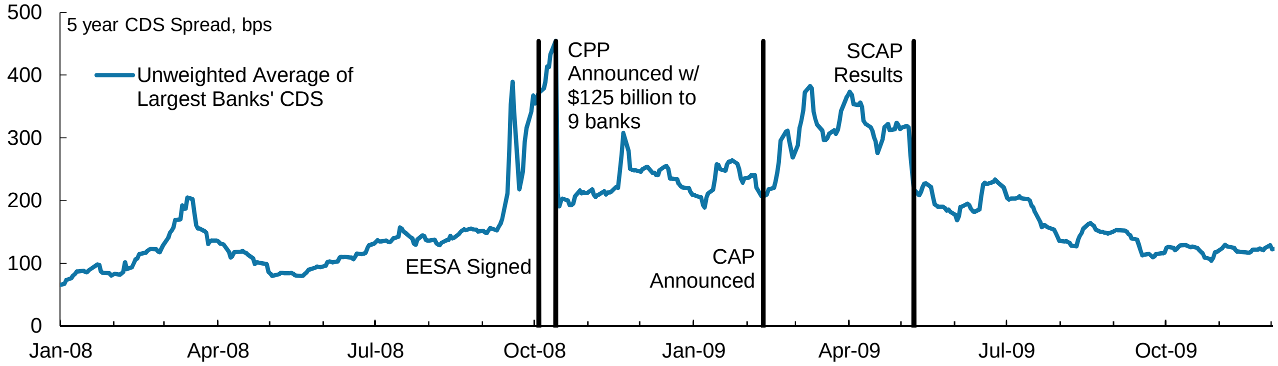
Capital Purchase Program



Design

- Mostly voluntary program for "healthy, viable" banks as deemed by their applicable federal banking regulator.
- Preferred investment of 1-3% RWA; average of 2.9%.
- 5% dividend for first 5 years, 9% after.
- Included 10-year warrants with option for Treasury to purchase amount equal to 15% of preferred equity.
- Various compensation and management restrictions (bolstered by ARRA in February 09).
- To exit preferred equity must be redeemed in full with "qualified equity offering" with regulators' approval
- After repayment of preferred, firms could purchase back warrants at fair market price.
- If redeemed before January 2010 firms would get a discount on the warrants.

Outcomes

- Many banks turned down CPP funds after Treasury approval, so CPP funds were viewed as relatively costly.
- By December 9, 2008, Treasury had only used $205 billion (of $250 billion initial commitment) in 742 transactions involving 707 financial institutions.
- Tier 1 ratios increased from 10.9% to 13.8%, although aggregate common equity fell due to further credit losses and write-downs.
- The largest firms repaid preferred investment by June and purchased warrants by August 2009.
- Of 707 institutions:

  260 full repayments
  190 auctioned investments
  32 bankruptcy/receivership
  17 remain
- Total recovered: $226.7 billion

Evaluation

- Which banks participated in the CPP? The banks that needed the capital the most received funding and strongest banks opted out → adverse signaling appeared to be minimized.
- Bayazitova (2012) finds Treasury was most likely to accept applications from larger banks with greater systemic risks; Treasury did not provide capital to banks with high levels of troubled assets.
- Taliaferro (2009) estimates FDIC's rejection rate at 11%, Fed's between 20-39%.
- Veronesi and Zingales (2009) find CPP resulted in a $84-107 billion net benefit to taxpayer, mostly due to reductions in the probability of bankruptcy.
- CPP may have prolonged banking recovery; CPP preferred was only buffered by common equity, so we needed SCAP to certify TCE as adequate.