United States Government Accountability Office

Report to Congressional Committees

April 2014

TROUBLED ASSET RELIEF PROGRAM

Status of the Wind Down of the Capital Purchase Program

GAO-14-388

GAO Highlights

Highlights of GAO-14-388, a report to congressional committees

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TROUBLED ASSET RELIEF PROGRAM

Status of the Wind Down of the Capital Purchase Program

Why GAO Did This Study

CPP was established as the primary means of restoring stability to the financial system under the Troubled Asset Relief Program (TARP). Under CPP, Treasury invested almost $205 billion in 707 eligible financial institutions between October 2008 and December 2009. CPP recipients have made dividend and interest payments to Treasury on the investments. TARP's authorizing legislation requires GAO to report every 60 days on TARP activities. This report examines (1) the status of CPP and (2) the financial condition of institutions remaining in the program.

To assess the program's status, GAO reviewed Treasury reports on the status of CPP. GAO also used financial and regulatory data to compare the financial condition of institutions remaining in CPP with those that had exited the program and those that did not participate. GAO also obtained information through a questionnaire from CPP participants as of November 20, 2013, and former CPP participants that raised capital in calendar year 2013. GAO received completed questionnaires from 72 of the 104 institutions.

GAO provided a draft of this report to Treasury for its review and comment. Treasury generally concurred with GAO's findings.

View GAO-14-388. For more information, contact A. Nicole Clowers, 202-512-8678, clowersa@gao.gov.

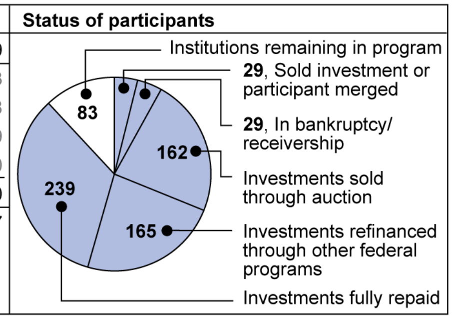
What GAO Found

The Department of Treasury (Treasury) continues to make progress in winding down the Capital Purchase Program (CPP). As of January 31, 2014, Treasury's data showed that 624 of the original 707 institutions, or about 88 percent, had exited CPP. Treasury had received about $225 billion from its CPP investments, exceeding the approximately $205 billion it had disbursed. Most institutions exited by repurchasing their preferred shares in full or by refinancing their investments through other federal programs. Treasury also continues to sell its investments in the institutions through auctions; a strategy first implemented in March 2012 to expedite the exit of a number of CPP participants. As of January 31, 2014, Treasury has sold all or part of its CPP investment in 162 institutions through auctions, receiving a total of about 80 percent of the principal amount. A relatively small number of the remaining 83 institutions accounted for most of the outstanding investments. Specifically, 10 institutions accounted for $1.5 billion or about 73 percent of the $2.1 billion in outstanding investments. Treasury estimated a lifetime gain of $16.1 billion for CPP as of November 30, 2013.

Status of Capital Purchase Program Funds and Participants, as of January 31, 2014

Status of funding (dollars in billions)	
Disbursed	$204.9
Repayments	195.3
Auction proceeds	2.8
Dividends/interest/other income	18.9
Warrant income	8.0
Total proceeds	225.0
Write-offs and losses	-4.7
Outstanding investments	2.1

Status of participants



Source: GAO analysis of Treasury data.

GAO's analysis of financial data found that the institutions remaining in CPP were generally less financially healthy than those that have exited or that never participated. In particular, the remaining CPP institutions tended to be less profitable, hold riskier assets, and have lower capital levels and reserves. Most remaining participants also have missed scheduled dividend or interest payments, with 60 missing their November 2013 payment. Further, 47 of the remaining CPP institutions were on the Federal Deposit Insurance Corporation's problem bank list in December 2013—that is, they demonstrated financial, operational, or managerial weaknesses that threatened their continued financial viability. Institutions that continue to miss dividend payments or find themselves on the problem bank list may have difficulty fully repaying their CPP investments because federal and state bank regulators may not allow these institutions to make dividend payments or repurchase outstanding CPP shares in an effort to preserve their capital and promote safety and soundness.

Contents

Abbreviations

CDCI	Community Development Capital Initiative
CPP	Capital Purchase Program
EESA	Emergency Economic Stabilization Act of 2008
FASB	Financial Accounting Standards Board
FDIC	Federal Deposit Insurance Corporation
GAAP	Generally Accepted Accounting Principles
SBLF	Small Business Lending Fund
TARP	Troubled Asset Relief Program
Treasury	U.S. Department of the Treasury

U.S. GOVERNMENT ACCOUNTABILITY OFFICE
441 G St. N.W.
Washington, DC 20548

April 7, 2014

Congressional Committees

From October 2008 through December 2009, the Department of the Treasury (Treasury) invested almost $205 billion in 707 financial institutions as part of the government's efforts to help stabilize U.S. financial markets and the economy. These investments were made through the Capital Purchase Program (CPP), the first and largest initiative under the Troubled Asset Relief Program (TARP).[1] TARP gave Treasury the authority to buy or guarantee up to $700 billion of the "troubled assets" that were believed to be at the heart of the financial crisis, including mortgages, mortgage-backed securities, and any other financial instruments deemed appropriate, such as equity investments.[2] Under this authority, in October 2008 Treasury created CPP to provide capital to viable financial institutions by purchasing preferred shares and subordinated debt. In return for its investments, Treasury received dividend or interest payments and warrants.[3] The program was closed to new investments on December 31, 2009, and since then Treasury has continued to oversee and divest its CPP investments, collect dividend and interest payments, and sell warrants. As of January 31, 2014, 624 CPP participants had exited the program, many by repurchasing their preferred shares or subordinated debt after consultation with their primary bank regulators.

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[1]As authorized by the Emergency Economic Stabilization Act of 2008 (EESA), Pub. L. No. 110-343, 122 Stat. 3765 (2008), codified at 12 U.S.C. §§ 5201 et seq. EESA, which was signed into law on October 3, 2008, established the Office of Financial Stability within Treasury and provided it with broad, flexible authorities to buy or guarantee troubled mortgage-related assets or any other financial instruments necessary to stabilize the financial markets.

