CBO

Report on the Troubled Asset Relief Program— March 2011

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A CBO REPORT

Report on the Troubled Asset Relief Program—March 2011

The Congress of the United States ■ Congressional Budget Office

Note

Numbers in the text and tables may not add up to totals because of rounding.

Preface

In October 2008, the Emergency Economic Stabilization Act of 2008 established the Troubled Asset Relief Program (TARP) to enable the Department of the Treasury to purchase or insure troubled assets as a way to promote stability in financial markets. Section 202 of that legislation requires the Congressional Budget Office (CBO) to prepare a report on those transactions within 45 days of a report issued by the Office of Management and Budget (OMB) on the TARP's activities. This fifth statutory report from CBO on the TARP's transactions follows the report that OMB submitted to the Congress on February 14, 2011.

Avi Lerner of CBO's Budget Analysis Division prepared the report under the supervision of Peter Fontaine, Theresa Gullo, and Jeffrey Holland. Francesca Castelli, Chad Chirico, Wendy Kiska, and Deborah Lucas contributed significantly to the analysis. Christine Bogusz edited the report, Kate Kelly proofread it, and Jeanine Rees prepared it for publication. Monte Ruffin oversaw the printing of the report, and Linda Schimmel handled the print distribution. The report is available on CBO's Web site (www.cbo.gov).

Douglas W. Elmendorf
Director

March 2011

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In October 2008, the Emergency Economic Stabilization Act of 2008 (Division A of Public Law 110-343) established the Troubled Asset Relief Program (TARP) to enable the Department of the Treasury to promote stability in financial markets through the purchase and guarantee of "troubled assets."[1] Section 202 of that legislation requires the Office of Management and Budget (OMB) to submit semiannual reports on the costs of the Treasury's purchases and guarantees of troubled assets.[2] The law also requires the Congressional Budget Office (CBO) to prepare an assessment of each OMB report within 45 days of its issuance. That assessment must discuss three elements:

- The costs of purchases and guarantees of troubled assets,
- The information and valuation methods used to calculate those costs, and
- The impact on the federal budget deficit and debt.

To fulfill its statutory requirement, CBO has prepared this report on transactions completed, outstanding, and anticipated under the TARP as of March 3, 2011. CBO estimates that the cost to the federal government of the TARP's transactions (also referred to as the subsidy cost), including grants for mortgage programs that have not been made yet, will amount to $19 billion. That cost stems largely from assistance to American International Group (AIG), aid to the automotive industry, and grant programs aimed at avoiding foreclosures. Other transactions with financial institutions will, taken together, yield a net gain to the federal government, in CBO's estimation.

CBO's current estimate of the cost of the TARP's transactions is $6 billion less than the $25 billion estimate shown in the agency's previous report on the TARP (issued in November 2010).[3] The reduction in the estimated cost results primarily from a lower assessment of losses from assistance provided to the automotive industry. CBO's current estimate is well below OMB's latest estimate of $64 billion, largely because of different assessments of the cost of the Treasury's housing programs under the TARP.

When the TARP was created, the U.S. financial system was in a precarious condition, and the transactions envisioned and ultimately undertaken engendered substantial financial risk for the federal government. The costs directly associated with the TARP, when taken in isolation, have come out toward the low end of the range of possible outcomes anticipated when the program was

1. The law defines troubled assets as "(A) residential or commercial mortgages and any securities, obligations, or other instruments that are based on or related to such mortgages, that in each case was originated or issued on or before March 14, 2008, the purchase of which the Secretary determines promotes financial market stability; and (B) any other financial instrument that the Secretary, after consultation with the Chairman of the Board of Governors of the Federal Reserve System, determines the purchase of which is necessary to promote financial market stability, but only upon transmittal of such determination, in writing, to the appropriate committees of Congress."

