$18.8 billion in common stock, \$4 billion in trust preferred securities, and \$1.7 billion in common stock to employees. FDIC did not believe that Bank of America should get any credit for trust preferred securities because, in its view, trust preferred securities had proven not to have the loss absorbing capacity of common equity, and the guidance clearly called for new common equity. Regulators ultimately determined that it would be preferable to count some amount of prospective asset sales, if backed by a commitment to raise additional common stock to the extent that the asset sales were not completed.

Bank of America Proposal 10 (Dec. 1, 2009)

- \$18.8 billion common issuance
- \$4.0 billion trust preferred securities
- \$1.7 billion employee stock compensation

Bank of America Proposal 11 (Dec. 1, 2009)

- \$18.8 billion common issuance
- \$4.0 billion asset sales
- \$1.7 billion employee stock compensation

Later on December 1, 2009, Bank of America submitted an 11th and final proposal, replacing the trust preferred securities with asset sales to be completed by December 31, 2010. The institution now proposed to repay the full \$45 billion TARP commitment and immediately exit by issuing \$18.8 billion in common stock, \$1.7 billion in common stock to employees, and committing to enter into binding contracts to sell assets by June 30, 2010, that would generate an additional \$4 billion in common equity by December 31, 2010, backstopped by common stock, and using existing liquidity.

The amount of common stock Bank of America eventually agreed to issue was more than twice the amount the institution initially proposed. Mr. Lewis told SIGTARP that each proposal Bank of America submitted was a “reasonable proposal” and that the institution was not “low-balling” as a tactic in negotiations. FDIC officials, however, told SIGTARP that in their view Bank of America’s outside advisor did low-ball its estimate of the amount the institution would be able to raise through an equity offering. Then-Chairman Bair told SIGTARP that FDIC eventually agreed to the 11th proposal after Bank of America officials made a verbal commitment to her that the bank would raise equity through an overallotment option in accordance with the 1-for-2 provision rather than rely on earnings from the asset sales.

On December 2, 2009, FRB approved Bank of America’s repayment proposal and Bank of America issued a press release detailing the terms of its exit from TARP. Bank of America’s common stock offering on December 4, 2009, raised \$19.3 billion, though the overallotment option was never exercised, and Bank of America repaid Treasury’s \$45 billion TARP investment in full on December 9, 2009. Then-Chairman Bair told SIGTARP that the offering was “oversubscribed” and said that FDIC was “disappointed” that the will was not there to issue additional common stock. She added, “They could’ve gotten the whole thing” and met the requirement to raise \$22.5 billion in new common stock in accordance with the 1-for-2 provision as originally designed. Governor Tarullo told SIGTARP that once Bank of America raised this “enormous amount of capital,” other TARP recipients thought that maybe they too should “go down this path” and raise equity in a sufficient amount to repay TARP in full and immediately exit.

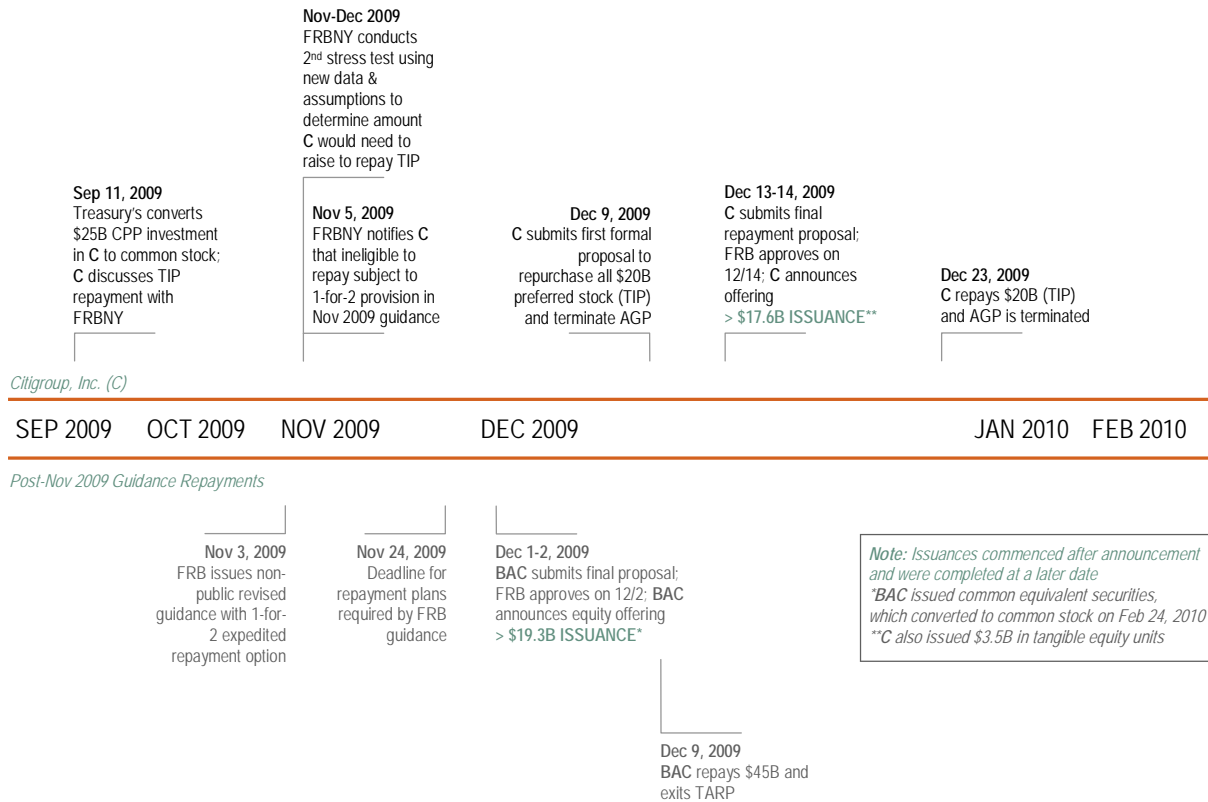
Bank of America increased its common stock issuance by \$500 million from \$18.8 billion to \$19.3 billion, still short of the \$22.5 billion called for by the 1-for-2 guidance. As a result, the amount of additional capital it was required to raise in 2010 decreased from \$4 billion to \$3 billion. Realizing that it would not meet a June 30, 2010, interim deadline to enter binding contracts, Bank of America requested that FRB waive the interim deadline and use more favorable accounting rules that were in place at the time the repayment agreement was signed to credit the proceeds from asset sales. FRB agreed to waive the interim deadline, but maintained the requirement that all asset sales be completed according to current accounting rules by December 31, 2010. On November 15, 2010, Bank of America reported to the Federal Reserve Bank of Richmond (“FRB Richmond”) that it would generate more than \$3.1 billion in post-tax profit with the completion of an asset sale on November 23, 2010. At that point, nearly one year after its exit, Bank of America satisfied the terms agreed to during the institution’s exit from TARP in December 2009.

Citigroup's TARP Exit

The Conversion of Treasury's CPP Investment to Common Stock, Citigroup's Repayment of TIP, and Treasury's Sale of Its Citigroup Common Stock

This section details the events leading to Citigroup's repayment of and exit from TARP. Citigroup's TARP exit proceeded differently from the other institutions discussed in this report, largely because Citigroup converted Treasury's \$25 billion CPP investment from preferred stock to common stock. While Treasury's \$20 billion TIP investment in Citigroup remained subject to repayment procedures similar to those pertaining to other SCAP institutions, Citigroup was required to raise additional capital beyond the minimum established by the November 2009 guidance. The SIGTARP report, "Extraordinary Financial Assistance Provided to Citigroup, Inc.," issued on January 13, 2011, describes in detail the process by which Citigroup sought to and ultimately repurchased the TIP trust preferred securities, as well as the trust preferred securities held by Treasury pursuant to AGP, and thus exited those aspects of its participation in TARP. In addition to summarizing the relevant events described in that report, this section adds several additional details. Figure 6 below shows the timeline of key events related to Citigroup's repayment and exit from TARP.

FIGURE 6
KEY TARP REPAYMENT EVENTS FOR CITIGROUP (C)



Sources: SIGTARP, OFS, FRB, Citigroup, and Bank of America.

As Citigroup’s share price continued to decline in late 2008 and early 2009, regulators recognized that concerns persisted about the quality of the institution’s capital. According to OCC examiners, the market viewed the \$45 billion of TARP preferred equity Citigroup received as the equivalent of debt, and wanted Citigroup to be infused with more common equity. Citigroup approached regulators to discuss such an infusion, and FRB began to analyze alternatives to bolster Citigroup’s common equity levels – specifically its Tangible Common Equity (“TCE”).⁴⁷ Treasury and regulators decided to focus on converting Treasury’s preferred stock to common stock.

In addition to converting the preferred stock held by Treasury, regulators also advocated for Citigroup to incentivize private shareholders to convert their preferred stock to common stock. FDIC suggested that Citigroup suspend the dividends the institution paid to its private preferred shareholders in order to do so. Citigroup, for its part, worked to obtain commitments from private investors

⁴⁷ TCE, as defined by Citigroup, represents common equity minus goodwill and intangible assets, other than Mortgage Servicing Rights, net of related deferred taxes. Other companies may calculate TCE differently.

to convert their preferred stock to common stock, pending Treasury's agreement to also convert its investment.⁴⁸

Citing the “urgency of the situation” and the potential ramifications of not completing the exchange offer, Treasury's Investment Committee⁴⁹ advised Secretary Geithner to participate in the offer under the condition that Treasury's involvement was contingent upon an unspecified amount of private-sector participation.⁵⁰ According to a memorandum prepared by Treasury's Investment Committee on February 26, 2009, taking no action to convert the Citigroup investment to common stock could have hastened the deterioration of Citigroup and reverberated throughout the U.S. economy, contributing materially to weaker economic performance and higher unemployment.

Treasury's CPP Investment Was Converted from Preferred Stock to Common Stock, Making Treasury Citigroup's Single Largest Common Stock Holder

On February 27, 2009, Treasury and Citigroup publicly announced the exchange offer. Citigroup also agreed to exchange up to \$27.5 billion of existing private preferred and trust preferred stock to common stock.⁵¹ Through a press release, Citigroup CEO Vikram Pandit announced that the singular goal of the exchange was to increase the institution's TCE from the fourth quarter 2008 level of \$29.7 billion to as much as \$81 billion.

Citigroup's stock price stabilized shortly after the exchange was announced, but the transaction could not be completed before the execution of an agreement between Treasury and Citigroup on June 9, 2009. On July 23, 2009, and July 30, 2009, Treasury converted its \$25 billion in Citigroup preferred stock to common stock equivalent, an interim security that would convert to common stock upon authorization.

⁴⁸ A Citigroup executive sent an email to Secretary Geithner on February 21, 2009, stating that Citigroup had \$15 billion of private preferred stock “ready to convert” should Treasury agree to convert some of its investment. The executive also indicated that the proposed conversion, combined with asset sales, would boost the institution's TCE to a satisfactory level “without having the [U.S. Government] own too much of Citi.”

⁴⁹ Treasury's TARP Investment Committee was created to serve as a decision-making body to approve the investment decisions made under TARP authority. The Investment Committee consists of TARP's Chief Investment Officer and senior Treasury officials from financial markets, economic policy, financial institutions, and financial stability.

⁵⁰ Treasury would assume additional risk by converting the preferred securities it held to more junior common equity, and forgo revenue from dividend payments owed to Treasury under the CPP preferred investment agreement. Treasury also agreed to exchange the preferred stock issued under TIP and AGP for trust preferred securities with the dividend rate on the new securities remaining unchanged. The final term sheet specified that Treasury would convert an amount of preferred stock equal to the amount converted by private equity holders, up to the \$25 billion issued under CPP, provided that private equity holders converted at least \$11.5 billion worth of preferred stock.

⁵¹ Citigroup would later increase the amount of the exchange offer to \$33 billion to meet the regulatory requirements announced with the results of the SCAP stress tests.

Around this time, FDIC expressed concern about Citigroup's management and its liquidity. In response to these concerns, Citigroup assured regulators that it would take specific action to strengthen its supervisory oversight of the bank's management and undergo a management review conducted by an independent third party consultant agreed to by all the regulators. Then-FDIC Chairman Bair told SIGTARP that some of the promises Citigroup made were "half-filled." While she said she was pleased with some of the management changes that resulted from the review, she added that she "thought there would have been more changes at the top." However, according to OCC, the independent management review was consistent with Citigroup's assurances, and then Comptroller Dugan told SIGTARP that he was unaware of any unfulfilled promises.

The common stock equivalent Treasury received in late July 2009 ultimately converted to approximately 7.7 billion shares of common stock at \$3.25 per share on September 11, 2009. At the time, Treasury became the largest single shareholder of Citigroup, holding approximately 33.6% of Citigroup common stock.⁵² The conversion would ultimately affect Citigroup's exit from CPP because the guidance outlining the process and criteria whereby SCAP institutions were permitted to repurchase TARP preferred shares did not apply to Treasury's common stock investment in Citigroup. Instead – unlike the other SCAP institutions that received CPP funds – Citigroup's exit from the program was dependent upon Treasury selling the common stock it held to the public market. Treasury ultimately sold its Citigroup stock into the market from April 26, 2010, through December 10, 2010.

Citigroup Sought to Repay TIP and Regulators Debated the Amount and Composition of the Capital Citigroup Would Be Required to Raise

After converting its CPP investment in Citigroup to common stock, Treasury still held the \$20 billion in trust preferred securities invested through TIP. Citigroup was permitted to repurchase this investment subject to approval from FRB, the holding company's primary Federal regulator.⁵³ On September 11, 2009 – the same day the CPP conversion was completed – Citigroup CEO Pandit met with Federal Reserve Bank of New York ("FRBNY") President William Dudley to discuss repaying TIP and terminating the ring-fence guarantee provided by the Government through AGP. During the meeting, Citigroup presented its financial condition, including the results of an internal stress test.

⁵² The agreed-upon price per share was based on the average of Citigroup's stock price over the previous 20 days.

⁵³ As noted above, the SIGTARP report, "Extraordinary Financial Assistance Provided to Citigroup, Inc.," January 13, 2011, describes in detail the process by which Citigroup sought to and ultimately did repurchase the TIP trust preferred securities, as well as the trust preferred securities held by Treasury pursuant to AGP, and thus exited those aspects of its participation in TARP.

FRBNY concluded that the information provided by Citigroup about its financial condition was insufficient to determine whether or not Citigroup was in a condition to repay TIP and terminate AGP. FRB later told Citigroup to wait until the agency issued revised guidance to remaining SCAP institutions on TARP repayment. FDIC also conducted an independent analysis of Citigroup's planning and forecasting processes and identified many of the same issues identified by FRBNY.