[2]Section 3(9) of EESA, 12 U.S.C. § 5202(9). EESA required that the appropriate committees of Congress be notified in writing that the Secretary of the Treasury, after consultation with the Chairman of the Board of Governors of the Federal Reserve System, had determined that it was necessary to purchase other financial instruments to promote financial market stability. EESA originally authorized Treasury to purchase or guarantee up to $700 billion in troubled assets. The Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010), reduced Treasury's authority to purchase or insure troubled assets to a maximum of $475 billion.

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

This report is based on our continuing analysis and monitoring of Treasury's activities in implementing the Emergency Economic Stabilization Act of 2008 (EESA), which provided us with broad oversight authorities for actions taken under TARP and required that we report at least every 60 days on TARP activities and performance.[4] To fulfill our statutorily mandated responsibilities, we have been monitoring and providing updates on TARP programs, including CPP.[5] This report examines (1) the status of CPP, including repayments and other proceeds, as well as investments outstanding; and (2) the financial condition of institutions remaining in CPP.

To assess the status of CPP, we analyzed Treasury reports on outstanding CPP investments, dividends paid, and the number of institutions that made full repayments. We also sent a questionnaire to current CPP participants as of November 20, 2013, and former CPP participants that raised capital during calendar year 2013 asking if the upcoming increase in the interest or dividend rate on CPP securities had an impact on their efforts to exit the program and/or retire any outstanding CPP securities.[6] We received completed questionnaires from 72 of the 104 institutions. To assess the financial condition of institutions that received investments under CPP, we used financial and regulatory data from SNL Financial to compare CPP participants remaining in the program with those that had exited the program and those that had never participated. We have assessed the reliability of SNL Financial data as part of previous studies through interviews with SNL officials and testing of SNL data against filed regulatory documents. We determined that the financial information we used was sufficiently reliable for the purposes of this report. We also leveraged our past reporting on TARP, as well as that

[4]Section 116 of EESA, 122 Stat. at 3783 (codified at 12 U.S.C. § 5226).

[5]See, for example, GAO, *Capital Purchase Program; Status of the Program and Financial Health of Remaining Participants*, GAO-13-458 (Washington, D.C.: May 7, 2013), *Troubled Asset Relief Program: Treasury Sees Some Returns as It Exits Programs and Continues to Fund Mortgage Programs*, GAO-13-192 (Washington, D.C.: Jan. 7, 2013), *Capital Purchase Program: Revenues Have Exceeded Investments, but Concerns about Outstanding Investments Remain*, GAO-12-301 (Washington, D.C.: Mar. 8, 2012), and *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*, GAO-11-47 (Washington, D.C.: Oct. 4, 2010).

[6]Throughout this report we use CPP securities to mean the senior preferred shares or subordinated debt Treasury received for its investments.

of the Special Inspector General for TARP, as appropriate. Appendix I has more information on our scope and methodology.

We conducted this performance audit from December 2013 to April 2014 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Background

Created in 2008, CPP was the primary initiative under TARP to help stabilize the financial markets and banking system by providing capital to qualifying regulated financial institutions through the purchase of senior preferred shares and subordinated debt.[7] Rather than purchasing troubled mortgage-backed securities and whole loans, as initially envisioned under TARP, Treasury used CPP investments to strengthen financial institutions' capital levels. Treasury determined that strengthening capital levels was the more effective mechanism to help stabilize financial markets, encourage interbank lending, and increase confidence in lenders and investors. Treasury believed that strengthening the capital positions of viable financial institutions would enhance confidence in the institutions themselves and the financial system overall and increase the institutions' capacity to undertake new lending and support the economy. On October 14, 2008, Treasury allocated $250 billion of the original $700 billion in overall TARP funds for CPP. The allocation was subsequently reduced in March 2009 to reflect lower estimated funding needs, as evidenced by actual participation rates, and the program was closed to new investments on December 31, 2009.

Under CPP, qualified financial institutions were eligible to receive an investment of between 1 and 3 percent of their risk-weighted assets, up to

[7]For purposes of CPP, qualifying financial institutions generally include stand-alone U.S.-controlled banks and savings associations, as well as bank holding companies and savings and loan holding companies.

a maximum of $25 billion.[8] In exchange for the investment, Treasury generally received senior preferred shares that would pay dividends at a rate of 5 percent annually for the first 5 years and 9 percent annually thereafter.[9] CPP investments made in late 2008 began paying the higher dividend or interest rate in late 2013 whereas the remaining investments will see the increase begin sometime in 2014. EESA required that Treasury also receive warrants to purchase shares of common or preferred stock or a senior debt instrument to further protect taxpayers and help ensure returns on the investments. Institutions are allowed to repay CPP investments with the approval of their primary federal bank regulator and afterward to repurchase warrants.

Treasury Continues to Make Progress in Winding Down the CPP Program

As of January 31, 2014, a total of 624 of the 707 institutions that originally participated in CPP, about 88 percent, had exited the program. Of the 624 institutions that exited CPP, 239 institutions repurchased their preferred shares or subordinated debentures in full (see fig. 1).[10] Another 165 institutions refinanced their shares through other federal programs: 28 through the Community Development Capital Initiative (CDCI) and 137 through the Small Business Lending Fund (SBLF).[11] An additional 162 institutions had their investments sold through auction and 29 institutions

[8]Risk-weighted assets are all assets and off-balance-sheet items held by an institution, weighted for risk according to the federal banking agencies' regulatory capital standards. In May 2009, Treasury increased the maximum amount of CPP funding that small financial institutions (qualifying financial institutions with total assets of less than $500 million) could receive from 3 to 5 percent of risk-weighted assets.