2. OMB's most recent report on the TARP was submitted on February 14, 2011, as part of *Analytical Perspectives, Budget of the United States Government, Fiscal Year 2012,* www.whitehouse.gov/sites/default/files/omb/budget/fy2012/assets/spec.pdf.

3. See Congressional Budget Office, *Report on the Troubled Asset Relief Program—November 2010* (November 2010).

Table 1.

Activities of the Troubled Asset Relief Program

	Billions of Dollars
Amount of Principal[a]	
Repaid	244
Written Off[b]	11
Outstanding	156
Subtotal	410
Additional Disbursements Anticipated	22
Total[c]	**432**
Estimated Subsidy Cost[d]	19

Sources: Congressional Budget Office; Department of the Treasury.

Note: Transactions are as of March 3, 2011.

a. Other funds were made available through asset guarantee programs, but no disbursements were made from those funds.

b. Includes realized losses on sales of General Motors stock.

c. Authority for the Troubled Asset Relief Program was originally set at a maximum of $700 billion; however, that total was reduced to $475 billion in the Dodd–Frank Wall Street Reform and Consumer Protection Act (Public Law 111-203).

d. The subsidy cost is estimated using procedures similar to those specified in the Federal Credit Reform Act of 1990, but with an adjustment for market risk as directed by the Emergency Economic Stablization Act (Division A of Public Law 110-343).

launched; however, funds invested, loaned, or granted to participating institutions through the Federal Reserve and other government entities helped limit those costs. As a result, only $432 billion will be disbursed through the TARP, CBO estimates, well below the $700 billion initially authorized (see Table 1). Overall, the outcomes of most transactions made through the TARP were favorable for the federal government.

Estimating the Costs of the TARP

CBO values the TARP's asset purchases and guarantees using procedures similar to those specified in the Federal Credit Reform Act of 1990, but with an adjustment for market risk as directed by the Emergency Economic Stabilization Act. The total estimated cost of the TARP reported here is a combination of prospective and realized costs. In brief:

- Projected future cash flows are discounted to a present value using a discount rate that accounts for: (a) the fact that money in hand now is worth more than the same amount received in the future; and (b) the premium that a private investor would require as compensation for the risk of the transaction. The risk premium used by CBO varies depending on the riskiness of the transaction.

- Cash flows that have already occurred—for instance, the Treasury's purchase of assets or its receipt of dividends or debt repayments—are converted to a present value using the rate on Treasury securities that most closely matches the time period for which the transaction was outstanding.

To explain more thoroughly, transactions that have been completed are valued by bringing all cash flows forward to the date of analysis using the Treasury's borrowing rate for the relevant period. For investments the Treasury has written off as uncollectible, the subsidy cost is considered to be 100 percent of the disbursed amount. Thus, CBO's estimate of the value of each completed transaction equals the realized gain or loss for the government.

Transactions that are outstanding—that is, transactions that have been initiated by the Treasury but are not yet completed—are valued by converting past cash flows to present values and combining them with the current values of assets held by the Treasury. For example, the estimated net cost of shares of preferred stock held through the TARP equals what the Treasury paid to acquire the shares (brought forward to the present using the Treasury's borrowing rate) minus the current value of the shares (based on market prices, if available) and any dividend payments already received by the government (also brought forward to the present using the Treasury's borrowing rate).

Transactions that CBO anticipates will occur are valued by discounting future cash flows to the present. For those transactions, such as future purchases made as part of the Public–Private Investment Program, the estimated cost equals the difference between what the Treasury is expected to pay and what the Treasury is expected to obtain in return, discounted to the date of the analysis on a risk-adjusted basis.

Table 2.