Nonetheless, regulators continued to discuss Citigroup's condition and prospects for repaying Treasury's \$20 billion TIP investment and terminating AGP. According to FRB Governor Tarullo, given Citigroup's "travails, its challenges," regulators would "treat them differently than a lot of institutions." He added that Citigroup would have to raise more capital, "way beyond 1-for-2." According to FDIC, regulators had agreed during the late October meetings that Citigroup would need to raise a minimum of \$1 in capital for every \$1 in TARP funds it repaid. OCC also stated that all regulators understood that Citigroup would be held to a higher standard, up to 1-for-1, though neither then-Comptroller Dugan nor OCC staff recalled a formal agreement during the late October meetings establishing such a requirement.⁵⁴

While discussing Citigroup's capital needs, regulators moved closer to issuing the November 2009 repayment guidance to all SCAP institutions. However, some Treasury and FRB officials were concerned that publicizing the guidance might stigmatize Citigroup because the institution would not be eligible to exit subject to the 1-for-2 minimum provision allowing consideration for expedited repayment. According to a former senior Treasury official, the concern within Treasury "was all about confidence and stability," with officials wary of taking any action that might destabilize an institution. Similarly, an FRB governor told SIGTARP that "if ultimately we're saying those that are repaying are healthy, then we're implicitly saying that those that won't aren't." FRB decided to issue the revised guidance non-publicly.

On November 5, 2009, an FRBNY official met with Citigroup CEO Pandit and Citigroup's Chief Financial Officer to discuss the revised guidance. During the meeting, the FRBNY official informed Citigroup management that the 1-for-2 provision would not apply to Citigroup. Instead, Citigroup would have to repay Treasury's \$20 billion TIP investment with a larger proportion of newly raised common equity than other SCAP institutions. That amount would be subject to the results of a repayment stress test to be conducted by FRBNY, FRB, and OCC starting on November 9, 2009. The repayment stress test for Citigroup used the format and process of the original SCAP stress test, but several data inputs were updated. For example, the original SCAP stress test used Citigroup financial data

⁵⁴ A draft version of the guidance disseminated on the same day as one of the meetings held at Treasury notes that in some circumstances an institution may be required to fully offset the redemption of Treasury capital by raising \$1 of new private common equity and \$1 of new private preferred equity for every \$2 in TARP funds being repaid.

as of December 31, 2008, while the repayment stress test used financial data as of September 30, 2009. The worst-case unemployment rate used in the stress test was increased from 10.4% to 11.1% to reflect an increase in the actual unemployment rate from 8.9% in April 2009 to 10% in November 2009. While actual housing prices had risen during that period, the worst-case forecast for housing prices in the repayment stress test was maintained at the same level used in the SCAP stress test.

The stress test was not the only factor influencing the assessment of Citigroup's capital needs to exit TARP. Complicating the analysis were other variables that could impact the institution's access to capital, including a decision on whether to terminate the ring-fence guarantee provided through AGP and a decision by Treasury on whether to grant a blanket exception to a rule impacting the sale of Citigroup common stock held by Treasury. Because Citigroup would still hold CPP funds, a decision on whether the institution would remain subject to stricter compensation restrictions, including being subject to the purview of the Special Master for TARP Executive Compensation, was also pending resolution.

Announcement of Bank of America's Repayment Intensified Market Speculation About Citigroup's Repayment Plans and Citigroup Requested to Exit from AGP in Addition to TIP

As regulators discussed Citigroup's capital raise requirements, Bank of America's December 2, 2009, announcement that it would repay TARP intensified market speculation about Citigroup's repayment prospects. That day, a Citigroup executive sent news reports to OCC highlighting some of the speculation. Subsequent media reports speculated on the possibility that no repayment agreement would be reached before the end of the year. According to an FRB email, Citigroup CEO Pandit also voiced concern to a senior Treasury official that Citigroup might become stigmatized by its continued participation in TIP and wondered how to respond publicly to the news of Bank of America's exit from TARP. When asked about the conversation, the Treasury official told SIGTARP that Mr. Pandit was "concerned about being the last one in extraordinary assistance from a competitive standpoint, for recruiting employees." Mr. Pandit told SIGTARP that "having \$45 billion from the Government had no positive impact on Citigroup's image" and also confirmed that the desire to escape management compensation restrictions was a factor motivating Citigroup's desire to exit TARP.⁵⁵

In the midst of the media speculation, regulators continued to seek consensus on the composition of the capital raise that would be required of Citigroup to repay TIP. That week, Citigroup specified that the institution was requesting a

⁵⁵ As detailed in SIGTARP's report, "Extraordinary Financial Assistance Provided to Citigroup, Inc.," there were several motivations for Citigroup's decision to repay its TIP funds when it did, which included executive compensation restrictions, employee morale, and the institution's image.

simultaneous termination of the ring-fence guarantee provided through AGP. Then-FDIC Chairman Bair expressed concern about terminating the ring-fence, worrying that Citigroup's request was "all about compensation." FRB recalculated the amount Citigroup would be required to raise to reflect the additional capital offset necessary to terminate AGP. FRB determined that Citigroup would need to raise a total of \$23.1 billion in common equity to meet the 1-for-1 TIP repayment requirement and simultaneously offset the capital hit that would result from terminating the ring-fence received through AGP.

Citigroup Submitted Three Proposals to Fully Repay TIP and Terminate Its Participation in AGP

On December 9, 2009, Citigroup sent FRBNY its first formal repayment proposal. The proposal, like the two that followed on December 10, 2009, and December 13, 2009, proposed to fully repay all \$20 billion in Citigroup TIP trust preferred securities and to terminate Citigroup's involvement in AGP.

Citigroup proposed to issue \$15 billion in common stock and to supplement the raise with a \$2.25 billion overallotment option (or green shoe),⁵⁶ \$2.5 billion in tangible equity units,⁵⁷ and \$1 billion in employee stock compensation. FRBNY responded to Citigroup's proposal by informing the institution that the capital raise detailed in the proposal did not contain enough common equity.

On December 10, 2009, Citigroup submitted a second proposal, in which it proposed to increase the amount it would issue through each type of capital instrument. Citigroup now proposed to issue \$17 billion in common stock supplemented with a \$2.55 billion overallotment option, \$3.5 billion in tangible

Citigroup Proposal 1 (Dec. 9, 2009)

- \$15 billion common stock issuance
- \$2.25 billion common stock overallotment option
- \$2.5 billion tangible equity units
- \$1 billion employee stock compensation

Tangible Equity Units

Innovative financial instruments that allowed Citigroup to raise additional common equity beyond the common stock it planned to issue.

Citigroup would receive full payment for the instruments in advance in exchange for stock to be delivered in three years and interest and principal payments on a note during the intervening period. Based on a review of the instrument's characteristics, FRB agreed to permit Citigroup to treat 80% of the value of the tangible equity units as Tier 1 Capital.

⁵⁶ In this case, the overallotment option allowed the underwriters to sell up to \$2.25 billion more than the initial allotment of \$15 billion, if the initial allotment was fully subscribed.

⁵⁷ Citigroup requested that 80%, or \$2.0 billion, of the tangible equity units count toward common equity. The tangible equity units consisted of a stock purchase contract and a junior subordinated amortizing note. The stock purchase contract has a settlement date of December 15, 2012, and prior to completion of a 10:1 reverse stock split would have settled for between 25.3968 and 31.7460 shares of Citigroup common stock (between 2.5397 and 3.1746 shares post split). The amortizing notes will pay holders equal quarterly installments of \$1.875 per amortizing note, totaling a 7.5% cash payment per year for each \$100 of tangible equity units. The final payment is scheduled for December 15, 2012.

equity units, and \$1.7 billion in employee stock compensation. An FRBNY official told SIGTARP that at the time FRBNY considered the amount of capital to be adequate but was concerned that Citigroup might not be able to fill its overallotment option, which was dependent on market

demand for its stock. In light of this concern, FRBNY informed Citigroup that the next repayment proposal should include a clause stipulating actions that Citigroup would need to take in the event the overallotment option was not sufficiently exercised.

**Citigroup Proposal 2
(Dec. 10, 2009)**

- \$17 billion common stock issuance
- \$2.55 billion common stock overallotment option
- \$3.5 billion tangible equity units
- \$1.7 billion employee stock compensation

On Sunday, December 13, 2009, Citigroup submitted its final proposal to FRBNY. Unlike previous proposals, the latest proposal included capital raise conditions and the cancellation of \$1.8 billion of trust preferred securities in connection with the termination of AGP. The proposal also included an acknowledgment that “if the offering of common stock and tangible equity units [did] not generate at least \$21.3 billion of additional equity capital, the regulators would expect Citigroup to issue additional [trust preferred securities] in a ratio of \$2 for every \$1 the equity raised falls short of \$21.3 billion, subject to a minimum equity raise of \$19.8 billion, up to a maximum of \$3.0 billion of [trust preferred securities].” Citigroup would have had to fill at least \$1.5 billion of the overallotment option in order to satisfy the requirement to generate additional equity capital of \$21.3 billion.

In part to address then-FDIC Chairman Bair’s concern that the ring-fence termination was motivated by a desire to remove compensation restrictions, Treasury and regulators specified in the ring-fence termination agreement that during 2010, FRB would review the compensation of the institution’s top 30 earners, in consultation with FDIC and OCC. With this agreement in place, regulators signed off on the proposal.

**Citigroup Proposal 3
(Dec. 13, 2009)**

- \$17 billion common stock issuance
- \$2.55 billion common stock overallotment option
- \$3.5 billion tangible equity units
- \$1.7 billion employee stock compensation
- Agreement to issue additional trust preferred securities as a backstop against failing to meet equity targets

The terms of the cancellation of AGP trust preferred securities, under which \$1.8 billion was canceled, resulted from separate negotiations with Treasury.⁵⁸ The Government kept the other \$5.2 billion in Citigroup trust preferred securities as payment for its guarantee of the asset pool for one year. According to this final

⁵⁸ For further details on the termination of Citigroup’s participation in AGP, see SIGTARP’s report “Extraordinary Financial Assistance Provided to Citigroup, Inc.,” issued on January 13, 2011.

Citigroup repayment proposal, Citigroup expected a \$1.1 billion capital benefit to result from the cancellation of the \$1.8 billion in AGP trust preferred securities that the Government surrendered. With this \$1.1 billion benefit added to the expected new capital raise of \$24.05 billion, Citigroup expected its proposal would generate up to \$25.15 billion in capital.

FRB Approved Citigroup's Proposal to Fully Repay TIP and Terminate Its Participation in AGP; Treasury Sold Its CPP Investment in Citigroup

On Monday, December 14, 2009 – one day after Citigroup submitted its final proposal – FRB sent Citigroup a letter indicating FRB approved Citigroup's final request to repay the TIP capital and terminate AGP. The letter also detailed the conditions Citigroup would need to meet to exit the two programs. On Wednesday, December 16, 2009, Citigroup priced its offering and announced the details of the corresponding capital raise, which Citigroup began executing that same day.

Citigroup's common stock offering occurred nearly simultaneously with Wells Fargo's, possibly impacting market demand for Citigroup's stock. Citigroup expressed frustration that Wells Fargo issued common stock to repay TARP nearly simultaneously. Mr. Pandit told SIGTARP, "Wells Fargo was perturbing in issuing equity right before we did." He added, "Anytime you have \$20 billion in equity to raise, and you go to bank buyers and there is another large raise, of course there is an impact from that."

Ultimately, Citigroup did not meet the \$1.5 billion overallocation option necessary to satisfy the total \$21.3 billion additional equity capital requirement. Instead, the institution raised only \$600 million from the overallocation, resulting in a \$900 million capital shortfall and a need to raise at least \$1.8 billion in additional trust preferred securities during the first quarter of 2010 to meet the requirement agreed to with the regulators if the equity raise fell short.

On December 23, 2009, Citigroup, Treasury, FDIC, and FRBNY all signed the Termination Agreement for Citigroup's participation in AGP. That same day, Treasury and Citigroup also signed an agreement for the repayment of TIP. In March 2010, Citigroup raised \$2.3 billion in trust preferred securities, satisfying the capital raise requirement under the terms of its repayment proposal.

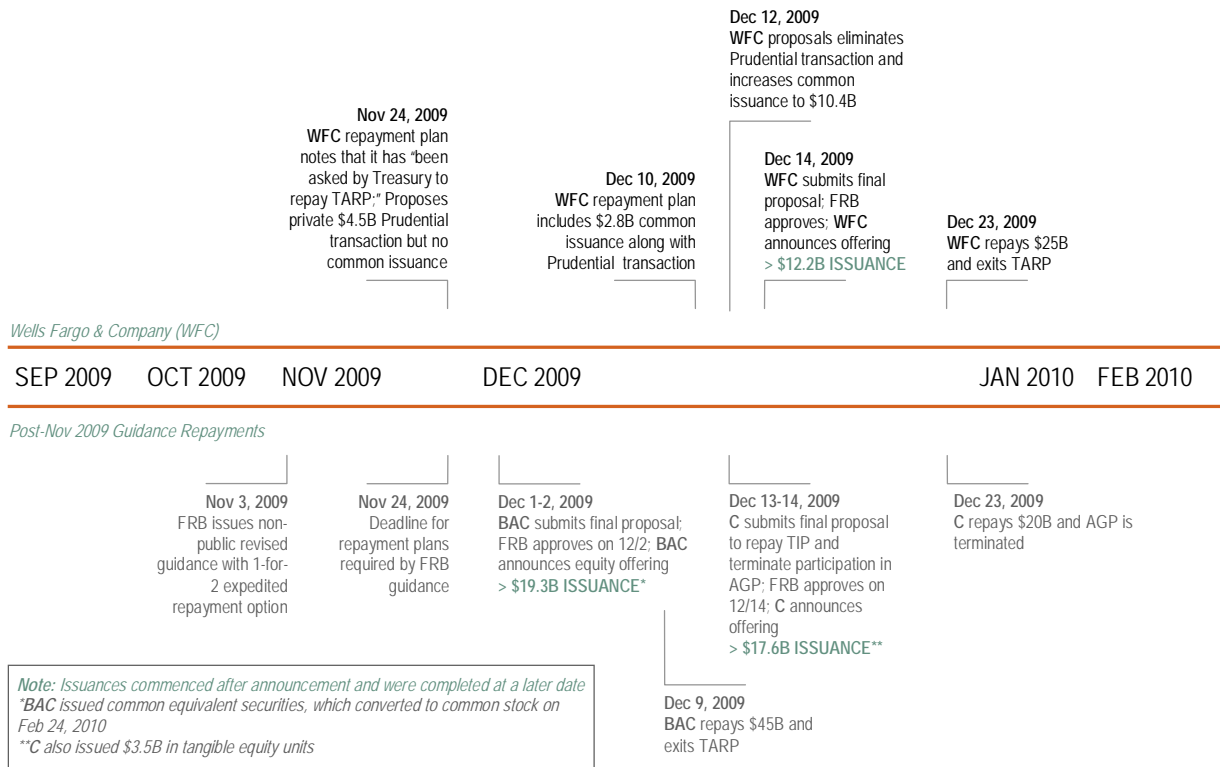
Although Treasury initially planned to sell some of its common stock investment in Citigroup concurrently with the institution's equity offering, it retained all of its CPP investment after Citigroup repaid TIP and terminated AGP. On March 29, 2010, Treasury announced that, under a prearranged written trading plan, it would sell its Citigroup common stock in an "orderly and measured" fashion over the course of 2010, subject to market conditions. Treasury ultimately sold this stock into the market from April 26, 2010, through

December 10, 2010, generating \$31.85 billion in proceeds to Treasury, or \$6.85 billion more than Treasury's original CPP investment in Citigroup. On January 25, 2011, Treasury auctioned warrants to purchase common stock in Citigroup that it received through CPP, TIP, and AGP for an aggregate of \$312.2 million.