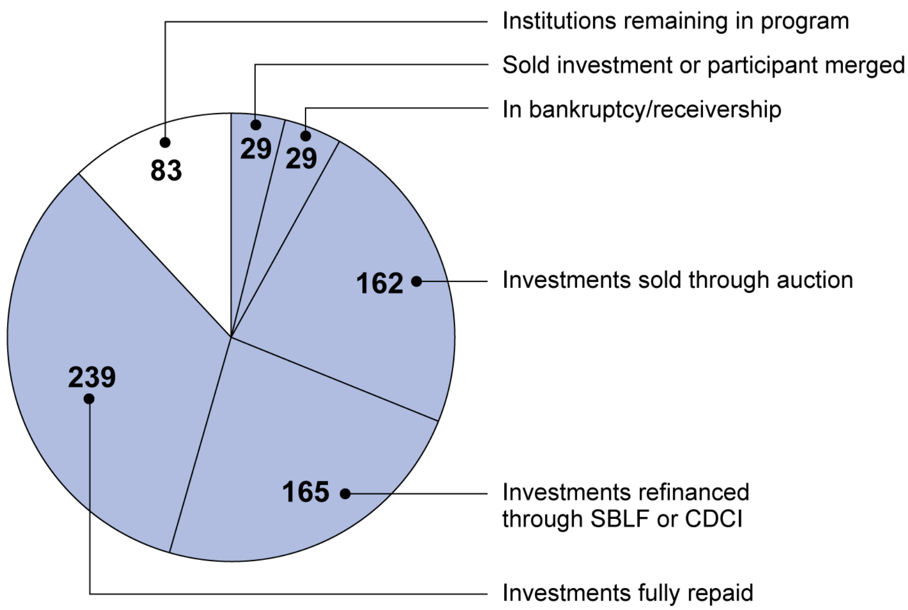
[9]For S corporations, a federal business type that provides certain tax and other benefits, Treasury received subordinated debt rather than preferred shares in order to preserve these institutions' special tax status. The U.S. Internal Revenue Code prohibits S corporations from having more than one class of stock outstanding. Interest rates for this debt are 7.7 percent for the first 5 years and 13.8 percent for the remaining years.

[10]Additionally, 4 institutions have made partial repayments but remain in the program.

[11]CDCI is a TARP program that provides capital to Community Development Financial Institutions that have a federal depository institution supervisor. Structured like CPP, the program also covered credit unions and provides more favorable capital terms than CPP. SBLF was created by the Small Business Jobs Act of 2010, Pub. L. No. 111-240, 124 Stat. 2504 (2010) to encourage small business lending. SBLF was a $30 billion fund operated by Treasury but separate from TARP that provided capital to qualified community banks and community development loan funds with assets of less than $10 billion. When SBLF closed on September 27, 2011, the program had approved $4 billion in disbursements to 332 institutions. Of the 332 institutions participating in SBLF, 137 were originally TARP participants with combined investments of $2.2 billion.

went into bankruptcy or receivership. The remaining 29 had their investments sold by Treasury (25), or merged with another institution (4).

Figure 1: Status of Institutions That Received Capital Purchase Program Investments, as of January 31, 2014



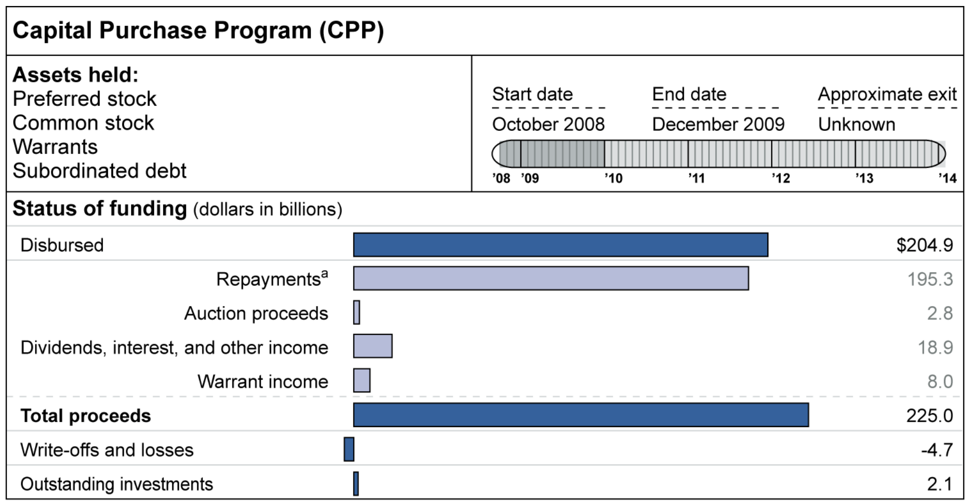
Source: GAO analysis of Treasury data.

Repayments and income from dividends, interest, and warrants from CPP investments have exceeded the amounts originally disbursed. Treasury disbursed $204.9 billion to 707 financial institutions nationwide from October 2008 through December 2009. As of January 31, 2014, Treasury had received $225 billion in repayments and income from its CPP investments, exceeding the amount originally disbursed by $20.1 billion (see fig. 2).[12] The repayments and income amount include $195.3 billion in repayments and $2.8 billion in auction sales of original CPP investments as well as $18.9 billion in dividends, interest, and other income and $8.0 billion in warrants sold. After accounting for write-offs and realized losses totaling $4.7 billion, CPP had $2.1 billion in

[12]Treasury, *Troubled Asset Relief Program (TARP) Monthly Report to Congress – January 2014* (Feb. 10, 2014).

outstanding investments as of January 31, 2014.[13] Treasury estimated a lifetime gain of $16.1 billion for CPP as of November 30, 2013.[14]

Figure 2: Status of the Capital Purchase Program, as of January 31, 2014



Source: GAO analysis of Treasury data.

[a]The total amount of repayments includes $336 million from institutions that transferred to the Community Development Capital Initiative and $2.2 billion from institutions that transferred to the Small Business Lending Fund.

Impact of Increasing Dividend or Interest Rate on CPP Securities Varies

About half of the institutions (37 of 72) that responded to our questionnaire about the impact of the upcoming or recent increase in the dividend or interest rate on CPP securities stated that it impacted or is impacting their efforts to exit the CPP program and/or retire any

[13]Write-offs and realized losses include losses sustained from investments in the 29 institutions that have gone into bankruptcy or receivership and any losses sustained from Treasury selling its investment in CPP institutions.

[14]Treasury estimates lifetime costs (or gains) on a quarterly basis using the aggregate value of investments at market prices in conjunction with the Office of Management and Budget and publishes them in its monthly reports to Congress. Estimated lifetime cost represents Treasury's best estimate of what the program will ultimately cost the taxpayer. Treasury's methodology for estimating lifetime costs includes the requirement to use a discount rate that reflects market risk as required by EESA for future cash flows.