Actual and Projected Cash Disbursements of the Troubled Asset Relief Program

(Billions of dollars)

	Principal Disbursed	Results to Date for Principal Disbursed			Additional Anticipated Disbursements
		Repaid	Written Off	Outstanding	
Support for Financial Institutions					
Capital Purchase Program	205	171	3	30	0
Additional assistance to Citigroup and Bank of America[a]	40	40	0	0	0
Community Development Capital Initiative	1	0	0	1	0
Assistance to AIG	68	2	0	66	2
Subtotal	313	213	3	97	2
Assistance to the Automotive Industry	80	29	8	42	2
Investment Partnerships					
Term Asset-Backed Securities Loan Facility[b]	*	0	0	*	*
Public–Private Investment Program	16	1	0	15	6
SBA 7(a) Purchase Program	*	*	0	*	0
Subtotal	16	1	0	16	7
Mortgage Programs[c]	1	0	0	1	12
Total	**410**	**244**	**11**	**156**	**22**

Sources: Congressional Budget Office; Department of the Treasury.

Notes: Amounts shown are as of March 3, 2011.

AIG = American International Group; SBA = Small Business Administration; * = between zero and $500 million.

a. The Treasury also agreed to provide $5 billion to cover potential losses on Citigroup's assets; however, those losses did not occur, so no disbursements were made.

b. The Treasury has currently committed $4 billion to absorb losses on loans made by the Federal Reserve through the Term Asset-Backed Securities Loan Facility. Many of those loans remain outstanding, and no losses have occurred to date; however, the Treasury provided $100 million in initial funding.

c. Of the $50 billion initially announced for the Home Affordable Modification Program, which includes funding for state housing finance agencies and the Federal Housing Administration, $13 billion will eventually be disbursed, CBO estimates.

Transactions of the TARP

The TARP's transactions fall into four broad categories:

- Capital purchases and other support for financial institutions,
- Financial assistance to the automotive industry,
- Investment partnerships designed to increase liquidity in securitization markets, and
- Mortgage programs.

Capital Purchases and Other Support for Financial Institutions

To provide support for financial institutions, the federal government disbursed $313 billion, most of which has already been repaid, and is projected to provide an additional $2 billion (see Table 2). CBO estimates a net gain to the government of $9 billion from those transactions (see Table 3).

Capital Purchase Program. Through the TARP's Capital Purchase Program (CPP), the Treasury purchased

Table 3.

Estimated Subsidy Cost or Gain over the Life of the Troubled Asset Relief Program

(Billions of dollars)

	Estimated Subsidy Cost or Gain (-) CBO	Estimated Subsidy Cost or Gain (-) OMB	Difference
Support for Financial Institutions			
Capital Purchase Program	-16	-6	-10
Additional assistance to Citigroup and Bank of America	-7	-7	*
Community Development Capital Initiative	*	*	*
Assistance to AIG	14	12	2
Subtotal	-9	-1	-8
Assistance to the Automotive Industry	14	20	-6
Investment Partnerships			
Term Asset-Backed Securities Loan Facility	*	*	1
Public–Private Investment Program	*	*	*
SBA 7(a) Purchase Program	*	*	*
Subtotal	1	*	1
Mortgage Programs	13	46	-33
Total	**19**	**64**	**-45**

Sources: Congressional Budget Office; Office of Management and Budget.

Notes: CBO's estimates are derived from data as of March 3, 2011, whereas OMB used data as of December 31, 2010.

AIG = American International Group; SBA = Small Business Administration; * = between -$500 million and $500 million.

$205 billion in shares of preferred stock from 707 financial institutions.[4] As of March 3, 2011, $171 billion (or 83 percent) of that preferred stock had been repurchased by issuing institutions. CBO estimates a net gain to the government of $16 billion from the CPP.

Preferred stock purchased through the CPP carries a promised dividend equal to 5 percent of the government's investment for the first five years and 9 percent thereafter. The shares of preferred stock are accompanied by warrants that allow the government to purchase common stock equal in cost to 15 percent of the amount invested in preferred stock; the warrants specify that the price at which the government may purchase shares is the average price of the institution's common stock over the 20 trading days preceding the date of the government's investment.[5] Financial institutions that are not publicly owned provided the government with additional shares of preferred stock instead of warrants. Under the terms of the CPP, participating financial institutions are subject to restrictions on the compensation they provide to their executives, the dividends they pay to their shareholders, and the amount of common stock they repurchase.