Wells Fargo's TARP Exit

This section details the events leading to Wells Fargo's repayment of TARP funds received through CPP. Wells Fargo proposed meeting the 1-for-2 provision in part by issuing stock through a private equity transaction. Regulators discussed how to treat this transaction at length until December 12, 2009, when the institution finally removed the transaction from its repayment proposal, and a final agreement was reached for Wells Fargo to exit TARP two days later. Figure 7 below shows the timeline of key events related to Wells Fargo's repayment and exit from TARP.

FIGURE 7
KEY TARP REPAYMENT EVENTS FOR WELLS FARGO (WFC)



Sources: SIGTARP, OFS, FRB, Wells Fargo, Citigroup, and Bank of America.

OCC officials told SIGTARP that Wells Fargo originally planned to repay TARP over time by accumulating and retaining earnings, and making smaller, partial TARP repayments using those earnings

rather than making a one-time repayment using proceeds from a common stock issuance. Wells Fargo's CEO John Stumpf explained to SIGTARP that the institution sought to repay TARP while minimizing the dilution to current shareholders that would result from issuing new common stock. On September 22, 2009, bank executives provided FRB with a TARP repayment plan that reflected this strategy. The plan envisioned Wells Fargo repaying Treasury's \$25 billion TARP investment over four installments, proposing to make the final payment in the third quarter of 2010. Regulators, however, were in the midst of developing what would become the November guidance that would govern repayments.

**Wells Fargo Proposal 1
(Sept. 22, 2009)**

Payments: 4 installments (4Q09 – 3Q10)

Wells Fargo Sought to Use Settlement with Prudential Toward the 1-for-2 Provision

Put Option

An option contract giving the owner the right, but not the obligation, to sell a specified amount of an underlying asset at a set price within a specified time.

Wells Fargo sought to apply the settlement of a pending transaction with Prudential Financial, Inc. ("Prudential") toward the 1-for-2 provision. As a result of acquiring Wachovia in December 2008, Wells Fargo owned a controlling interest in a retail securities brokerage joint venture with Prudential.

Prudential elected to exercise a "put option" to sell its minority interest in the joint venture to Wells Fargo, creating a \$4.5 billion⁵⁹ obligation that Wells Fargo was required to settle with Prudential by January 4, 2010. This obligation could be settled in cash or in Wells Fargo common stock, which Prudential intended to liquidate by selling to public markets.

Wells Fargo planned to issue common stock to settle the Prudential transaction and apply the private issuance toward the 1-for-2 provision to seek partial repayment.⁶⁰ On the day FRB issued the revised guidance, Wells Fargo met with regulators to discuss this possibility, but did not receive clarity on whether the

**Wells Fargo Proposal 2
(Nov. 24, 2009)**

Payments: 3 installments
Sources of capital raise:
• \$4.5 billion Prudential (private) common stock issuance
• \$1.2 billion employee stock issuance

⁵⁹ In its November 4, 2009, letter, Wells Fargo estimated the value of Prudential's minority interest to be up to \$5 billion. In repayment proposals later submitted to FRB, Wells Fargo specified that it planned to issue \$4.5 billion of common stock to settle with Prudential. The latter amount is used here for simplicity.

⁶⁰ The November 2009 guidance stated that firms may repay all or part of TARP by "issu[ing] \$1 of new common equity for every \$2" repaid so long as the firm can, among other things, show "recent access to *public* equity markets" (emphasis added).

Prudential transaction would count. On November 24, 2009, Wells Fargo submitted a TARP repayment proposal that relied on receiving credit for the Prudential transaction.

In early December 2009, regulators discussed Wells Fargo's request to count stock issued privately through the Prudential transaction toward the 1-for-2 provision. While the private transaction did not demonstrate public market access, it would improve the quality of Wells Fargo's capital by increasing the institution's common equity. As regulators discussed the request, on December 3, 2009, one day after FRB approved Bank of America's TARP repayment plan, Wells Fargo submitted a proposal to repay half, or \$12.5 billion, of Treasury's \$25 billion TARP investment by the end of 2009, and to repay the remainder in the second quarter of 2010. The institution proposed to use the 1-for-2 expedited repayment provision for the first payment, in part by using the \$4.5 billion common stock issued through the Prudential transaction.

Wells Fargo Proposal 3 (Dec. 3, 2009)

Payments: 2 installments

Sources of capital raise:

- \$1.25 billion public common stock issuance
- \$4.5 billion Prudential (private) common stock issuance
- \$1.1 billion employee stock issuance

However, FDIC indicated the Prudential transaction did not meet the requirements of the expedited repayment provision established in the November 2009 guidance. On December 7, 2009, at the bank's request, FDIC and Wells Fargo met to discuss the transaction. During the meeting, then-FDIC Chairman Bair and other FDIC officials told Wells Fargo that the plan would have to comply with the November 2009 guidance and that FDIC was not supportive of counting the Prudential transaction toward the 1-for-2 provision.

Regulators Informed Wells Fargo that only a Proposal for Full TARP Repayment Could Provide the Institution with Certainty

Although Wells Fargo planned to make partial TARP repayments, officials from the Federal Reserve Bank of San Francisco ("FRB San Francisco") told SIGTARP that the bank also sought to signal certainty to markets by publicly stating that regulators had fully approved a plan that would allow for an exit from TARP. However, according to regulators, only the immediate portion of a multi-stage repayment plan could be approved, so the

Wells Fargo Proposal 4 (Dec. 10, 2009)

Payments: 2 installments

Sources of capital raise:*

- \$2.8 billion common issuance
- \$4.5 billion Prudential (private) common stock issuance
- \$1.7 billion employee issuance
- \$0.4 billion capital via reduction in publicly identified, high risk, liquidating portfolios
- \$0.8 billion core deposit intangible amortization

*Wells Fargo also proposed to use \$2.8 billion in retained earnings

institution could not publicly announce that regulators had approved a full repayment plan or state definitively that it would not be required to raise additional capital to fund later repayments.

FRB San Francisco officials told SIGTARP that regulators had concerns with the institution relying on earnings to repay over time, noting, “what if you have a bad quarter?” and pointing out that the economic outlook was uncertain in late 2009. The only way for the institution to signal certainty to markets regarding its exit from TARP was to repay all of Treasury’s \$25 billion investment in full. Moreover, these officials noted, because regulators might not allow the Prudential transaction to count toward the 1-for-2 provision, its inclusion in future proposals would also complicate matters and prolong deliberation.

Nonetheless, on December 10, 2009, Wells Fargo submitted a revised proposal that again listed the Prudential transaction and included earnings as a key source of funds for repayment. The institution also continued to propose repayment over two installments – approximately \$14 billion in January 2010 and the remaining \$11 billion by March 31, 2010. Wells Fargo pointed to Bank of America’s recent capital raise, which did not consist entirely of newly issued common stock, and stated that similar principles should also apply to Wells Fargo. However, given its reliance on the Prudential transaction, officials from both FRB and FDIC considered the proposal unacceptable.

On December 11, 2009, Wells Fargo submitted a new proposal, almost doubling the amount of common stock it proposed to issue, but still including the Prudential transaction and adding gains on asset sales. While OCC was supportive of this proposal, FDIC was not. Wells Fargo submitted a second proposal that day, which, among other adjustments, increased the amount of employee stock it proposed to issue and the amount of proceeds it proposed to generate from asset sales.

Wells Fargo Proposal 5 (Dec. 11, 2009)

Payments: 2 installments

Sources of capital raise:*

- \$5.0 billion common issuance
- \$4.5 billion Prudential (private) common stock issuance
- \$1.7 billion employee issuance
- \$0.5 billion gain on asset sale
- \$0.4 billion capital via reduction in publicly identified, high risk, liquidating portfolios
- \$0.8 billion core deposit intangible amortization

**Wells Fargo also proposed to use \$2.8 billion in retained earnings*

Wells Fargo Proposal 6 (Dec. 11, 2009)

Payment: 1 installment

Sources of capital raise:

- \$5.0 billion common issuance
- \$4.5 billion Prudential (private) common stock issuance
- \$2.25 billion employee issuance
- \$1.5 billion post-tax profit on asset sale

Agreement Was Reached Soon After Wells Fargo Removed the Prudential Transaction and Increased the Amount of Common Stock It Proposed to Issue

On Saturday, December 12, 2009, after a week of media speculation that Citigroup was negotiating repayment of TIP, Wells Fargo significantly revised its repayment proposal, more than doubling the proposed public issuance to \$10.4 billion and removing the Prudential transaction. With the

encouragement of FRB San Francisco, Wells Fargo also included the possibility of an overallotment option, which could reduce or eliminate the \$1.35 billion in common stock issued to employees. Over the weekend, Wells Fargo and FRB worked to review the specific assets Wells Fargo proposed to sell and to develop a proposal that addressed regulators' preference for first reducing asset sales rather than the employee stock issuance in the event the overallotment was exercised.

Wells Fargo Proposal 7 (Dec. 12, 2009)

- Payment: 1 installment
Sources of capital raise:
- \$10.4 billion common issuance (plus overallotment option)
 - \$1.35 billion employee issuance (to go first, if overallotment exercised)
 - \$1.5 billion post-tax profit on asset sale

On Monday, December 14, 2009, the same day that Citigroup announced its agreement with Treasury and regulators to repay TARP funds received through TIP, FDIC agreed to Wells Fargo's proposal as long as asset sales would be eliminated first by the exercise of the overallotment option. An FDIC official noted,

“We would expect that the green shoe would cover the entire amount of the raise if demand is sufficient.” Around midday, Wells Fargo submitted its final proposal to regulators, which conformed to regulators' expectations regarding asset sales. That afternoon, FRB approved Wells Fargo's CPP repayment request, and the institution announced shortly thereafter that it had reached an agreement with regulators to repay Treasury and exit TARP.

Wells Fargo Proposal 8 (Dec. 14, 2009)

- Payment: 1 installment
Sources of capital raise:
- \$10.4 billion common issuance (plus overallotment option)
 - \$1.35 billion employee issuance
 - \$1.5 billion post-tax profit on asset sales (to go first, if overallotment exercised)

Wells Fargo CEO Stumpf told SIGTARP that multiple factors were driving the bank's timeline to have its TARP repayment approved, including time pressures to settle the Prudential transaction by early January 2010 and to access equity markets before the end-of-year holidays. In discussing the decision to repay in full by the end of 2009, Mr. Stumpf told SIGTARP, “I recall being guided by what would be best for shareholders – and simply that.” Regulators also noted to SIGTARP that Wells Fargo shareholders likely held a great deal of influence over the company's repayment proposals. Referring to the bank's shareholders, an FDIC official commented to SIGTARP, “It's a very vocal group at Wells Fargo. They're legendary.”

However, encouragement from Treasury may have also contributed to Wells Fargo's decision to repay in full through a one-time stock issuance. A letter attached to Wells Fargo's November 24, 2009, repayment proposal stated that Wells Fargo was "asked by the U.S. Treasury to repay TARP." The former Wells Fargo CFO who signed the letter told SIGTARP that then-Treasury Assistant Secretary Herb Allison and Wells Fargo CEO Stumpf discussed Treasury's desire to see Wells Fargo repay TARP and Treasury's concern about the market's perception of the institution if it remained in TARP while its peers repaid. Mr. Stumpf told SIGTARP he had a "couple of conversations" with Assistant Treasury Secretary Allison, but recalled only discussing warrants and loan modifications, rather than Wells Fargo's repayment plans. Secretary Geithner, however, told SIGTARP that he asked Assistant Secretary Allison to encourage institutions to repay. According to Secretary Geithner, Treasury believed "the financial system would be stronger if [TARP institutions] could demonstrate they could raise private capital. So if you put pressure on firms to seek private capital, the system becomes stronger." Assistant Secretary Allison told SIGTARP that he spoke to most of the remaining SCAP institutions about their TARP repayment plans and that while it was up to regulators to decide when institutions would be allowed to repay, "the message was that we want the money back as soon as you can do this." He added that firms also wanted to repay "because of executive compensation and the negative stigma TARP had."

Wells Fargo Completed a Successful Common Stock Offering and Exited TARP

On December 14, 2009, Wells Fargo announced its \$10.4 billion common stock offering plus a \$1.56 billion overallotment option. The next day, Wells Fargo priced the \$10.65 billion offering at \$25 per share and completed its offering by the end of the day, including fully subscribing the overallotment option. Its total raise of \$12.25 billion eliminated the need for any asset sales and reduced the amount of shares issued to employees pursuant to the TARP repayment agreement.

The following week, on December 23, 2009, Wells Fargo wired \$25 billion plus accrued dividends to Treasury, fully repaying the CPP investment and exiting TARP. It was the same day that Citigroup repaid TIP and terminated its participation in AGP.