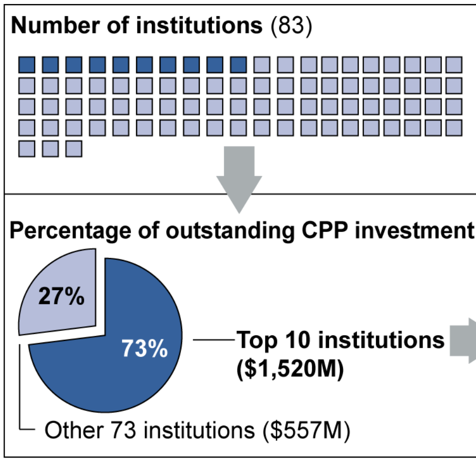
outstanding CPP securities.[15] These respondents' comments indicated that the institutions are taking a range of actions. Some institutions indicated that the increase led them to raise alternative capital. For example, one institution completed a public offering of common stock and used the proceeds to redeem its CPP shares. Others indicated that they are working with Treasury to participate in a future auction or attempting to negotiate with Treasury to restructure the CPP debt. Still others commented that the increase in the interest or dividend rate will increase the burden on the institution, make it more difficult to raise alternative capital, and further reduce their ability to exit the program. Thirty-three institutions responded that the increase did not or is not impacting their efforts to exit the program or retire CPP securities.

Remaining Capital Purchase Program Investment Concentrated in a Few Institutions

As of January 31, 2014, the 83 remaining institutions accounted for the $2.1 billion in outstanding investments or about 1 percent of the original investment. The outstanding investments were concentrated in a relatively small number of institutions. Specifically, the 10 largest remaining CPP investments accounted for $1.5 billion (73 percent) of outstanding investments and 2 institutions accounted for more than half of this amount (see fig. 3). In contrast, the remaining $557 million (24 percent) was spread among the other 73 institutions.

[15]Under CPP terms, CPP securities will pay a dividend or interest rate of 5 percent per annum until the fifth anniversary of the date of the investment and thereafter a rate of 9 percent per annum. The dividend and interest rate on CPP investments made in late 2008 increased in late 2013 whereas the remaining investments will see the increase begin sometime in 2014. For nonpublic institutions, Treasury immediately exercised its warrants and received preferred shares paying dividends of 9 percent per annum.

Figure 3: Remaining Capital Purchase Program (CPP) Investments, as of January 31, 2014



Outstanding CPP investment by top 10 institutions

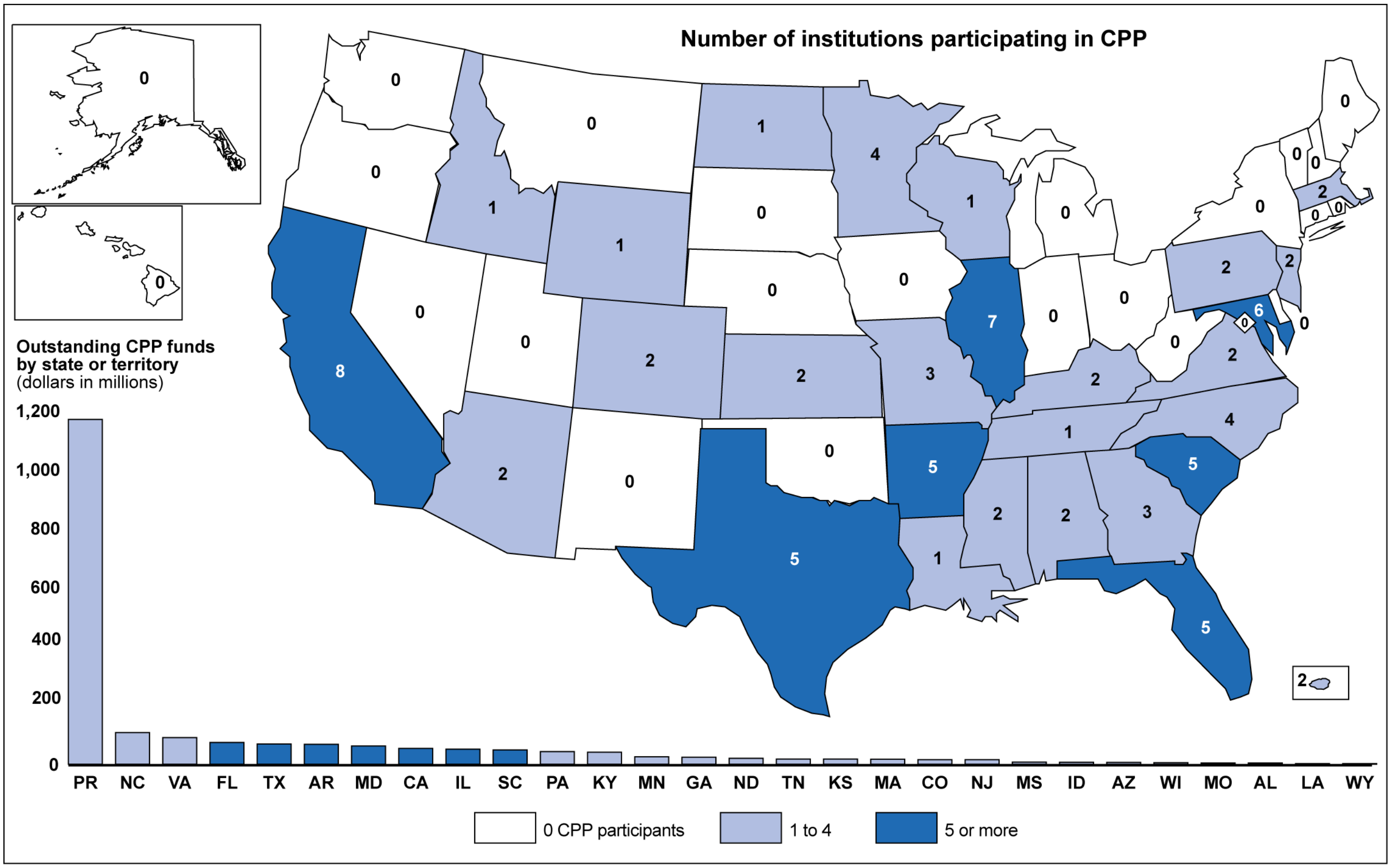
	Institution	Location	Investment amount (in millions)	Percentage of total outsanding investment
1	Popular, Inc.	San Juan, PR	$935.0	45.0%
2	First BanCorp[a]	San Juan, PR	239.0	11.5
3	Hampton Roads Bankshares, Inc.[a]	Norfolk, VA	80.3	3.9
4	CommunityOne Bancorp[a]	Charlotte, NC	51.5	2.5
5	U.S. Century Bank	Miami, FL	50.2	2.4
6	VantageSouth Bancshares Inc.	Cary, NC	42.8	2.1
7	Porter Bancorp Inc.	Louisville, KY	35.0	1.7
8	Royal Bancshares of Pennsylvania, Inc.	Narberth, PA	30.4	1.5
9	First United Corporation	Oakland, MD	30.0	1.4
10	Patriot Bancshares, Inc.	Houston, TX	26.0	1.3
	Total top 10		**$1,520.3**	**73.2%**
	All other CPP outstanding		$557.4	26.8%
	All CPP outstanding		**$2,077.8**	**100.0%**