The net gain of $16 billion estimated for the CPP comprises the following:

- Gains of more than $19 billion from transactions with banks that have fully repaid the Treasury's investment. That amount includes a roughly $7 billion net gain to the government realized from the sale of common shares of Citigroup; those shares had been acquired in exchange for $25 billion of preferred stock that the Treasury had purchased through the CPP.

- Unrecoverable losses of $3 billion from institutions that declared bankruptcy, were taken over by the Federal Deposit Insurance Corporation, or were authorized by the Treasury to renegotiate the terms of the investment.

- A net subsidy cost of less than $500 million for the program's outstanding investments, including dividends paid and the present value of preferred shares and warrants still held by the Treasury.

Additional Assistance to Citigroup and Bank of America. In addition to receiving funds from the CPP, two financial institutions—Citigroup and Bank of America—also received supplementary support through the Treasury's Targeted Investment Program (TIP). All of that supplementary support has since been repaid or terminated, resulting in a $7 billion net gain to the federal government.

4. "Preferred stock" refers to shares of equity that provide a specific dividend to be paid before any dividends are paid to those who hold common stock and that take precedence over common stock in the event of a liquidation.

5. A "warrant" gives the holder the option, but not the obligation, to purchase stock at a fixed price.

Citigroup and Bank of America each received $20 billion in capital through the TIP. Furthermore, the Treasury agreed to absorb up to $5 billion in potential losses on a $301 billion pool of Citigroup's assets, and the Treasury announced plans to guarantee a pool of Bank of America's assets.

On December 23, 2009, Citigroup repaid the $20 billion in financing it received through the TIP and canceled the loss-sharing agreement. In exchange for accepting early termination of that agreement, the Treasury retained over $2 billion of Citigroup preferred stock, which it sold on September 30, 2010. Bank of America also repaid the $20 billion in financing it received through the TIP; the plan for the Treasury to guarantee a pool of Bank of America's assets was never implemented.[6]

Community Development Capital Initiative. The Community Development Capital Initiative (CDCI) has a structure similar to that of the CPP, but it invested in "community development financial institutions" rather than financial institutions more broadly.[7] The preferred stock purchased by the Treasury under the CDCI requires only a 2 percent dividend for the first eight years, compared with 5 percent for the first five years under the CPP. After that initial period, the CDCI requires dividend payments at a rate of 9 percent, as does the CPP. CBO estimates a subsidy rate for the CDCI of 27 percent; with investments of $570 million, the net cost to the government is projected to be about $150 million.

Assistance to American International Group. AIG initially received financial assistance in two forms through the TARP: The Treasury purchased $40 billion in preferred stock from AIG and established a $30 billion line of credit for the company.[8] The Treasury subsequently received another $8 billion in preferred stock in exchange for providing $8 billion to AIG pursuant to that line of credit. On January 14, 2011, AIG restructured its obligations under the TARP. As part of that restructuring, the Treasury agreed to exchange its existing preferred stock—with a total value of $48 billion—for approximately 1.1 billion shares of AIG common stock. In addition, AIG drew down over $20 billion from the balance on its line of credit to purchase preferred shares in former AIG subsidiaries from the Federal Reserve Bank of New York. As of March 3, AIG had $2 billion still available on its line of credit and had repaid the Treasury $2 billion from the partial sale of those newly acquired shares in former subsidiaries.[9] On the basis of current market prices for shares of common stock in AIG (adjusted to reflect the effect on the stock price of the perceived possibility of additional federal assistance), CBO estimates a subsidy cost of $14 billion to the Treasury for the assistance to AIG.