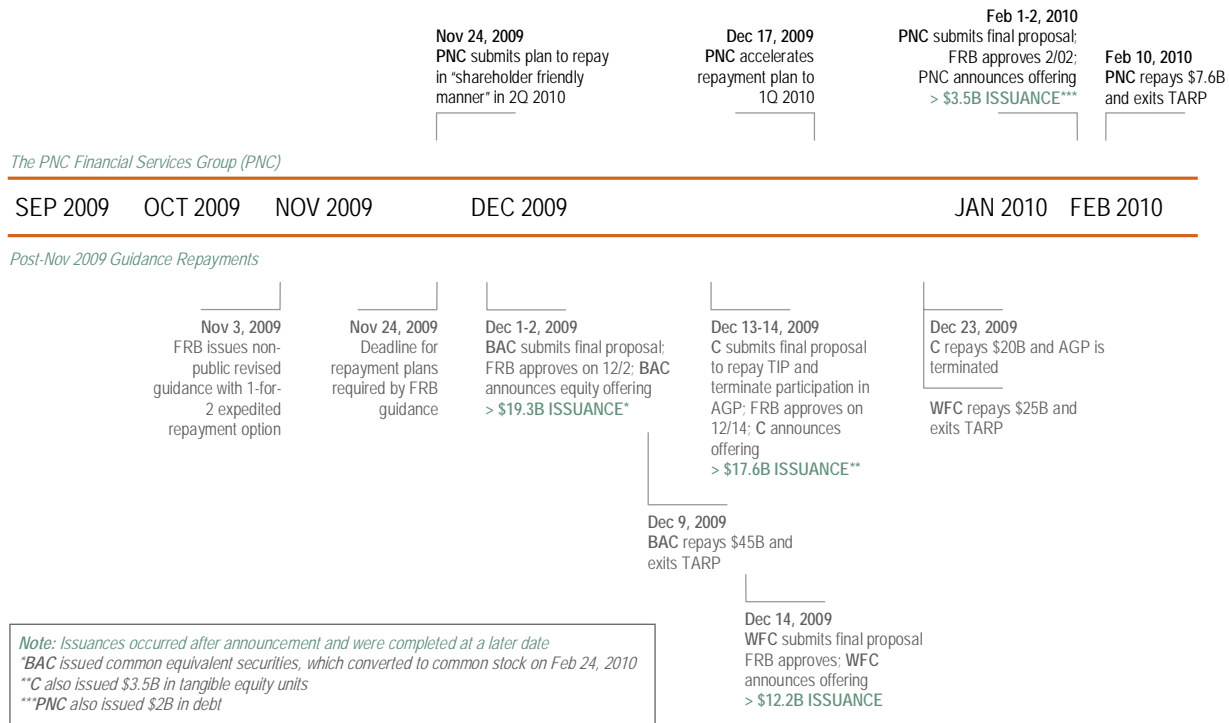
PNC's TARP Exit

This section details the events leading to PNC's repayment of and exit from TARP in February 2010. PNC's repayment proposals included counting the sale of a subsidiary toward the 1-for-2 repayment option, seeking credit for both the profit and reduction of goodwill from the sale. After PNC received approval for TARP repayment and commenced its public offering, regulators and PNC realized they held different understandings of the role of the overallocation in TARP repayment and PNC's limited control over whether the overallocation was exercised.

Figure 8 below shows the timeline of key events related to PNC's repayment and exit from TARP.

FIGURE 8

KEY TARP REPAYMENT EVENTS FOR THE PNC FINANCIAL SERVICES GROUP (PNC)



Sources: SIGTARP, OFS, FRB, FDIC, PNC, Wells Fargo, Citigroup, and Bank of America.

PNC Accelerated Its TARP Repayment Plans After Other SCAP Institutions Repaid in December 2009

PNC, the 12th-largest U.S. bank holding company, was the fourth SCAP institution to repay TARP in the months immediately following the issuance of the November 2009 revised repayment guidance. As early as June 2009, PNC's CEO James Rohr was publicly quoted as stating that the institution was going to repay TARP "in a shareholder-friendly manner." After reviewing the November 2009 guidance, PNC initially declined to seek expedited repayment through the 1-for-2 option, instead opting to wait for FRB to complete its review of the institution's longer-term capital plan. Its November 24, 2009, repayment plan stated its intent to wait until the second quarter of 2010 to fully repay Treasury's \$7.6 billion CPP investment by using various sources of capital, including proceeds from a \$1 billion common stock offering and the sale of its subsidiary service unit, PNC Global Investment Servicing ("PNC Global").⁶¹

PNC Proposal 1 (Nov. 24, 2009)

Repay in 2Q10

- \$1 billion common issuance
- \$1.6 billion dividends upstreamed from bank
- \$2.1 billion asset sale (PNC Global)
- \$3.6 billion debt and/or hybrid instruments (\$0.3 billion for TARP repayment; \$3.3 billion to meet liquidity policy levels)

However, on December 17, 2009, just days after Citigroup and Wells Fargo announced reaching an agreement with regulators to repay TARP, PNC submitted a revised TARP repayment proposal to the Federal Reserve Bank of Cleveland ("FRB Cleveland"), proposing to accelerate repayment to the first quarter of 2010

PNC Proposal 2 (Dec. 17, 2009)

Repay in 1Q10

- \$1.6 billion common issuance
- \$1.7 billion asset sale (PNC Global)*
 - \$0.7 billion post-tax profit
 - \$1.1 billion reduction in goodwill
- \$0.8 billion other asset sale
- \$2.4 billion debt

* Figures do not total due to rounding.

and increase the common stock issuance to \$1.6 billion. Though well short of a 1-for-2 common stock issuance, PNC stated that the terms were consistent with the expedited repayment option under the assumption that FRB would count the capital benefits generated through the sale of PNC Global toward meeting the provision.

⁶¹ PNC Global was the largest single-source provider to the U.S. mutual fund industry and a servicer of the global investment industry.

PNC Requested that Goodwill Reductions from Asset Sales Be Counted Toward Repayment

Though FRB's repayment guidance did not mention the sale of assets, the sale of PNC Global was a key component of PNC's repayment strategy. By November 16, 2009, PNC had already identified, contacted, and met with five potential buyers, receiving preliminary bids from at least three of them. PNC estimated the sale price at \$2.3 billion, which would generate approximately \$1.6 billion in capital benefits for the firm, of which approximately \$500 million represented PNC's profit on the transaction after deducting taxes. The remaining \$1.1 billion was generated by replacing goodwill with cash.

Goodwill

An intangible asset that, in an acquisition, represents the amount paid for a company over the fair value of its assets.

Goodwill, like other intangible assets, is excluded from regulatory Tier 1 Capital. The reduction of goodwill associated with asset sales – all else equal – increases Tier 1 Capital and Tier 1 Common ratios by reducing the amount of intangibles that a firm is required to exclude from regulatory capital.

While PNC's capital ratios would improve from the reduction in goodwill resulting from the sale of PNC Global, the sale would generate no new common equity for the institution. Further, no credit for the reduction of goodwill had previously been given to other institutions seeking an expedited TARP repayment. However, PNC argued that because the institution would sell PNC Global at a value that equaled 35 times the subsidiary's 2009 earnings, the sale would generate substantial cash without significantly reducing future earnings. PNC further noted that the loss absorption capacity of the capital raised through asset sales was no different than that of capital raised through the issuance of new common stock.

On January 15, 2010, PNC proposed to increase the common stock offering to \$2.4 billion and listed multiple options for crediting the gains from the sale of PNC Global, but regulators had yet to agree on whether the reduction in intangible assets would receive credit toward the 1-for-2 provision.

PNC Proposal 3 (Jan. 15, 2010)

- \$2.4 billion common issuance
- From sale of PNC Global:
 - \$0.7 billion post-tax profit at 1:2
 - OR
 - \$1.7 billion post-tax profit & goodwill reduction at 1:1
- Remainder via other asset sales at 1:1

PNC Proposal 4 (Jan. 22, 2010)

- \$2.5 billion common issuance
- \$1.6 billion sale of PNC Global
 - \$0.5 billion post-tax profit
 - \$1.1 billion goodwill reduction
- \$0.6 billion other future asset sales
- \$0.8 billion contingent common (only if PNC Global fails to close)

PNC's next repayment proposal, sent on January 22, 2010, increased the proposed common stock offering by another \$100 million to \$2.5 billion, while still requesting credit for the \$1.1 billion in reduction of goodwill. OCC supported PNC's proposal and was concerned that requiring more issuance might incentivize PNC to remain in CPP and repay through earnings over time – an outcome OCC did not want. However, neither FDIC nor FRB approved of the proposal, and both regulators suggested the institution submit a proposal that included a larger common stock offering.

FDIC Consented to a Goodwill Reduction for Asset Sales but Pushed for a \$4 Billion Common Issuance

PNC wanted to announce both the PNC Global sale and the TARP repayment at the same time on Monday, February 1, 2010. However, on January 28, *The Wall*

PNC Proposal 5 (Jan. 30, 2010)

- \$3.0 billion common issuance
- \$0.45 billion over allotment option
(potentially exercised; may reduce amount of debt issued)
- \$1.8 billion sale of PNC Global
- \$1.5-2.0 billion debt issuance *(to maintain liquidity until sale closes)*

Street Journal published an article leaking details of the then-secret sale of PNC Global and its connection with PNC's TARP repayment efforts. The next day, FDIC suggested to PNC's CEO Rohr that the bank issue \$4 billion in common stock. According to an FDIC email, Mr. Rohr rejected the idea.

Instead, on January 30, 2010, PNC sent FDIC a revised repayment plan, proposing to issue \$3 billion in common stock, along with the sale of PNC Global, but also including the “potential exercise” of a \$450 million over allotment option to supplement the public offering. In addition, it extended the proposed closing date of the PNC Global transaction from the second to the third quarter of 2010, and included a \$1.5 billion to \$2.0 billion debt issuance. The debt issuance was critical to maintaining PNC's liquidity given the timing between the repayment of \$7.6 billion of TARP funds in the first quarter of 2010 and the cash replenishment expected from completing the sale of PNC Global later in the year.

While staff reviewed PNC's latest proposal, then-FDIC Chairman Bair requested FRB's support for FDIC's position that PNC issue \$4 billion of common stock. The additional capital raise that FDIC sought to require would have limited the decrease in PNC's Tier 1 Capital cushion resulting from CPP repayment, reflecting the concern that then-Chairman Bair expressed to SIGTARP about protecting FDIC's exposure to TLGP.

Ultimately, regulators, including FDIC, agreed to allow a smaller offering, with the over allotment option, under the condition that PNC commit to additional asset sales should key capital ratios fall below minimum levels. PNC agreed to backstop the maintenance of its regulatory capital ratios – including its Tier 1 Common ratio – until June 30, 2011, with the commitment to sell common equity or assets as part of its CPP repayment terms.

PNC Approved for Repayment but Understanding Differed on the Role of the Overallotment Option

On the evening of February 1, 2010, PNC submitted a revised proposal specifying that the overallotment option, if exercised, would serve as a backstop to the sale of PNC Global. FRB and FDIC worked to develop language for the maintenance of PNC's regulatory capital ratios and to ensure a clear understanding of the linkage between PNC's debt issuance and its liquidity given the lag between TARP repayment and the closing of PNC Global.

Early on February 2, 2010, BNY Mellon announced that it would acquire PNC Global. That day, an FDIC email indicated that then-Chairman Bair spoke with Mr. Rohr

and was comfortable with repayment as long as the overallotment option was filled. Then-Chairman Bair confirmed to SIGTARP that PNC called her and "personally assured [her] they would exercise" the overallotment option. According to FRB, similar communications took place between PNC and FRB. PNC informed SIGTARP that the bank did not intend to suggest that it was in a position to commit the underwriters to exercise the option. As previously discussed, the overallotment is an option granted to the underwriter by the

PNC Proposal 6 (Feb. 1, 2010)

- \$3.0 billion common issuance at 1:2
- \$1.6 billion sale of PNC Global at 1:1*
 - \$0.5 billion post-tax profit
 - \$1.1 billion goodwill reduction
- \$1.5-2.0 billion debt issuance (*to maintain liquidity*)
- Maintain Tier 1 Common, Leverage, or Tier 1 ratios through 6/30/11

**Backstop to PNC Global sale:*

- \$0.45 billion overallotment option at 1:2 (*potentially exercised*)
- OR
- Additional equity raise and/or asset sales at 1:1

PNC Proposal 7 (Feb. 2, 2010)*

- \$3.0 billion common issuance at 1:2 (*plus overallotment option*)
- \$1.6 billion sale of PNC Global at 1:1 (*may be reduced if overallotment option exercised*)
 - \$0.5 billion post-tax profit
 - \$1.1 billion goodwill reduction
- \$1.5-2.0 billion debt issuance (*to maintain liquidity*)
- Sell assets and/or raise equity if Tier 1 Common, Leverage, or Tier 1 ratios fall below internal minimums before 6/30/11

**Includes terms cited in PNC's Feb. 1 proposal and Feb. 2 email to regulators*

company offering shares. While the option creates an opportunity to sell more shares than originally planned, it also serves to protect underwriters by ensuring access to additional shares at the offering price in the event that shares are oversold and their price increases. PNC told SIGTARP that while it expected PNC's underwriters to exercise the overallotment option, the decision was ultimately at the discretion of the underwriter and thus, never within PNC's control.

Later on February 2, a PNC executive re-sent the previous day's written repayment proposal, and listed in the email among "terms agreed to/confirmed this morning," PNC's agreement to use its "best efforts" to exercise the overallotment. That afternoon, FRB approved the repayment request, and within

a few hours, PNC publicly announced that it had reached agreement with regulators to repay TARP and commenced its public offering priced at \$54 per share. Through discussions with PNC, regulators understood that the \$450 million over allotment would be exercised if demand was sufficient. Despite a strong initial response allowing PNC to raise \$3 billion in common equity and \$2 billion in debt, a drop in PNC's share price from \$54 to \$51 over the next few days caused the underwriters conducting the offering to delay filling the over allotment option, which they had 30 days to exercise.

At the time, regulators expressed frustration that the over allotment option was not filled immediately after the offering. However, FRB informed SIGTARP that there was no requirement that PNC exercise the option prior to redemption. PNC also told SIGTARP that it made clear to its underwriters that the bank wanted the over allotment option to be exercised, and encouraged them to exercise the option, even if doing so somewhat lessened the underwriters' profit.

On February 10, 2010, PNC notified regulators that it repaid its CPP funds to Treasury. A few hours later, an FDIC official inquired with PNC about the status of the over allotment, noting that Mr. Rohr's commitment to then-Chairman Bair regarding the over allotment option was crucial to the agency's support for PNC's repayment. FDIC and PNC held a conference call to ensure a common understanding of the over allotment process and the authority granted to the underwriter in deciding whether to exercise the over allotment option. The price of PNC shares gradually rose and starting February 26, 2010, reached daily highs of at least \$54. On March 4, 2010, one day before the over allotment option was set to expire, PNC's underwriters exercised the option, allowing PNC to issue an additional \$450 million of common stock. As a result, through the offering and the exercise of the over allotment option, PNC issued a total of nearly \$3.5 billion in common stock in connection with its \$7.6 billion TARP repayment.