Source: GAO analysis of Treasury data.

[a]Original investment has been converted at a discount to common stock in the institution. Amount shown is original.

As of January 31, 2014, the number of states with at least one institution with CPP investments outstanding was 28, and the number of states with at least 5 such institutions was 7 (see fig. 4). California had the highest number of remaining CPP institutions with 8, followed by Illinois with 7. In terms of total CPP investments outstanding, Puerto Rico had the largest amount ($1.2 billion), followed by North Carolina ($108 million), Virginia ($91 million), and Florida ($74 million).

Figure 4: Remaining Participation in the Capital Purchase Program (CPP) by State, as of January 31, 2014



Sources: GAO analysis of Treasury data; Map Resources (map).

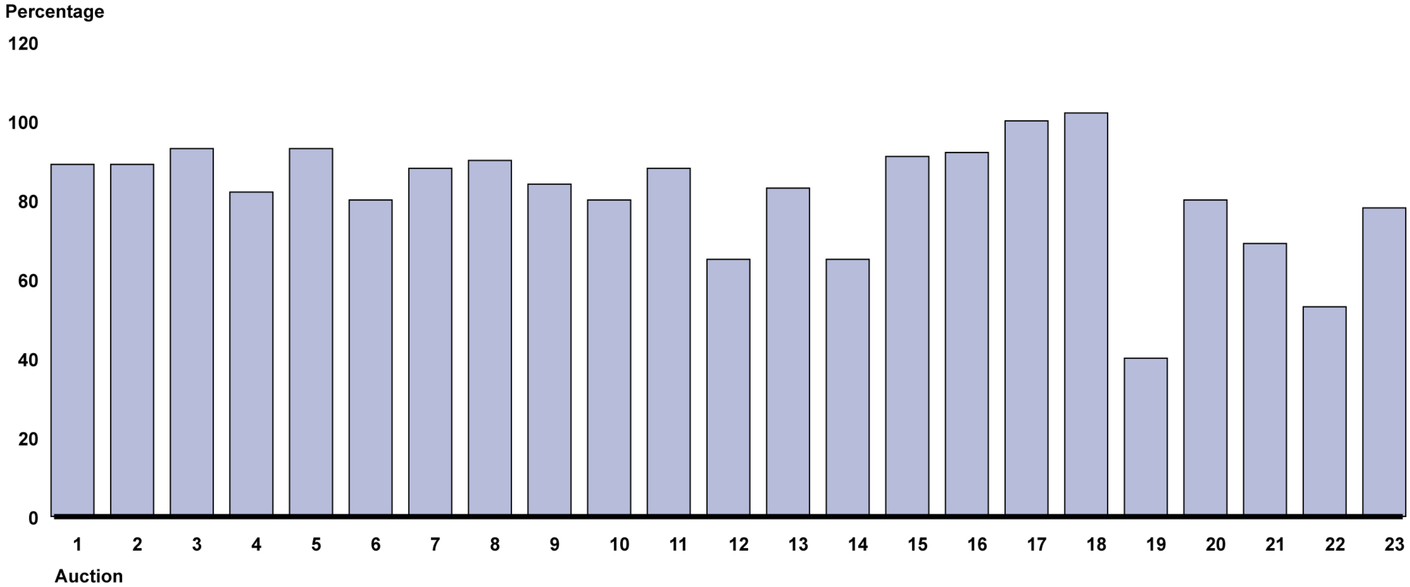
Treasury Continues to Utilize Auctions as a Means of Winding Down the Program

Treasury began selling its investments in banks through auctions beginning in March 2012 as a way to balance the speed of exiting the investments with maximizing returns for taxpayers.[16] As of January 31, 2014, Treasury had conducted a total of 23 auctions and received a total of about 80 percent of the principal amount (see fig. 5).[17] As figure 5 shows, the total proceeds from selling securities do not include any income received from repurchases, dividends, or other sources or any missed dividend or interest payments, the rights to which are sold with the securities. For example, if an institution whose securities were being sold by Treasury at auction had missed $100,000 worth of dividend payments, the purchaser of the securities would own the right to receive those past-due dividends if the institution can pay them. As of January 31, 2014, Treasury has sold all or part of its investments in 162 institutions, through the auction process, including the rights to approximately $207 million in missed dividends and interest payments.

[16]We reported on Treasury's auction process in a previous report. See GAO, *Troubled Asset Relief Program: Treasury's Use of Auctions to Exit the Capital Purchase Program*, GAO-13-630 (Washington, D.C.: July 8, 2013).

[17]On March 7, 2014, Treasury announced $45.1 million in proceeds from priced of auctions of preferred stock of four institutions. In addition, on March 31, 2014 Treasury announced that it was commencing auctions for its preferred stock and subordinated debt in an additional four institutions.

Figure 5: Total Sales Proceeds as a Percentage of Treasury's Outstanding Investment by Auction, as of January 31, 2014 (Excludes Income from Repurchases, Dividends, and Other Sources)



Source: GAO analysis of Treasury and SNL Financial data.