Financial Assistance to the Automotive Industry

General Motors (GM) and Chrysler, along with their associated financing intermediaries, received just over $79 billion in TARP funds. In addition, the federal government offered to guarantee $5 billion in loans to parts manufacturers for GM and Chrysler; only $413 million of such loans was actually disbursed, however, bringing the total assistance to the automotive industry to about $80 billion.[10] The total subsidy cost for assistance to the automotive industry is expected to be $14 billion, in CBO's estimation.

Following the bankruptcy proceedings of GM and Chrysler, the Treasury agreed to exchange the debt positions it held in the original companies for a blend of debt, equity, and preferred shares in the newly configured companies—"New GM" and "New Chrysler"—that emerged after bankruptcy. Since that time, the companies have repurchased roughly $11 billion in debt. The Treasury holds about 33 percent of New GM's equity following the sale of more than 400 million shares as part of the company's initial public offering; that sale generated $13.5 billion in gross proceeds for the Treasury. The Treasury also retains $1 billion in debt obligations of

6. Bank of America paid the Treasury $276 million in connection with terminating the asset guarantee plan. See Department of the Treasury, "Treasury, Federal Reserve and the FDIC Provide Assistance to Bank of America" (press release, HP-1356, January 16, 2009), and "Summary of Terms: Eligible Asset Guarantee" (press release, January 15, 2009).

7. An eligible "community development financial institution" must be a bank, thrift, or credit union certified by the Treasury as targeting more than 60 percent of its small business lending and other economic development activities toward underserved communities.

8. The maximum amount that could be borrowed under the line of credit was $30 billion minus $165 million for retention bonus payments made to employees of AIG Financial Products Corp. and AIG Trading Group, Inc., in March 2009.

9. On March 8, 2011, AIG repaid an additional $7 billion, bringing the total repayment to $9 billion. That additional repayment does not substantially affect CBO's estimate of the subsidy provided to AIG.

10. The support program for parts manufacturers ended in April 2010, yielding a small net gain to the Treasury.

"Old GM," which remains in bankruptcy as Motors Liquidation Corporation. The Treasury's investment in New Chrysler consists of a line of credit amounting to $7 billion—including $2 billion in funds available but undrawn (the bulk of which CBO expects will be used)—and ownership of 9.9 percent of the company's equity. On March 2, 2011, the Treasury sold nearly $3 billion of preferred shares of Ally Financial (formerly GMAC); the remaining $15 billion investment in that company consists of $6 billion in preferred stock and ownership of 73.8 percent of the company's equity.[11]

Investment Partnerships

To encourage private investment in certain financial assets, the Treasury created public–private partnerships for investment in specific sectors. Those initiatives will cost the federal government a total of about $500 million, CBO estimates.

Term Asset-Backed Securities Loan Facility. The Treasury initially committed $20 billion to cover potential losses of the Federal Reserve's Term Asset-Backed Securities Loan Facility (TALF), which provided financing to investors who bought highly rated securities backed by assets such as automobile loans, credit card loans, student loans, and business loans guaranteed by the Small Business Administration. Because the TALF is closed to new loans and the Federal Reserve provided less financing than originally anticipated, the Treasury has reduced its commitment to $4 billion, for which CBO estimates a net subsidy cost to the Treasury of about $250 million.

Public–Private Investment Program. Through the Public–Private Investment Program, the Treasury agreed to provide "nonrecourse" debt and to match private-sector equity in Public–Private Investment Funds (PPIFs), which purchase illiquid assets from financial institutions.[12] In July 2010, the Treasury reduced the total amount available to the PPIFs from $30 billion to $22 billion. Those partnerships each have three years to draw on TARP funds, and they are scheduled to end eight years from their initiation dates but may be extended for up to two more years.

11. Ally Financial and New and Old Chrysler are private companies and thus do not have publicly traded shares.

12. "Nonrecourse" debt refers to a loan that is secured by specifically pledged collateral; that is, if the borrower defaults, the lender has claim only to that collateral and not to any other assets of the borrower. That debt constituted 50 percent of the total funding.