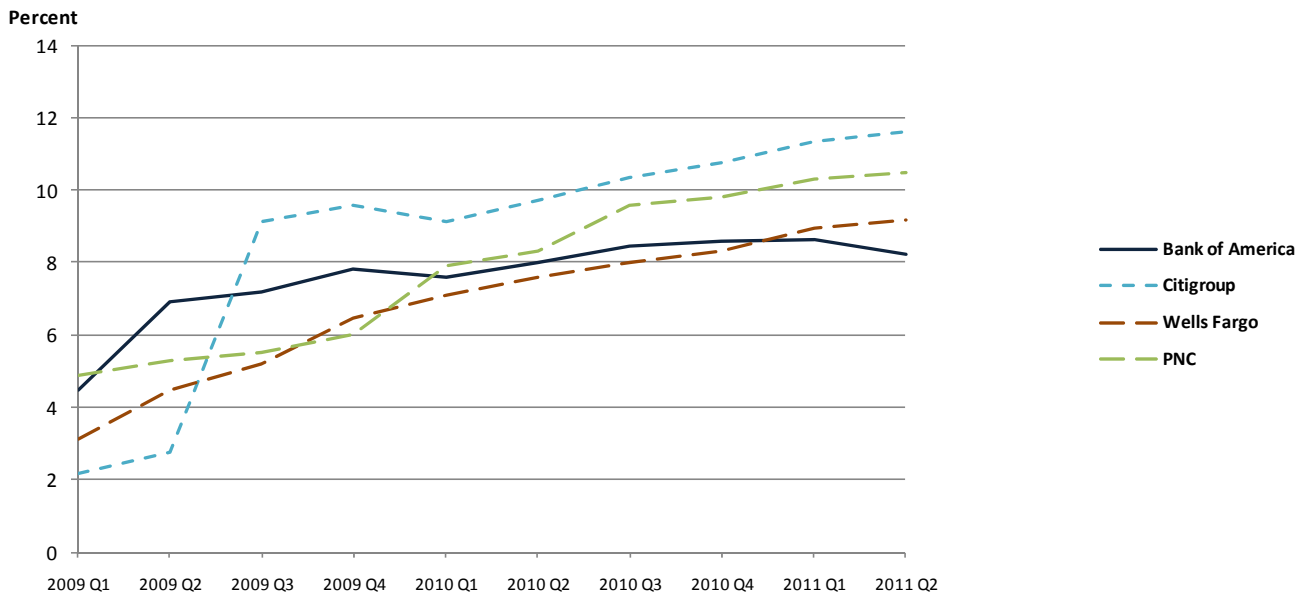
Capital Quality Improved Among Bank of America, Citigroup, Wells Fargo, and PNC, but Pressures Remain

The public equity offerings in support of Bank of America's, Citigroup's, and Wells Fargo's TARP repayments each rank among the 10 largest in U.S. history, with Bank of America's and Citigroup's comprising two of the top three. Combined, the offerings totaled \$49.1 billion in new common stock, including stock raised through the exercise of over-allotment options.

The issuances boosted each institution's Tier 1 Common ratio – a measure of the capital that provides the most loss absorption capacity – at the end of 2009. A few months after Bank of America, Wells Fargo, and Citigroup exited, PNC's \$3.5 billion common stock issuance in support of its TARP repayment had a similar effect on the bank's Tier 1 Common ratio. As of the second quarter of 2011, the capital ratios of Citigroup, Wells Fargo, and PNC have improved to varying degrees. Citigroup has seen the most improvement to its Tier 1 Common ratio since first receiving TARP funds in late 2008, aided by the exchange of preferred shares held by both Treasury and private investors to common stock in 2009, in addition to the common equity Citigroup raised in connection with TARP repayment later that year.⁶² However, Bank of America's Tier 1 Common ratio has declined recently, reflecting in part losses of about \$8.8 billion reported by the institution during the second quarter of 2011. To date, the same ratio for Wells Fargo and PNC has maintained a positive trajectory since the institutions repaid TARP. Figure 9 shows the Tier 1 Common ratios of all four institutions from the first quarter of 2009 through the second quarter of 2011.

⁶² Citigroup also sold off a number of non-core businesses through its "Citi Holdings" division, reducing the amount of assets the institution held by \$128 billion in 2010.

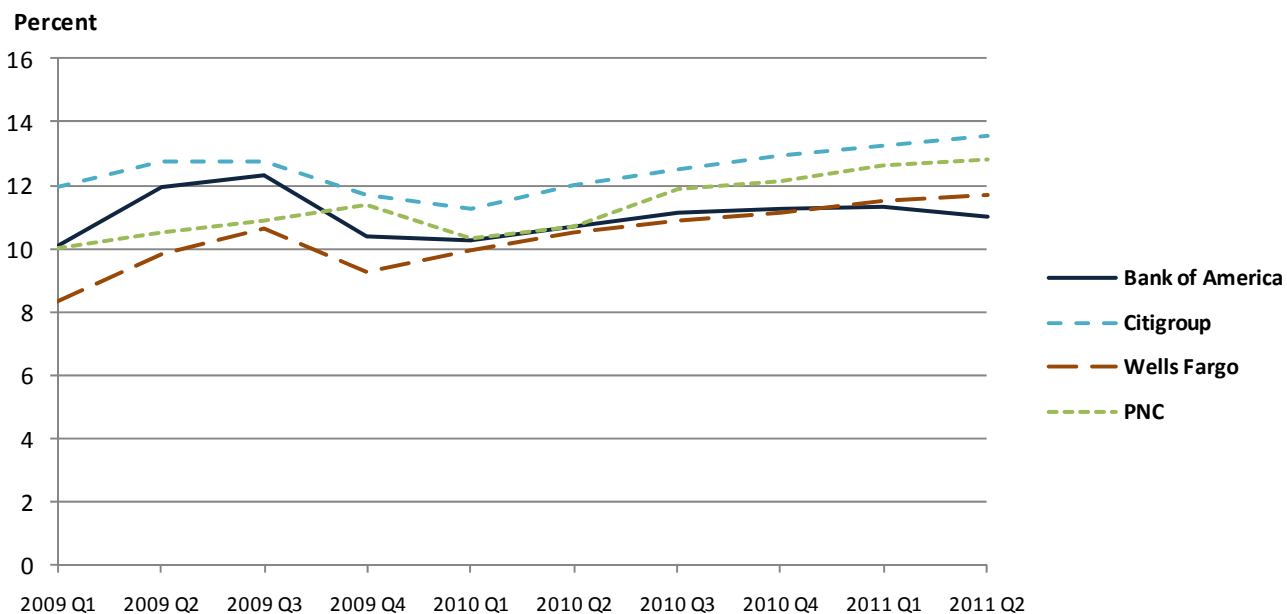
FIGURE 9
TIER 1 COMMON RATIOS OF BANK OF AMERICA, CITIGROUP, WELLS FARGO, AND PNC



Source: SIGTARP analysis of Bloomberg data.
Note: Quarterly data reflect the Tier 1 Common equity ratio at the end of each quarter.

While the quality of capital improved with TARP repayment, each institution’s Tier 1 Capital ratio – which includes both preferred and common equity elements – initially declined as TARP capital was not replaced dollar for dollar. In recent quarters, the Tier 1 Capital ratios of Citigroup, Wells Fargo, and PNC have edged above pre-repayment levels, though Bank of America’s remains lower. According to FDIC, to varying degrees, each institution’s capital base remains pressured by mortgage-related costs associated with credit, servicing, and litigation, along with recent uncertainty in European markets. Figure 10 on the following page shows the Tier 1 Capital ratios of all four institutions from the first quarter of 2009 through the second quarter of 2011.

FIGURE 10
TIER 1 CAPITAL RATIOS OF BANK OF AMERICA, CITIGROUP, WELLS FARGO, AND PNC



Source: SIGTARP analysis of Bloomberg data.
 Note: Quarterly data reflect the Tier 1 Capital ratio at the end of each quarter.

Conclusions

In the first several months of TARP, Treasury invested approximately \$200 billion in financial institutions under terms that, with certain exceptions, prohibited repayment for three years. Despite the dramatic efforts by the Government to inject this capital, by early 2009, the market still lacked confidence in some of the nation's largest financial institutions and some TARP banks complained of a TARP stigma. On February 17, 2009, the American Recovery and Reinvestment Act of 2009 removed the three-year restriction, and in the following weeks, some TARP recipients proposed to repay Treasury and exit TARP. With encouragement from Treasury, and in an effort to ramp back Government ownership in these institutions, Federal banking regulators, including FRB, FDIC, and OCC, scrambled to develop criteria and guidance to evaluate a bank's TARP exit proposal.

On June 1, 2009, FRB issued TARP repayment guidance specific to SCAP institutions – the large banks subject to the stress tests conducted by regulators in early 2009. Approximately 80% (\$163.5 billion) of all CPP funds went to 17 SCAP banks. The June guidance focused on capital – specifically, the TARP recipient's ability to satisfy requirements such as demonstrating access to equity markets by issuing new common stock. FRB officials told SIGTARP that the amount of common stock each institution was required to raise was driven in part by the results of the recently completed stress tests. Based on the June guidance, the SCAP institutions that met the stress test capital targets became eligible to repay TARP, and nine did so on June 17, 2009. The remaining eight SCAP institutions in TARP, which included some of the nation's largest banks, such as Bank of America, Citigroup, Wells Fargo, and PNC, were viewed by regulators at that time as weaker than those that had been permitted to repay in June. Regulators decided that these remaining SCAP banks in TARP needed to meet stricter criteria before regulators would consider their TARP exit requests.

Revised guidance issued by FRB and developed in consultation with Treasury and the other regulators in November 2009 offered the remaining SCAP institutions in TARP an option for expedited repayment of TARP funds. The November guidance provided that subject to satisfying SCAP requirements, the remaining institutions “may be permitted” to repay all or part of Treasury's TARP capital if they “issue at least \$1 in new common equity for every \$2” in TARP repaid, referred to as the “1-for-2” provision. FRB and FDIC agreed that the 1-for-2 was a minimum requirement for expedited repayment, and that some institutions, such as Citigroup, would need to raise additional common stock beyond the 1-for-2.

In developing the 1-for-2 provision, regulators were focused on the ability of the institution to absorb losses once Government support through TARP was removed. An FRB official told SIGTARP that this ratio was based upon the results of the stress tests, which gave FRB insight into the level of capital required

to buffer the SCAP institutions in the event of particularly adverse market conditions. FRB Governor Tarullo, Chairman of FRB's Committee on Bank Supervision, told SIGTARP that the regulators agreed on a public capital raise requirement to make sure that post-TARP the institutions were effectively functioning market intermediaries that could stand up to adverse conditions. He added that one lesson of the financial crisis was that the markets primarily cared about common equity, rather than other types of capital, and that FRB would not allow an institution to repay TARP without it having enough capital to absorb losses.

Shortly after FRB issued the November 2009 guidance, some of the largest remaining TARP institutions – Bank of America, Wells Fargo, and PNC – sought expedited repayment, but balked at meeting the requirement of a 1-for-2 common stock issuance, seeking instead to combine a smaller common stock issuance with other methods of raising capital, such as selling assets and issuing employee stock, that remove sources of future revenue or do not provide market validation. Citigroup, which was required to issue new common stock beyond the 1-for-2, also initially submitted proposals that fell short of regulators' expectations. Bank of America, Citigroup, and Wells Fargo ultimately repaid TARP investments in December 2009, followed soon after by PNC. For these institutions, the path to TARP repayment was far more complex and contentious than it had been for the institutions that repaid in June 2009, revealing both strengths and weaknesses in the TARP exit process.

SIGTARP found that interagency sharing of data, vigorous debate among regulators, and hard-won consensus increased the amount and improved the quality of the capital that SCAP institutions were required to raise to exit TARP. FRB was the primary regulator for these institutions and was responsible for recommending to Treasury whether or not a company should be allowed to repay. FRB agreed to consult with FDIC and OCC, and often with Treasury, on repayment proposals. That consultation often generated both conflict and frustration due to varied and occasionally conflicting policy approaches. FDIC, exposed through its deposit insurance fund and its emergency lending program, was by far the most persistent in insisting that banks raise more common stock. The checks-and-balances that resulted from this interagency coordination helped to ensure that the nation's largest financial institutions were better capitalized upon exiting TARP than prior to TARP. However, three aspects of the TARP exit process serve as important lessons learned from the financial crisis.

First, Federal banking regulators were prepared to and did relax the revised repayment criteria only weeks after that criteria had been established, bowing at least in part to a desire to ramp back the Government's stake in financial institutions and to pressure by institutions seeking a swift TARP exit to avoid executive compensation restrictions and the stigma associated with TARP participation. The large financial institutions seeking to exit TARP were notably

persistent in their efforts to resist regulatory demands to issue common stock, seeking instead more creative, cheaper, and less sturdy alternatives that provide less short- or long-term loss protection than new common stock. Some SCAP institutions pushed back against the 1-for-2 common stock provision, seeking to minimize the dilution to shareholders that would result from a surge of new common shares and, in at least one case, warning of possible failed public offerings that might erode market confidence. To varying degrees, regulators bent to these concerns, relaxing the repayment requirement by allowing banks to replace some amount of new common stock issuance with other actions such as asset sales or the issuance of trust preferred securities or employee stock. Because the regulators failed to adhere to FRB's clearly and recently established requirements, the process to review a TARP bank's exit proposal was ad hoc and inconsistent.

Second, by not waiting until the banks were in a position to meet the 1-for-2 provision entirely with new common stock, there was arguably a missed opportunity to further strengthen the quality of each institution's capital base to protect against future losses without diminishing future revenues. Despite the fact that the regulators had established the 1-for-2 minimum weeks before as necessary for each bank to absorb losses under adverse market conditions, the discussion quickly switched to analysis of how much each bank could raise in new common stock during a frenzied period where each of these TARP banks wanted to exit at that time based in part on news that other large banks were exiting TARP. Concerned about a lack of market confidence that might result from being the last large bank to exit TARP, and executive compensation restrictions, banks argued that the market would not support a 1-for-2 common stock issuance. Meanwhile, regulators feared that a failed offering would have devastating consequences.

Rather than wait until the markets could bear a 1-for-2 common stock issuance, the regulators accepted repayment terms that were based on what the market could bear at that time. During these discussions, FDIC remained a holdout, arguing that the 1-for-2 provision had to be met with only new common stock. For example, regarding Bank of America's TARP exit, then-FDIC Chairman Bair told SIGTARP that "the argument [FRB and OCC] used against us – which frustrated me to no end – is that [Bank of America] can't use the 2-for-1 because they're not strong enough to raise 2-for-1. That just mystified me. The point was if they're not strong enough, they shouldn't have been exiting TARP." However, FRB Governor Tarullo told SIGTARP that it was not about Bank of America's strength, but instead about how much the market could absorb at that time. Then-FRB Vice Chairman Kohn also stated that FRB wanted to push Bank of America and Citigroup but was concerned that "if they went out for something and didn't get it, it would be a vote of no confidence." The institutions arguably missed an opportunity to wait until the market could absorb a 1-for-2 common stock

issuance, which would have had long lasting consequences in further strengthening the quality of their capital base.