In 2013, we reported that according to Treasury officials, the auction results reflected the potential risk associated with the liquidity of the investments, the credit quality of the financial institutions (including their ability to make future dividend or interest payments), and the prospect of receiving previous missed payments that had accrued.[18] For example, later auctions have tended to include smaller institutions with more cumulative missed payments. In a few cases, the prospect of recouping these missed payments made the institutions particularly attractive to investors and helped raise the sale price of those securities above their par value. Although Treasury has not generally recouped its full investment in individual institutions through the auctions, in 2013, Treasury officials told us that accepting a discount and transferring ownership of these institutions to the private sector was in the best interest of the taxpayer. Because of the inherent risk factors of these institutions, Treasury officials did not anticipate that they would be able to make full repayments in the near future. The officials added that had they

[18] GAO-13-630.

chosen not to auction these positions, their values could have decreased later. Treasury officials also said that while auctions were generally priced at a discount to the principal amount, the prices were generally equal to or above Treasury's internal valuations.

Remaining CPP Institutions Are Generally Less Financially Healthy Than Those That Have Exited

Institutions that remain in CPP tend to be financially weaker than institutions that have exited the program and institutions that did not receive CPP capital. Our analysis considered various measures that describe banking institutions' profitability, asset quality, capital adequacy, and ability to cover losses. We analyzed financial data on the 83 institutions remaining in CPP as of January 31, 2014, and 482 former CPP institutions, which we split into three groups: (1) those that repaid their investments, (2) those that exited through an auction, and (3) those that refinanced their investments through SBLF.[19] The current and former CPP institutions in our analysis accounted for 565 of the 707 institutions that participated in CPP. We compared the 565 institutions to a non-CPP group (i.e., institutions that have not participated in CPP) of 7,177 active financial institutions for which financial information was available. All financial information generally reflects quarterly regulatory filings on December 31, 2013.

Table 1 provides the results of our analysis of these measures, including the following.

- Mostly smaller institutions remain in the program and larger institutions tended to exit through repayment. For example, institutions that exited through repayment had a median asset size of $1.7 billion, compared with $548 million for those that refinanced through SBLF and $385 million for those that exited through an auction.
- In the aggregate, the remaining institutions were noticeably less financially healthy than each of the groups of former CPP participants.
- As a group, institutions that exited through auctions were significantly less financially healthy than the group of institutions that repaid their investments or refinanced through SBLF.

[19] We pulled data from SNL Financial on March 4, 2013.

- Overall, the institutions that remain in CPP are less financially healthy than both the group of institutions that never participated in CPP and the aggregate group that had exited CPP.

Table 1: Aggregate Financial Information on Capital Purchase Program (CPP) Participants and Nonparticipants, as of December 31, 2013

	Former CPP				Remaining CPP	Non-CPP
	Repaid	Auctioned	SBLF	**Total**		
Number of institutions	224	130	128	**482**	83	7,177
Assets (thousands)	1,654,556	384,723	547,828	**715,688**	285,118	187,022
Texas Ratio[a]	17.18	33.90	15.03	**19.58**	53.21	12.37
Return on average assets (percent)	.86	0.56	0.76	**0.77**	0.30	0.75
Noncurrent loan percentage	1.35	2.02	.99	**1.33**	2.83	1.05
Net charge-offs to average loans ratio	0.20	0.36	0.12	**0.20**	0.18	0.09
Tier 1 risk-based capital ratio[b]	13.14	13.31	13.35	**13.30**	11.97	15.61
Common equity Tier 1 ratio	12.21	11.79	11.01	**11.76**	10.48	15.48
Reserves to nonperforming loans ratio	77.34	55.35	84.06	**70.37**	41.92	76.16

Source: GAO analysis of SNL Financial data.

Note: The figures in the table represent median values for all institutions in the particular population. We analyzed financial data on the 83 institutions remaining in CPP as of January 31, 2014, and 482 former CPP institutions, accounting for 565 of the 707 institutions that participated in CPP. Financial data were available from SNL Financial for 440 of the 565 institutions, and we accounted for the remaining 125 institutions using SNL Financial information for the holding company or its largest subsidiary. The 142 CPP institutions our analysis excluded had no data available in SNL Financial, had been acquired, or were defunct.

[a]The Texas Ratio is defined as nonperforming assets plus loans 90 or more days past due divided by tangible equity and reserves.

[b]The Tier 1 risk-based capital ratio measures Tier 1 capital as a share of risk-weighted assets

In particular, remaining CPP institutions had noticeably higher median Texas Ratios than each group of former CPP institutions as well as the non-CPP group. The Texas Ratio helps determine a bank's likelihood of failure by comparing its troubled loans to its capital.[20] The higher the ratio, the more likely the institution is to fail. As of December 31, 2013, remaining CPP institutions had a median Texas Ratio of 53.21, compared with 19.58 for former CPP institutions and 12.37 for the non-CPP group. Further, of the institutions that exited CPP, those that exited through

[20]The Texas Ratio is defined as nonperforming assets plus loans 90 or more days past due divided by tangible equity and reserves.

auctions had the highest median Texas Ratio (33.90), compared with those that exited through full repayments (17.18) or by refinancing to SBLF (15.03).

Profitability measures for remaining CPP institutions were lower than those for former CPP participants and the non-CPP group. For example, the median return on average assets measure shows how profitable a company is relative to its total assets and how efficient management is at using its assets to generate earnings. For the quarter ending December 31, 2013, remaining CPP institutions had a median return on average assets of 0.30, compared with 0.77 for former CPP institutions and 0.75 for the non-CPP group.[21] Further, among the institutions that had exited CPP, those that participated in Treasury's auctions had the lowest return on average assets at 0.56, compared with 0.86 for those that repaid their investments and 0.76 for those that refinanced to SBLF.

Remaining CPP institutions also held relatively more poorly performing assets. For example, remaining CPP institutions had a higher median percentage of noncurrent loans than former CPP institutions and the non-CPP group. As of December 31, 2013, a median of 2.83 percent of loans for remaining CPP institutions were noncurrent, compared with 1.33 percent for former CPP institutions and 1.05 percent for the non-CPP group. Remaining CPP institutions had a median ratio of net charge-offs to average loans (0.18) about equal to that of former CPP institutions (0.20), but a higher median ratio than the non-CPP group (0.09), as of December 31, 2013.[22] For both of these ratios, the auction participants had higher values than institutions that made full repayments or refinanced to SBLF.