Through March 3, the Treasury had disbursed a total of $16 billion through this program. More than $5 billion of that amount was used to purchase equity capital in the PPIFs, which was fully matched by private-sector investments, and roughly $11 billion was for loans. CBO expects that the Treasury will ultimately disburse the entire $22 billion made available to the program, with a subsidy cost of roughly $250 million.

Securities Guaranteed by the Small Business Administration. The Treasury also developed a program to purchase up to $1 billion in securities guaranteed by the Small Business Administration. As of October 3, 2010, when the TARP's authority to make new purchases in existing programs expired, the Treasury had purchased $0.4 billion of those securities. CBO estimates a low subsidy rate and a small cost for this program.

Mortgage Programs

The federal government initially committed a total of $75 billion for the Home Affordable Modification Program, which was intended to provide direct payments to mortgage servicers to allow them to help homeowners avoid foreclosure. Of that total, $50 billion was made available through the TARP, and the remaining $25 billion was to be provided through Fannie Mae and Freddie Mac. Through the end of February, roughly 600,000 homeowners had received permanent modifications to their mortgages through the program. In addition, the Treasury has committed roughly $8 billion of the program's funding for grants to selected state housing finance agencies and another $8 billion for programs of the Federal Housing Administration.[13] Total disbursements for mortgage programs were about $1.2 billion through the end of February, but CBO anticipates that the TARP ultimately will disburse a total of $13 billion for those programs. Because most payments provided through those programs are direct grants and require no repayments, the government's cost is generally equal to the full amount of the disbursements (that is, the program has a 100 percent subsidy).

13. The Hardest Hit Fund provides money to housing finance agencies in states identified by the Treasury as facing the most severe declines in home prices and employment rates. The Federal Housing Administration's Short Refinance program makes incentive payments to lenders for refinancing existing loans to borrowers who have negative home equity.

Comparison of CBO's and OMB's Estimates

Although OMB used an approach similar to CBO's to value the TARP's asset purchases and guarantees, its most recent estimate of the program's total cost was $45 billion higher than CBO's current estimate (see Table 3 on page 4). That difference stems principally from three factors:

- OMB estimated that $46 billion will be disbursed through the Treasury's mortgage programs; CBO anticipates that only $13 billion will be spent. The difference between those two estimates results primarily from the disparate outlooks on the number of eligible households and their likely participation rate.

- CBO derived its market-based valuations from information available through March 3, 2011, whereas OMB used data as of December 31, 2010. Because both agencies estimate subsidy costs using market prices, fluctuations in prices and the timing of repurchases lead to different estimates of the costs. Since the date of OMB's analysis, market prices for shares of financial institutions generally have increased, which has raised the estimated value of the Treasury's outstanding investments (particularly those made through the CPP), in turn lowering the estimated net cost of the TARP.

- CBO's assessment of the cost of assistance to the automotive industry is lower than that of OMB; fluctuations in market prices and additional repayments of principal occurring after OMB completed its analysis contributed to the difference.

Changes from CBO's November Estimates

In its *Report on the Troubled Asset Relief Program—November 2010,* CBO reported a projected cost of $25 billion for the TARP over its lifetime. Since the publication of that report, the estimated cost has fallen by $6 billion, to $19 billion, primarily as a result of a decline in the estimated cost of assistance to the automotive industry. CBO's estimate of the cost of that assistance has dropped from $19 billion to $14 billion because the financial status of the companies continues to strengthen, thereby leading to an increase in the estimated value of the Treasury's investments. A number of other factors accounted for an additional $2 billion reduction in the projected cost. CBO also raised its estimate of the total expected expenditures for the Treasury's mortgage initiatives from $12 billion to $13 billion, primarily because of an increase in the projected average cost per modified loan.