Third, SIGTARP also found that Treasury encouraged TARP banks to expedite repayment, opening Treasury to criticism that it put accelerating TARP repayment ahead of ensuring that institutions exiting TARP were sufficiently strong to do so safely. Secretary Geithner told SIGTARP that putting pressure on firms to raise private capital was part of a “forceful strategy of raising capital early” and “We thought the American economy would be in a better position if [the firms] went out and raised capital.” Treasury’s involvement was also more extensive than previously understood publicly. In testimony before Congress, Treasury officials repeatedly explained that regulators decide when it is appropriate for a bank to repay Treasury. However, while regulators negotiated the terms of repayment with individual institutions, Treasury hosted and participated in critical meetings about the repayment guidance, commented on individual TARP recipient’s repayment proposals, and in at least one instance urged the bank (Wells Fargo) to expedite its repayment plan.

The result was nearly simultaneous repayments by Bank of America, Wells Fargo, and Citigroup in an already fragile market. Bank of America’s offering of \$19.3 billion was the largest ever common stock offering in the United States. The combined repayments of the three banks involved \$49.1 billion in new common stock offerings in a span of two weeks (with PNC to follow with a \$3.5 billion offering), despite warnings that large equity offerings might be too much for the market to bear. While none of the offerings failed, Citigroup exercised only a portion of its overallocation option and later complained that Wells Fargo’s simultaneous offering sapped demand for Citigroup’s stock.

The lessons of the financial crisis and the events surrounding TARP repayments and exit demonstrate the importance of implementing strong capital requirements and holding institutions strictly accountable to those requirements. Some of the nation’s largest financial institutions had too little capital before the last crisis, a fact that not only contributed to the crisis itself but also necessitated the subsequent bailouts. While regulators leveraged TARP repayment requirements to improve the quality of capital held by the nation’s largest financial institutions in the wake of the financial crisis, they relaxed those requirements shortly after establishing them. Whether these institutions exited TARP with a strong and high-quality capital structure sufficient to absorb their own losses and survive adverse market conditions without further affecting the broader financial system remains to be seen.

Federal banking regulators, along with Treasury, bear responsibility for ensuring that the nation’s largest and systemically important financial institutions hold enough high-quality capital to absorb future losses and maintain their viability in the event of a possible future severe shock to the financial system. The Dodd-

Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act”) includes provisions designed to address the quality of capital held by banks, such as prohibiting newly issued trust preferred securities from inclusion in Tier 1 Capital calculations. In addition, the Dodd-Frank Act provides that the Financial Stability Oversight Council has the authority to recommend heightened capital standards for companies designated as systemically significant and provides for an orderly liquidation authority.

There will always be tension between the protection of the greater financial system through robust capital requirements and the desire of individual financial institutions to maximize profits and shareholder returns. While striking the right balance is no easy task, regulators must remain vigilant against institutional demands to relax capital requirements while taking on ever more risk. In a recent speech, Governor Tarullo acknowledged that regulators had historically approved “increasingly diluted forms of capital under political pressures,” and warned of the “slippery slope effect” that results from allowing lower quality capital to comprise an ever-increasing portion of a bank’s capital structure.

Today, some institutions remain too big, too interconnected, and too essential to the global financial system such that their failure or severe distress could potentially trigger serious consequences to the broader economy. Unless and until such institutions, either on their own accord or through regulatory pressure or requirements, are restructured, simplified, and maintain adequate capital to absorb their own losses, they will pose a grave threat to the entire financial system. The greater financial system’s need for protection against the failure of those institutions in the next possible downturn is particularly acute.

Management Comments

In its management response, which is reproduced in full in Appendix G, FRB notes that it carefully and thoroughly analyzed requests to repay TARP and that it put limits on the extent to which institutions were allowed to substitute asset sales for common equity issuance. FRB also notes that common stock issued through an employee stock compensation plan improves an institution's capital structure in the same way as a public offering of common stock.

FDIC did not provide a formal response to the report because unless there are recommendations for agency action or there are factual errors of consequence that FDIC believes require correction, it does not typically provide a formal written response to an invitation to review a document in advance of its publication.

In its management response, also reproduced in full in Appendix G, OCC agrees with SIGTARP's overall conclusion regarding the importance of implementing strong capital requirements and holding institutions accountable to such requirements. However, OCC strongly disagrees with SIGTARP's conclusion that the repayment process was ad hoc and inconsistent because the regulators failed to adhere to FRB's requirements, arguing that the flexibility to deviate somewhat from the guidance was pragmatic and necessary, and produced successful results. OCC also disagrees with SIGTARP's conclusion that there was a missed opportunity to further strengthen each institution's capital base, on the grounds that it believes waiting for better repayment terms would have been a riskier strategy than moving forward with the equity issuances.

In its management response, also reproduced in full in Appendix G, Treasury strongly agreed with SIGTARP's conclusion that interagency coordination improved the terms of TARP repayment. Treasury also notes that its involvement in the TARP exit process was motivated by a belief that stabilizing the financial system depended upon the nation's largest financial institutions being able to raise private capital again, and that postponing the common stock offerings associated with repayment could have risked undermining investor confidence.

Appendix A – Scope and Methodology

We performed this audit under the authority of Public Law 110-343, as amended, which also incorporates the duties and responsibilities of inspectors general under the Inspector General Act of 1978, as amended. SIGTARP undertook this audit to examine the process used by Treasury and regulators to approve the nation's largest financial institutions to repay Treasury and exit TARP. Our specific reporting objectives were to determine Treasury's role in the TARP repayment process and the extent to which Federal banking regulators have consistently coordinated and applied TARP repayment criteria for banks exiting TARP. We performed work at Treasury, FRB, FDIC, OCC, and OTS in Washington, D.C. We also conducted field interviews with current and former Government officials and bank executives in California, Florida, and New York. Our audit work was conducted between February 2010 and July 2011. The scope of this audit covered the 13 TARP repayments completed by December 31, 2010, by bank holding companies stress tested under SCAP.

To determine the extent to which Federal banking regulators consistently coordinated and applied TARP repayment criteria, we reviewed the Emergency Economic Stabilization Act of 2008, the American Recovery and Reinvestment Act of 2009, general securities purchase agreements and term sheets for CPP investments, Treasury's TARP transaction reports, TARP repayment guidance issued by Treasury and FRB, and repayment request evaluation guidance produced by FRB. We reviewed available FRB, FRBNY, FRB Richmond, FRB San Francisco, FRB Cleveland, FDIC, and OCC documentation, including analyses, documents, meeting minutes, emails, and repayment approvals for all 13 institutions covered in this audit, as available. We also reviewed financial institution repayment proposals, board minutes, news releases, and SEC filings pertaining to TARP repayments. We interviewed FRB Governor Daniel Tarullo, former FRB Vice Chairman Donald Kohn, former FDIC Chairman Sheila Bair, former Comptroller John Dugan, and Treasury Secretary Timothy F. Geithner as well as other senior officials at Treasury, FRB, FRB San Francisco, FDIC, and OCC to understand the process developed by Federal banking regulators and its implementation. We also spoke with the chief executive officers of Bank of America, Citigroup, and Wells Fargo, former executives of Bank of America and Wells Fargo, and senior officials of PNC to obtain their views on the repayment process.

To determine Treasury's role in the TARP repayment process, we reviewed statements and responses provided by Secretary Geithner and former Assistant Secretary Herbert Allison to Congress. We interviewed the Secretary and the former Assistant Secretary, FRB Governor Tarullo, former FRB Vice Chairman Kohn, former FDIC Chairman Bair, and former Comptroller Dugan as well as senior officials at Treasury, FRB, FRB San Francisco, FDIC, and OCC to understand the role of Treasury in TARP repayments. We also spoke with chief executive officers of Bank of America, Citigroup, and Wells Fargo, former executives of Bank of America and Wells Fargo, and senior officials of PNC to understand the nature of their contact with Treasury regarding TARP repayment. Additionally, we reviewed available Treasury, FRB, FDIC, OCC, and financial institution documentation pertaining to Treasury involvement in the repayment process.

SIGTARP conducted this performance audit in accordance with generally accepted government auditing standards prescribed by the Comptroller General of the United States. Those standards require that SIGTARP plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis

for findings and conclusions based on the audit objectives. SIGTARP believes that the evidence obtained provides a reasonable basis for the findings and conclusions based on the audit objectives.

Limitations on Data

SIGTARP relied upon Treasury and regulators to identify and provide email communication or documents related to TARP repayments. It is possible that the documentation provided by agencies did not reflect a comprehensive response to SIGTARP's documentation requests, potentially limiting the review. Additionally, FRB objected to the inclusion of a significant amount of text on the grounds that it was confidential and that disclosure might, among other things, affect FRB's ability to maintain open communication with supervised financial institutions. SIGTARP respectfully disagrees with FRB's prediction of harm, but out of an abundance of caution, has removed some of the text, while reaching agreement with FRB on the inclusion of other portions. The exclusion of certain text somewhat limits the depth of information included in the report.

Use of Computer-Processed Data

To perform this audit, we used data provided by Treasury to report on TARP transaction amounts and dates. To assess the extent to which Treasury generated reliable data, we reviewed the November 2010 Government Accountability Office ("GAO") financial audit of Treasury's Office of Financial Stability ("OFS") financial statements for fiscal years 2010 and 2009. In GAO's opinion, OFS' fiscal years 2010 and 2009 financial statements for TARP were fairly presented in all material respects. Therefore, SIGTARP found nothing material that would impede the use of TARP transaction report data to determine TARP investment and repayment amounts and dates. We also used data from Bloomberg Professional to analyze historical public equity offerings and the Tier 1 Common ratios and daily stock prices of select SCAP institutions. Because it is among the most widely used systems for financial data, we view the information provided by Bloomberg Professional to be the best available for purposes of our review.

Internal Controls

As part of the overall evaluation of the TARP repayment decision-making process, we examined internal controls related to the review and approval of TARP repayment requests of SCAP institutions by regulators.

Prior Coverage

Other oversight bodies have reported on the process by which institutions exited CPP. GAO found that the CPP repayment approval process "lacks adequate transparency,"⁶³ and the Congressional Oversight Panel ("COP") noted that the repayment criteria were "opaque."⁶⁴ COP also stated that "a lack of clarity (surrounding the repayment criteria) breeds uncertainty and instability in the financial markets and provides a disservice to taxpayers as well as investors."⁶⁵ In another report on CPP, GAO found that Treasury does not collect information on or monitor regulators' repayment decisions, and therefore "has no basis for determining whether regulators evaluate similar institutions consistently and cannot provide feedback to

⁶³ Government Accountability Office, Report No. 09-658, "Troubled Asset Relief Program: June 2009 Status of Efforts to Address Transparency and Accountability Issues," June 17, 2009.

⁶⁴ Congressional Oversight Panel, "July Oversight Report: Small Banks in the Capital Purchase Program," July 14, 2010.

⁶⁵ Congressional Oversight Panel, "January Oversight Report: Exiting TARP and Unwinding Its Impact on the Financial Markets," January 13, 2010.

regulators on the consistency of their decision making.”⁶⁶ To address this concern, GAO recommended that Treasury “periodically collect and review information on the analysis supporting regulators’ decisions and provide feedback for regulators’ consideration on the extent to which they are evaluating similar institutions consistently.” Treasury replied that it would consider ways to address GAO’s recommendation and noted that Treasury has facilitated meetings among regulators in the past.

⁶⁶ Government Accountability Office, Report No. 11-47, “Troubled Asset Relief Program: Opportunities Exist to Apply Lessons Learned from the Capital Purchase Program to Similarly Designed Programs and to Improve the Repayment Process,” October 4, 2010.

Appendix B – Role of Federal Banking Regulators

Federal Reserve Board (“FRB”): FRB administers U.S. monetary policy and has supervisory and regulatory authority over bank holding companies; state-chartered banks that choose to join the Federal Reserve System; the U.S. operations of foreign banking organizations; certain U.S. entities that engage in international banking; and pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act”), FRB also has authority to supervise and regulate U.S. and foreign nonbank financial companies selected by the Financial Stability Oversight Council. The Federal Reserve works with other Federal and state supervisory authorities to promote the safety and soundness of the banking industry and fosters the stability of the broader financial system.

Office of the Comptroller of the Currency (“OCC”): OCC, an agency within Treasury, charters, regulates, and supervises all National Association (“N.A.”) banks. N.A. banks are federally chartered (organized under the laws of the United States, as opposed to state statutes) and are incorporated under the National Bank Act. OCC’s nationwide staff of examiners analyze, among other things, a bank’s portfolios, capital, earnings, liquidity, and compliance with consumer banking laws. As of September 30, 2010, OCC regulated more than 1,450 national banks with total assets of approximately \$8.5 trillion, comprising approximately 70% of commercial bank assets in the United States.

Federal Deposit Insurance Corporation (“FDIC”): FDIC, an independent agency of the Federal Government, directly examines and supervises more than 4,900 banks and savings banks that are chartered by the states and that do not join the Federal Reserve System. To protect insured depositors, FDIC responds immediately if a bank or thrift institution fails, generally by selling the deposits and loans of the failed institution to another institution. Pursuant to the Dodd-Frank Act, FDIC also has the authority to liquidate failing financial companies that pose a significant risk to U.S. financial stability. FDIC also provides deposit insurance, which guarantees the deposits in member banks, up to \$250,000 per depositor.

Office of Thrift Supervision (“OTS”): Established as a bureau of Treasury on August 9, 1989, OTS charters, examines, supervises, and regulates Federal savings associations insured by FDIC. OTS also examines, supervises, and regulates state-chartered savings associations insured by FDIC and provides for the registration, examination, and regulation of savings and loan holding companies and other affiliates. Effective on July 21, 2011, the Dodd-Frank Act transfers the duties and authorities of OTS to FRB, FDIC, and OCC, and abolishes OTS 90 days after. All OTS functions relating to Federal savings associations, all OTS rulemaking authority for Federal and state savings associations, and the majority of OTS employees will be transferred to OCC. OTS’ supervisory responsibility for state-chartered savings associations and OTS employees to support these responsibilities will be transferred to FDIC; and OTS’ authority for consolidated supervision of savings and loan holding companies and their non-depository subsidiaries will be transferred to FRB.

Appendix C – Additional FAQs on Capital Purchase Program Repayment Published by Treasury in May 2009

Q1. What is the policy for returning CPP money?

Under the original terms of the CPP, banks were prohibited from repaying within the first 3 years unless they completed a qualified equity offering. However, the provisions introduced by the American Recovery and Reinvestment Act of 2009 indicate that once an institution notifies Treasury that it would like to repay its CPP investment, Treasury must permit a TARP recipient to repay subject to consultation with the appropriate Federal Banking Agency.

All institutions seeking to repay CPP will be subject to the existing supervisory procedures for approving redemption requests for capital instruments. Supervisors will carefully weigh an institution's desire to redeem outstanding CPP preferred stock against the contribution of Treasury capital to the institution's overall soundness, capital adequacy, and ability to lend, including confirming that the institution has a comprehensive internal capital assessment process.

The 19 BHCs that were subject to the SCAP process must have a post-repayment capital base at least consistent with the SCAP buffer, and must be able to demonstrate its financial strength by issuing senior unsecured debt for a term greater than five years not backed by FDIC guarantees, in amounts sufficient to demonstrate a capacity to meet funding needs independent of government guarantees.