Compared with former CPP institutions and the non-CPP group, remaining CPP institutions held less regulatory capital as a percentage of assets. Regulators require minimum amounts of capital to lessen an institution's risk of default and improve its ability to sustain operating losses. Regulatory capital can be measured in several ways, but we focused on Tier 1 capital, which includes both a common-equity capital ratio and a Tier 1 capital ratio, because it is the most stable form of

[21] Return on average assets is net income divided by average total assets.

[22] A charge-off occurs when a bank recognizes that a particular asset or loan will not be collectible and must be written off.

regulatory capital.[23] The Tier 1 risk-based capital ratio measures Tier 1 capital as a share of risk-weighted assets, and the common equity Tier 1 ratio measures common equity Tier 1 as a share of risk-weighted assets, which generally does not include TARP funds. Using these measures, the remaining CPP institutions had lower median Tier 1 capital levels than former CPP institutions and the non-CPP group. The remaining CPP institutions also had a median common equity Tier 1 capital ratio below that of the former CPP institutions and the non-CPP group. As of December 31, 2013, the median common equity Tier 1 capital ratio for remaining CPP institutions was 10.48 percent of risk-weighted assets, compared with 11.76 percent for former CPP institutions and 15.48 percent for the non-CPP group.

Finally, remaining CPP institutions had significantly lower reserves for covering losses compared with former CPP institutions and the non-CPP group. As of December 31, 2013, the median ratio of reserves to nonperforming loans was lower for remaining CPP institutions (41.92) than for former CPP participants (70.37) and the non-CPP group (76.16). Of those institutions that have exited the program, auction participants had the lowest ratio (55.35), compared with 77.34 for those that repaid their investments and 84.06 for those that refinanced to SBLF.

[23]In October 2013, the Office of the Comptroller of the Currency and the Board of Governors of the Federal Reserve System adopted final rules that established new minimum regulatory capital requirements for U.S. banking organizations. The new minimum risk-based capital ratios include a common equity Tier 1 capital ratio, a Tier 1 capital ratio, and a total capital ratio. Common equity Tier 1 capital generally includes retained earnings and common stock that meets certain criteria after making certain capital deductions and adjustments. Additional Tier 1 capital generally includes certain noncumulative perpetual preferred stock, related surplus and minority interests that are not included in common equity Tier 1 capital, and preferred stock and other instruments issued under EESA. 78 Fed. Reg. 62018.

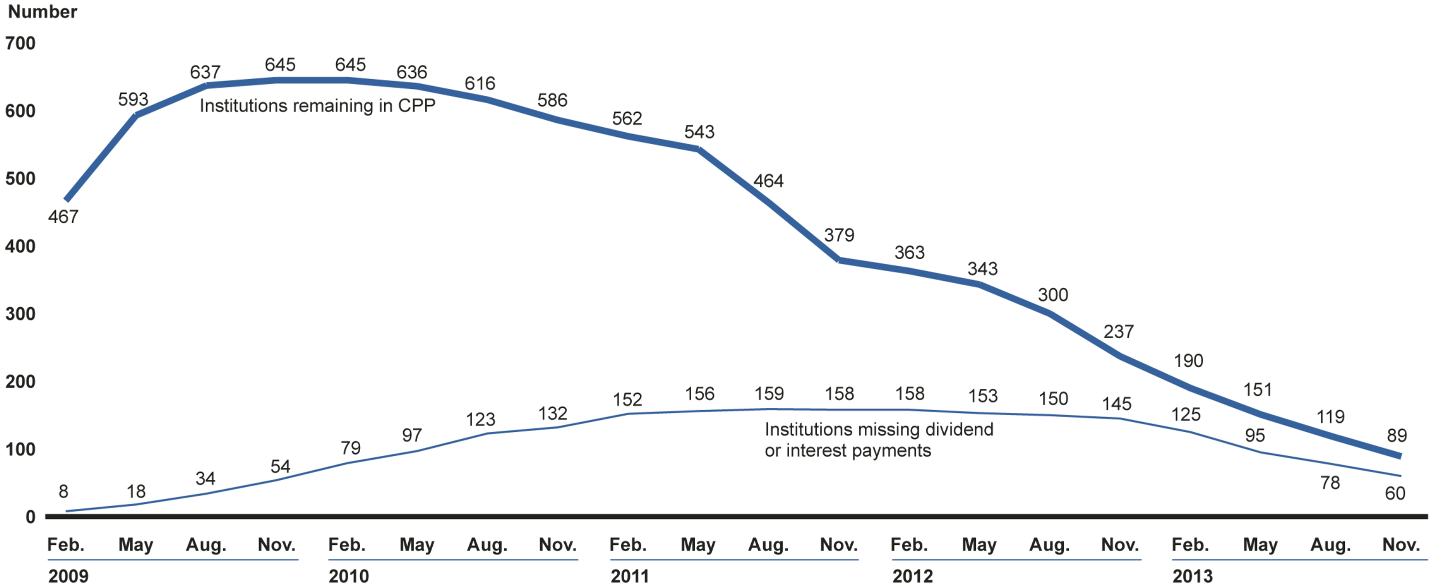
Most Remaining CPP Participants Have Missed Dividend or Interest Payments

The number of CPP participating institutions missing dividend or interest payments in a given quarter increased steadily from 8 in February 2009 to 159 in August 2011 and has since declined each quarter to 60 in November 2013 (see fig. 6).[24] Almost 84 percent, or 75 of the 89 financial institutions remaining in CPP as of November 30, 2013, have missed a dividend payment.[25] Most of the institutions with missed payments have missed them in several quarters. In particular, all but one of the institutions that missed payments in November 2013 had also missed payments in each of the previous three quarters. Moreover, the 60 institutions that missed payments in November 2013 had an average of 13 missed payments.

[24]In its dividend and interest reports, Treasury no longer considers a payment to be missed or unpaid once the institution (1) repays its investment amount and exits CPP, (2) repays dividends by way of capitalization at the time of exchange, or (3) enters bankruptcy or has its bank subsidiary placed into receivership. However, we included such institutions in our counts.