Q2: What will happen to the warrants that Treasury owns in these banks?

After repaying their CPP preferred stock, institutions also have the right to repurchase the warrants issued to Treasury for their appraised market value. If an institution chooses not to repurchase the warrants, Treasury may liquidate registered warrants. The warrants cannot be sold to an investor until the bank has had an opportunity to repurchase them.

Q3. How will you value the warrants that you own in banks that are repaying CPP investments?

The issuer can repurchase the warrants at "fair market value," as defined in Section 4.9 of the Securities Purchase Agreement. Specifically, the bank wishing to repurchase warrants will hire an independent advisor that will use standard industry practices to value the warrants and will present the offer to Treasury, which will independently calculate its own determination of fair market value using a robust process which includes third party input. If those values differ, then Treasury and the bank will follow the process defined in Section 4.9 to reach a mutually agreed upon fair market value.

Q4. How will the public know when a firm has repaid its CPP preferred or repurchased Treasury's warrants?

Information on CPP preferred repayments and warrant repurchases is made available online and updated regularly in the TARP Transactions Reports. The reports can be found at <http://www.financialstability.gov/latest/reportsanddocs.html>.

Q5: For CPP participants who have used the public institution transaction documents, how is the warrant exercise price calculated?

Treasury is aware that there is some confusion around this calculation. All warrant exercise prices have been calculated in a consistent manner, taking the average of the closing prices for the 20 trading days up to and including the day prior to the date on which the TARP Investment Committee recommends that the Assistant Secretary for Financial Stability approve the investment. Please note that (i) the recommendation of the Investment Committee constitutes preliminary approval, but final approval of an investment occurs only when the transaction documents are executed and delivered by Treasury; and (ii) a trading day is defined as a day on which there was trading activity in a given name.

Appendix D – June 2009 and November 2009 TARP Repayment Guidance to SCAP Institutions

Supervisory Capital Assessment Program

Clarifying Guidance --

**Criteria for Redemption of U.S. Treasury Capital for
BHCs that Participated in the SCAP**

November 3, 2009

November 3, 2009

Criteria for TARP Redemption for Supervisory Capital Assessment Program (SCAP) BHCs

This guidance clarifies considerations outlined in the guidance on TARP redemption for SCAP banks that was distributed in June, 2009. (See appendix for June, 2009 guidance)

- I. A bank holding company (BHC) must have capital levels such that it can satisfy the SCAP “more adverse” 4% Tier I Common and the 6% Tier I pro forma risk-based capital ratios upon redemption of US Treasury (UST) capital.
- II. A BHC must have recently demonstrated the ability to access the long-term debt markets without reliance on the Federal Deposit Insurance Corporation’s Temporary Liquidity Guarantee Program (TLGP), and shown recent access to public equity markets.
- III. After redeeming its UST capital, a BHC must be able to:
 - Remain in a position to continue to fulfill its role as an intermediary that facilitates lending to creditworthy households and businesses;
 - Maintain capital levels that are consistent with supervisory expectations;
 - Serve as a source of financial and managerial strength and support to its subsidiary bank(s); and
 - Meet the ongoing funding requirements and obligations to counterparties of the holding company and its bank subsidiaries.
- IV. A BHC must submit for supervisory review a forward-looking assessment of its prospective capital position and potential capital needs, and show evidence of a robust longer-term capital assessment and management process geared toward achieving and maintaining a prudent level and composition of capital commensurate with its business activities and firm-wide risk profile.
- V. Within the next 21 days, each SCAP BHC that continues to hold UST capital must submit to the Federal Reserve a detailed plan for how it intends to redeem that capital, and must include in that plan the firm’s intended timing for the redemption.

The Federal Reserve believes that a BHC’s safety and soundness is enhanced by a composition of capital that strongly favors common equity raised in private markets. In keeping with this, a BHC that can satisfy (I) through (III) above, while undergoing a supervisory review of its longer-term capital planning process and expected future capital levels, may be permitted to redeem all or part of its UST capital under the condition that it issue \$1 of new common equity for every \$2 of UST capital being redeemed. This measure provides a BHC with the opportunity to improve the composition of its capital and reduce its reliance on U.S. government programs while its supervisors review and assess its longer-term capital plans.

June 1, 2009

Appendix – June, 2009 Guidance

I. Guidelines for Supervisory Approval to Redeem US Treasury Capital

All Bank Holding Companies (BHCs) wishing to redeem capital received from the Department of the Treasury (UST) must first obtain supervisory approval. The following guidance outlines the requirements and considerations that will inform the decision-making process for the 19 BHCs that participated in the Supervisory Capital Assessment Program (SCAP).

A BHC that participated in the SCAP and was not required to augment its capital buffer will become eligible to be considered for approval to redeem UST capital once it has successfully demonstrated access to common equity through public issuance in the equity capital markets.

A BHC that participated in the SCAP and was required to augment its capital buffer will become eligible to be considered to redeem UST capital once the SCAP capital buffer is in place and any other relevant supervisory objectives have been achieved.

Requests for redemption will be reviewed and considered on a firm-by-firm basis. Approval of each request will be based on supervisors' determination that the BHC satisfies the five considerations outlined below. Requests to redeem UST capital must be accompanied by a description of the BHC's internal capital assessment, planning and management processes, including guidelines approved by the Board of Directors for capital assessment, planning and management and the most recently-approved targets for capital levels for the consolidated entity.

The Federal Reserve's process for evaluating redemption requests will include consideration of the following:

1. Whether the BHC can redeem UST capital and remain in a position to continue to fulfill its role as an intermediary that facilitates lending to creditworthy households and businesses;
2. Whether, after redeeming UST capital, the BHC will be able to maintain capital levels that are consistent with supervisory expectations (including the buffer under SCAP), industry norms and historical levels for the firm, including the firm's own internal capital targets;
3. Whether the BHC has demonstrated access to common equity through public issuance in equity capital markets and demonstrated the ability to raise a significant amount of unsecured senior debt with a maturity of five or more years without reliance on the TLGP;
4. Whether the BHC and its bank subsidiaries will be able to meet obligations to counterparties, as well as ongoing funding requirements, while reducing reliance on UST capital and the TLGP; and
5. Whether the BHC will be able to continue to serve as a source of financial and managerial strength and support to its subsidiary bank(s) after the redemption.

June 1, 2009

Supervisory review and acceptance of a firm's current internal capital assessment, planning and management processes is not a precondition for approval of the redemption of UST capital.

- However, the evaluation of a BHCs' internal capital assessment processes remains a critical component of supervisory efforts. Going forward, ensuring that BHCs make progress in enhancing those processes, where it is deemed necessary, will be a key focus of supervisors.
- All BHCs participating in the SCAP will be subject to reviews of their internal capital assessment, planning and management guidelines and processes, and will be required to develop action plans to address any weaknesses in those processes. The action plans will include detailed timelines for achieving the objectives outlined in the plans. (See Section II below for further discussion of internal capital assessment, planning and management issues.)

II. Improving Internal Capital Assessment and Management Processes

The recent supervisory assessment of firms' capital positions has re-emphasized the importance of effective capital planning that adequately considers both short-term and long-term capital needs, including contingency plans designed to allow a BHC to maintain capital adequacy during a range of potentially adverse environments. Each BHC is expected to demonstrate longer-term capital assessment, planning and management processes that are geared towards achieving and maintaining a level and composition of capital that is prudent given its own specific business activities and firm-wide risk profiles.

Internal capital planning processes should consider all risks a BHC may face, including not only credit and market risks, but operational, reputational and funding/liquidity risks as well. Consistent with #4 above, a key aspect of longer-term capital planning should be considerations of a BHC's ability to continue to meet obligations to counterparties, as well as its ongoing funding requirements, while reducing its reliance on UST capital and the TLGP.

Internal capital assessment processes should identify and measure a BHC's firm-wide risks, generate a corresponding estimate of capital needs based on those risks, and determine available capital resources to meet estimated capital needs. Measures of expected and potential future capital levels and needs should be consistent with supervisory expectations and should consider longer-term industry norms and historical levels of the firm's own internal capital targets.

Importantly, BHCs should consider their possible capital needs and their ability to maintain adequate capital and, if necessary, augment capital, during times of financial and economic stress when capital needs can increase and access to external capital resources may decline. They should consider the impact that market disruptions may have on a BHC's market and credit risk exposures, as well as on its funding/liquidity position. Internal capital assessment processes should be consistent with the complexity of a BHC's activities and risk profile and generally should include:

- A well-defined statement outlining the overall risk tolerance of the organization;

June 1, 2009

- Robust risk management practices to support estimates of capital needs;
- Recognition of ways in which all types of risks -- including operational, reputational and liquidity risks -- can affect capital adequacy;
- Appropriate treatment of potential risk concentrations;
- Stress testing to complement more traditional risk measurement methods;
- Proper governance over the capital assessment process, including ongoing involvement of senior management and regular interaction with the board of directors;
- Clear definitions of capital components used to support estimated capital needs, including the demonstrated capacity of those components to absorb loss; and
- Recognition that capital cushions above estimated capital needs are prudent given the inherent uncertainty in estimating future capital needs and assessing capital adequacy.

Appendix E – FRB Redemption Request Decision Memo

TARP CAPITAL PURCHASE PROGRAM Redemption Request Decision Memo

Reserve Bank Completing Form: _____
 Applicable Federal Banking Agency(ies): _____
 QFI Name/City/State That Received TARP CPP Funds: _____

 RSSD: _____ Total Consolidated Assets: \$ _____
 TARP Funds Received: \$ _____ Date TARP Funds Received: _____
 Date Redemption Request Received: _____
 Amount of Redemption Request: Stock/Sr. Securities \$ _____ Warrants: \$ _____
 Partial Redemption: % Redeemed: _____ (must be ≥ 25%)
 Full Redemption
Summary Condition and Performance Information (Lead Bank(s) and BHC):
 C/CAMELS (R) Ratings (Date/Agency): _____ SR-SABR Rating: _____
 CRA Rating (Date): _____ SR-SABR Viability Probability: _____ %
 C/RFI Rating (Date): _____

Largest Bank Performance Ratios			
	<i>Application¹ As Of:</i>	<i>Most Current¹ As Of:</i>	<i>Post Redemption</i>
Tier 1 Risk-Based Capital			
Total Risk-Based Capital			
Tier 1 Leverage Ratio			
Classified Assets/(Net Tier 1 capital + ALLL) (if post redemption ≥ 100%, please discuss)			
(NPLs + OREO)/(Net Tier 1 capital + ALLL) (if post redemption ≥ 40%, please discuss)			
Construction & Development Loans/ Total RBC (if post redemption ≥ 300%, please discuss)			
CRE/Total RBC			
Non-owner Occ CRE/Total RBC			
Net Noncore Funding Dependence			

¹ Include TARP CPP Application ratios, if available. If most recent performance ratios were before TARP CPP funds were received or invested in the bank, calculate pro forma ratios with TARP CPP funds.

revised 12/09/09

RSSD: _____ Name: _____

BHC (FR Y-9C filers only) Performance Ratios (if applicable)			
	<i>Application² as of:</i>	<i>Most Current² as of:</i>	<i>Post Redemption (using 3/31/09 capital rules)</i>
Tier 1 Risk-Based Capital			
Total Risk-Based Capital			
Tier 1 Leverage Ratio			
Classified Assets/(Net Tier 1 capital + ALLL) (if post redemption ≥ 100%, please discuss)			
(NPLs + OREO)/(Net Tier 1 capital + ALLL) (if post redemption ≥ 40%, please discuss)			
Construction & Development Loans/ Total RBC (if post redemption ≥ 300%, please discuss)			
CRE/Total RBC			
Non-owner Occ CRE/Total RBC			
Net Noncore Funding Dependence			

² Include TARP CPP Application ratios, if available. If most recent performance ratios were before TARP CPP funds were received, calculate pro forma ratios with TARP CPP funds.

Reserve Bank Recommendation:

Approve Redemption Request

Deny Redemption Request

Yes No N/A

1. Has there been a significant change in the financial condition and/or viability of the institution since it applied for TARP CPP? *For a community institution, please verify this in a conversation with management or, if a shell BHC, the federal banking regulator of the largest subsidiary bank. (if yes, please discuss below)*

2. Are management’s capital planning processes appropriate given the current financial condition and risk profile of the organization *and* will the company be able to maintain capital levels appropriate to its risk profile over the next two years, even assuming worsening economic conditions (considering factors such as the level and composition of capital, earnings, asset quality, the ALLL, and liquidity, among others)? *(For all institutions, please briefly discuss below the relevant supervisory work conducted to assess the reasonableness of the capital planning processes and projections and the analysis supporting the conclusion.)*

RSSD: _____ Name: _____

Yes No N/A

- 3. Is the redemption of TARP CPP proceeds by the holding company consistent with SR 09-4? *(For institutions over \$5 billion in total assets, please briefly discuss below the analysis supporting the conclusion, including a discussion of the BHC's ability to serve as a source of financial and managerial strength to the subsidiary bank(s) after the redemption.) (if no, please discuss below)*
- 4. Is the BHC or any subsidiary bank(s) subject to a MOU or formal enforcement action? *(if yes, please discuss below whether the redemption could affect the areas covered in the enforcement action and consult with the subsidiary bank(s) primary federal regulator concerning the redemption request)*
- 5. If a BHC, does the BHC have sufficient cash to redeem the TARP CPP proceeds without a dividend from the bank? *(if no, please discuss below)*

Source of cash (i.e., on hand, debt offering, stock offering, other): _____
(if other than cash or equity, please discuss below)
- 6. If a subsidiary bank(s) must pay a dividend to the parent to allow the parent to redeem the TARP CPP proceeds, does the payment of the dividend require prior regulatory approval under applicable law or regulation? *(if yes, please discuss below)*
- 7. If a subsidiary bank(s) must pay a dividend to the parent to allow the parent to redeem the TARP CPP proceeds, is the dividend less than or equal to the amount of TARP CPP funds invested in the bank? *(if no, please discuss below)*
- 8. If a subsidiary bank(s) must liquidate a class of stock owned by the parent to allow the parent to redeem the TARP CPP proceeds, does the liquidation of the class of stock require prior regulatory approval under applicable law or regulation? *(if yes, please discuss below)*
- 9 (a). If a state chartered subsidiary bank(s) must pay a dividend to the parent or liquidate a class of stock owned by the parent to allow the parent to redeem the TARP CPP proceeds *or* if the state chartered QFI is applying to directly redeem the TARP CPP proceeds, has the Reserve Bank consulted with the state banking regulator on the impact of the dividend, liquidation, or redemption? *(if no, please discuss below)*
- 9 (b). If the Reserve Bank consulted with a state banking regulator, did the state banking regulator in writing concur with or not object to the state chartered QFI's or the QFI's bank subsidiary's request to pay a dividend to the parent, liquidate a class of stock owned by the parent, or directly redeem the TARP CPP proceeds? *(if no, please discuss below)*

RSSD: _____ Name: _____

Yes No N/A

- 10 (a). Regardless of whether a subsidiary bank(s) must pay a dividend to the parent or liquidate or redeem a class of stock owned by the parent to allow the parent to redeem the TARP CPP proceeds, has the Reserve Bank consulted with the federal banking regulator of the subsidiary bank(s) on the impact of the dividend, liquidation, or redemption? *(if no, please discuss below)*
- 10 (b). If the Reserve Bank consulted with another federal banking regulator, did the federal banking regulator in writing concur with or not object to (i) the QFF's bank subsidiary paying a dividend to the parent or liquidating or redeeming a class of stock owned by the parent, if applicable, and (ii) the proposed redemption by the bank holding company? *(if no, please discuss below)*
- 11 (a). Did the institution or any of its subsidiaries issue debt under the Temporary Liquidity Guarantee Program (TLGP)? *(if yes, please respond to question 11(b))*
- 11 (b). If applicable, has the institution or the subsidiary that issued TLGP debt demonstrated the ability to issue debt without reliance on the FDIC guarantee? *(if no, please discuss below)*
- 12. Would the redemption of TARP CPP proceeds by the holding company require an application to be filed under Regulation Y, §225.4(b)? *(if yes, please discuss below, including a discussion of when the §225.4(b) application was filed)*

Explanations to Questions Above

- Explanation of Answers to Above Questions Requiring Explanation

For Redemption Disapproval Recommendations:

- Summary of Factors that Warrant Disapproval

Appendix F – SCAP Institutions' Exit from CPP

SCAP INSTITUTIONS' EXIT FROM CPP		
Institution	CPP Investment Amount	Date Exited CPP (if applicable)
JPMorgan Chase & Co.	\$25,000,000,000	6-17-2009
The Goldman Sachs Group, Inc.	\$10,000,000,000	6-17-2009
Morgan Stanley	\$10,000,000,000	6-17-2009
U.S. Bancorp	\$6,599,000,000	6-17-2009
Capital One Financial Corp.	\$3,555,199,000	6-17-2009
American Express Co.	\$3,388,890,000	6-17-2009
BB&T Corp.	\$3,133,640,000	6-17-2009
Bank of New York Mellon Corp.	\$3,000,000,000	6-17-2009
State Street Corp.	\$2,000,000,000	6-17-2009
Bank of America Corp.	\$25,000,000,000	12-09-2009
Wells Fargo & Co.	\$25,000,000,000	12-23-2009
The PNC Financial Services Group, Inc.	\$7,579,200,000	2-10-2010
Citigroup Inc.	\$25,000,000,000	12-10-2010
Fifth Third Bancorp	\$3,408,000,000	2-2-2011
KeyCorp	\$2,500,000,000	3-30-2011
Regions Financial Corp.	\$3,500,000,000	Has not exited
SunTrust Banks, Inc.	\$4,850,000,000	3-30-2011
GMAC (now Ally Financial)	Did not participate in CPP	
MetLife	Did not participate in TARP	

Source: SIGTARP analysis of Treasury *Transactions Report* data, 6/22/11.

Appendix G – Management Comments from FRB, OCC, and Treasury



BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

SCOTT G. ALVAREZ
GENERAL COUNSEL

September 27, 2011

Christy L. Romero
Acting Special Inspector General
for the Troubled Asset Relief Program
1801 L Street, N.W., 4th floor
Washington, D.C. 20220

Dear Ms. Romero:

Thank you for giving the Federal Reserve the opportunity to comment on the draft report titled *Exiting TARP: Repayments by the Largest Financial Institutions*. We have worked closely with SIGTARP on this report, and, as you have acknowledged, cooperated fully with all of your requests for documentation and interviews. We have provided comments on several earlier versions of this report and are pleased to provide this formal comment on your final draft.

As SIGTARP notes, many institutions that were part of the SCAP process have now fully repaid the taxpayer and exited the CPP program and TARP altogether. The SCAP process was a rigorous review of the capital needs of the largest banking institutions under several stressed situations.

The report recognizes that the Board carefully and thoroughly analyzed the requests to repay TARP by all of the banking organizations that were part of the SCAP process. In approving these requests, the Board required these banking organizations to complete the largest capital raising efforts ever conducted by U.S. banking organizations. These successful capital raising efforts were supplemented by other activities by these banking organizations to increase their real capital cushions. As a result, each firm's Tier 1 Common ratio increased substantially. While led by the Federal Reserve, all of the banking agencies were consulted throughout this review process and, as the report acknowledges, all agreed with the final decision to allow each banking organization to repay TARP.

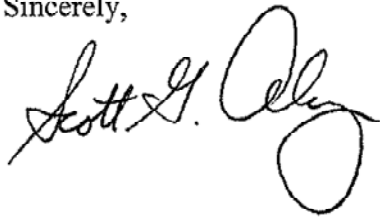
SIGTARP expressed concern that the Board allowed some banking entities to substitute asset sales for issuing common equity. We note that the Board put limits on the reliance on increases in capital resulting from asset sales and applied tougher standards and gave less credit to asset sales than to capital generated through the issuance of common stock. We also note that SIGTARP does not count stock issued through an employee stock compensation plan in lieu of stock issued for cash in a public offering toward meeting the 1-for-2 guidance. However, these

Christy Romero
Page Two

common equity issuances improve an institution's capital situation in the same way as a public offering of stock.

We appreciate the efforts of the SIGTARP in reviewing this process and thank you for providing us the opportunity to comment.

Sincerely,

A handwritten signature in black ink, appearing to read "Scott G. Allen". The signature is written in a cursive style with a large, looped flourish at the end.



MEMORANDUM

Comptroller of the Currency
Administrator of National Banks

Washington, DC 20219

To: Christy L. Romero, Acting Special Inspector General for the Troubled Asset Relief Program

From: John Walsh, Acting Comptroller of the Currency

Date: 9/26/11

Subject: Comments on Draft Audit Report -- Exiting the Troubled Asset Relief Program (TARP)

We have received and reviewed your draft audit report titled "Exiting TARP: Repayments by the Largest Financial Institutions." You conducted this audit, project 018, under the authority of Public Law 110-343, as amended, which also incorporates the duties and responsibilities of inspectors general under the Inspector General Act of 1978, as amended.

We agree with the Special Inspector General for the Troubled Asset Relief Program's (SIGTARP) findings that interagency sharing of data, vigorous debate among regulators, and hard-won consensus increased the amount and improved the quality of the capital that Supervisory Capital Assessment Program (SCAP) institutions were required to raise to exit TARP.

Overall, you conclude that the lessons of the financial crisis and the events surrounding TARP repayments and exit demonstrate the importance of implementing strong capital requirements and holding institutions strictly accountable to those requirements. You also identified three aspects of the TARP exit process that you concluded serve as lessons learned: (1) because the regulators failed to adhere to the Federal Reserve Board's (FRB) clearly and recently established requirements, the process to review a TARP bank's exit proposal was ad hoc and inconsistent; (2) by not waiting until the banks were in a position to meet the 1-for-2 provision entirely with new common stock, there was arguably a missed opportunity to further strengthen the quality of each institution's capital base to protect against future losses without selling sources of revenue; and (3) Treasury encouraged TARP banks to expedite repayment, opening Treasury to criticism that it put accelerating TARP repayment ahead of ensuring that institutions exiting TARP were sufficiently strong to do so safely.

We agree with SIGTARP's overall conclusion regarding the importance of implementing strong capital requirements and holding institutions accountable to such requirements.

However, we strongly disagree with your conclusion about the first lesson learned, *i.e.*, that because the regulators failed to adhere to FRB's "clearly and recently established requirements," the process to review a TARP's bank's exit proposal was ad hoc and inconsistent. The deviation

from the guidance resulted from a strong concern that the market would not bear the full amount of the equity raise implied by the guidance. In the end the regulators were not willing to insist on amounts that seriously risked a failed underwriting, and were also not willing to postpone going to the markets with the hope that a marginally higher amount could be raised later -- not when substantial amounts could be raised immediately that would result in significantly higher equity ratios, well above regulatory minimums, while at the same time allowing the government to exit from its capital investments in individual companies. These companies were pushed to raise as much equity capital as outside experts thought they could do under the circumstances, and real, loss-absorbing equity levels were increased by other means, such as asset sales. The flexibility to deviate somewhat from the pre-announced goals was pragmatic and necessary, and it produced very successful results: much stronger equity capital ratios for the banks; the government exit from capital ownership of these banks; and enhanced confidence in the U.S. banking system.

Your second conclusion -- that there was arguably a missed opportunity to further strengthen the quality of each institution's capital base to protect against future losses without selling sources of revenue by not waiting until the banks were in a position to meet the 1-for-2 provision entirely with new common stock -- misses the point that most regulators *wanted* the banks to move as swiftly as possible to repay TARP. Regulators wanted repayment so long as banks' loss-absorbing capital positions were substantially strengthened and a substantial amount of market-validating new equity was raised. Getting the government out of stock ownership in this manner was expected to be highly confidence-reinforcing, as proved to be the case; while failing to do so, including for any one firm, could have had the opposite effect. Moreover, at that time the window was clearly open for tapping the markets, and based on previous painful experience, there was no guarantee as to how long the window would stay open. In these circumstances, we believed that waiting in the hope of better terms later was far riskier than moving forward immediately with substantial, multi-billion dollar equity raises for the institutions involved.

We appreciate the opportunity to comment on the draft report.



DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

ASSISTANT SECRETARY

September 28, 2011

Christy L. Romero
Acting Special Inspector General
for the Troubled Asset Relief Program
United States Department of the Treasury
1500 Pennsylvania Avenue, NW
Washington, D.C. 20220

RE: Response to SIGTARP's Final Audit Report: "Exiting TARP: Repayments by the Largest Financial Institutions"

Dear Ms. Romero:

I am writing in response to your draft final audit report entitled, *Exiting TARP: Repayments by the Largest Financial Institutions*, dated September 21, 2011. The Department of the Treasury appreciates the Special Inspector General's ("SIGTARP's") review of the process that Treasury and the federal banking regulators¹ established for the largest banks to exit the Capital Purchase Program and related Troubled Asset Relief ("TARP") programs. This letter provides Treasury's official response to the SIGTARP audit report.

Your audit report concludes that the "interagency sharing of data, vigorous debate among regulators, and hard-won consensus increased the amount and improved the quality of the capital that SCAP institutions were required to raise to exit TARP." We strongly agree. We also agree with your conclusion that "[t]he checks-and-balances that resulted from this interagency coordination helped to ensure that the nation's largest financial institutions were better capitalized upon exiting TARP than prior to TARP." As the audit report notes, these actions were taken in the wake of a period of historic turmoil in the financial markets, when there were substantial risks of catastrophic damage to our financial system and economy. SIGTARP's report provides a useful record that describes how the regulators' coordinated, and ultimately unanimous, actions helped to restore liquidity and stability to the U.S. financial system.

Treasury's involvement in the TARP exit process was motivated by a fundamental belief that stabilizing our financial system ultimately depended upon the nation's largest financial institutions being able to raise private capital again. It was for this reason that Treasury encouraged firms to raise private capital and to repay the taxpayers' investments. As our offices have discussed, however, we are concerned that portions of your audit report could be misconstrued to suggest that some of the TARP repayments occurred prior to the institutions being "sufficiently strong to do so safely."

¹ Namely, the Federal Reserve Board ("Federal Reserve"), the Federal Deposit Insurance Corporation ("FDIC"), the Office of the Comptroller of the Currency ("OCC"), and the Office of Thrift Supervision ("OTS").

In recapitalizing the system, Treasury recognized that private capital could not be raised until the condition of the major financial institutions was made clear. As your audit report documents, it was for this reason that Treasury worked with the federal banking regulators to develop a comprehensive, forward-looking “stress test” for the nineteen largest bank holding companies to determine which ones would need more capital to remain well-capitalized if economic conditions deteriorated significantly more than expected. While Treasury “was asked for and offered its opinions on proposed standards,” as your audit report notes “the standards were determined by the regulators and Treasury deferred to their judgment as to what should be required.” In the end, the stress test was conducted with unprecedented openness and transparency, which helped restore market confidence in our financial system.

Following the completion of the stress test, and consistent with Treasury’s judgment that the financial system would be stronger if the largest bank holding companies could demonstrate they could raise private capital, Treasury encouraged these firms to reduce their dependency on emergency support and to replace public capital with private capital as soon as practicable. As the report acknowledges, however, Treasury understood and repeatedly stated that the decision on when an institution should repay the taxpayers’ investment was ultimately left to the regulators.

Finally, the report suggests that there was “arguably a missed opportunity to further strengthen the quality of each institution’s capital base” by not “waiting until the banks were in a position to meet the 1 for 2 position entirely with new common stock.” As the report notes, three of the four relevant offerings were among the ten largest in U.S. history. Your comment seems to assume that market conditions would have allowed even larger stock offerings sooner thereafter. Moreover, postponing those offerings could have risked undermining investor confidence and the ultimate goal of restoring financial stability.

We appreciate the opportunity to respond to your draft audit report. We look forward to continuing to work with you and your team as we move forward.

Sincerely,



Timothy G. Massad
Assistant Secretary for Financial Stability

Appendix H – Audit Team Members

This review was conducted and the report was prepared under the direction of Kurt Hyde, Deputy Inspector General for Audit and Evaluation, and Kimberley A. Caprio, Assistant Deputy Special Inspector General for Audit and Evaluation, Office of the Special Inspector General for the Troubled Asset Relief Program.

The staff members making significant contributions to this report include Shannon Williams, Daniel Novillo, Jean Tanaka, and Marc Geller

SIGTARP Hotline

If you are aware of fraud, waste, abuse, mismanagement, or misrepresentations associated with the Troubled Asset Relief Program, please contact the SIGTARP Hotline.

By *Online Form*: www.SIGTARP.gov

By *Phone*: Call toll free: (877) SIG-2009

By *Fax*: (202) 622-4559

By *Mail*:

**Hotline: Office of the Special Inspector General
for the Troubled Asset Relief Program**
1801 L Street., NW, 3rd Floor
Washington, D.C. 20220

Press Inquiries

If you have any inquiries,
please contact our Press Office:

Julie Vorman
Acting Director of Communications
Julie.Vorman@treasury.gov
202-927-1310

Legislative Affairs

For Congressional inquiries,
please contact our Legislative Affairs Office:

Lori Hayman
Director of Legislative Affairs
Lori.Hayman@treasury.gov
202-927-8941

Obtaining Copies of Testimony and Reports

To obtain copies of testimony and reports, please log on to our website at www.SIGTARP.gov.