[25]Under CPP terms, institutions pay cumulative dividends on their preferred shares, except for banks that are not subsidiaries of holding companies, which pay noncumulative dividends. Some other types of institutions, such as S corporations, received their CPP investments in the form of subordinated debt and pay interest rather than dividends. CPP dividend and interest payments are due on February 15, May 15, August 15, and November 15 of each year, or the first business day subsequent to those dates. The reporting period ends on the last day of the calendar month in which the dividend or interest payment is due. The first dividend payments were due in February 2009, and since then, 246 of the 707 participants had missed at least one payment, accounting for a cumulative total of 2,137 missed payments. The November 30, 2013, Dividend and Interest Report is the most recent data available for a month in which dividends are due.

Figure 6: Number of Institutions Missing Scheduled Dividend or Interest Payments and Number of Institutions Participating in the Capital Purchase Program by Quarter, February 2009 through November 2013



Source: GAO analysis of Treasury data.

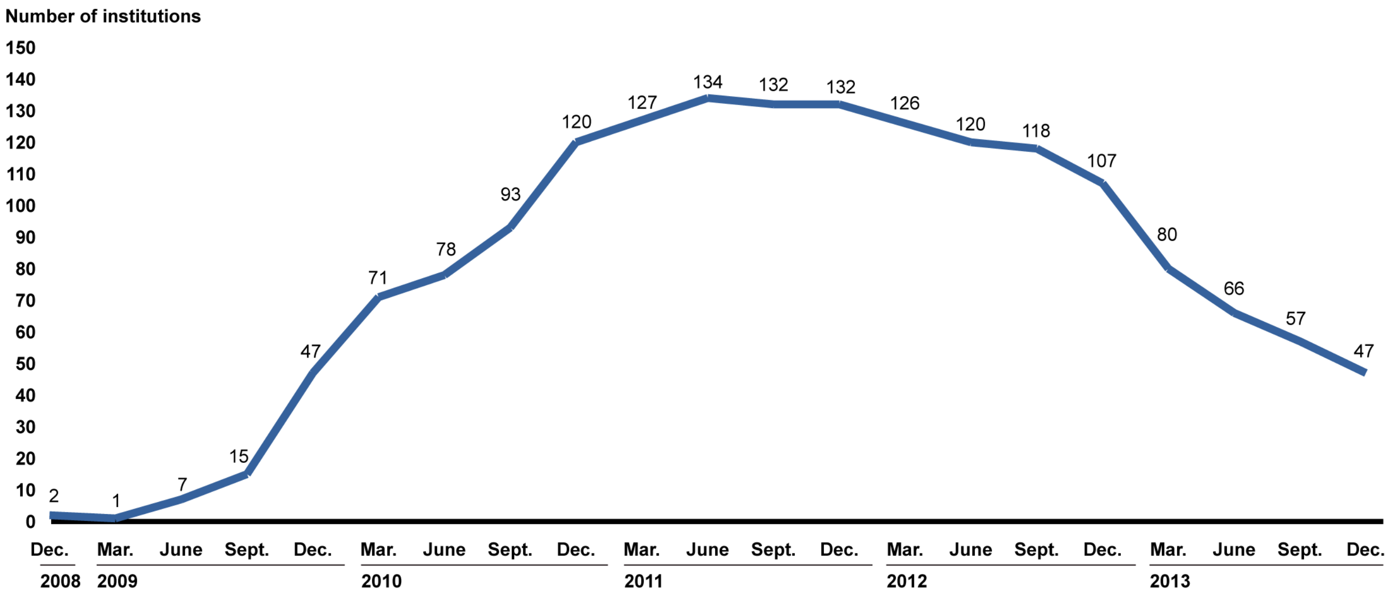
Note: Dividend and interest payments are due on a quarterly basis. The number of participating institutions in any given quarter did not reach 707 (that is, the total number of institutions that participated in CPP) because institutions entered and exited the programs at different times. Also, 89 institutions remained in CPP as of November 30, 2013, but as of January 31, 2014, that number had decreased to 83.

Institutions can elect whether to pay dividends and may choose not to pay for a variety of reasons, including decisions that they or their federal and state regulators make to conserve cash and maintain (or increase) capital levels. Institutions are required to pay dividends only if they declare dividends, although unpaid cumulative dividends generally accrue and the institution must pay them before making payments to other types of shareholders, such as holders of common stock. However, investors view a company's ability to pay dividends as an indicator of its financial strength and may see failure to pay full dividends as a sign of financial weakness.

The Number of Remaining CPP Institutions on FDIC's Problem Bank List Has Declined

Showing a similar trend to missed dividend or interest payments, the number of CPP institutions on the Federal Deposit Insurance Corporation's (FDIC) "problem bank list" has decreased in recent months after months of steady increases. This list is a compilation of banks with demonstrated financial, operational, or managerial weaknesses that threaten their continued financial viability and is publicly reported on a quarterly basis.[26] As of December 31, 2013, 47 CPP institutions were on the problem bank list (see fig. 7). The number of these institutions increased every quarter beginning in March 2009, hitting a high of 134 in June 2011, even as the number of institutions participating in CPP declined. As figure 7 shows, the number of problem banks fell slightly for the first time in the third quarter of 2011 and has declined to 47 as of December 31, 2013. Federal and state bank regulators may not allow institutions on the problem bank list to make dividend payments in an effort to preserve their capital and promote safety and soundness.

Figure 7: Number of Capital Purchase Program (CPP) Institutions on FDIC's Problem Bank List, December 2008 through December 2014



Source: FDIC.

[26]While some CPP funds were disbursed to bank holding companies, FDIC's problem bank list does not include them. FDIC accounted for bank holding companies participating in CPP when their subsidiary depositories were designated as problem banks. It is possible that a bank holding company CPP recipient downstreamed CPP funds to a subsidiary depository that appeared on the problem bank list. However, it is unclear the extent to which this downstreaming occurred and thus the extent to which subsidiaries on the list may have benefitted from CPP funds. Multiple subsidiary depositories of the same CPP bank holding company that were designated as problem banks were counted separately.

Note: The numbers presented in this figure were compiled by FDIC in response to our request and are not otherwise maintained or published by FDIC. FDIC's problem bank list does not include bank holding companies. Bank holding company recipients of CPP funds were accounted for if one or more of their subsidiary depositories were designated as problem banks. Each subsidiary depository appearing on the list was counted separately.

These observations are consistent with the analysis in our May 2013 and March 2012 reports, which also showed that the remaining CPP institutions were financially weaker than institutions that had exited the program and institutions that did not receive CPP capital.[27]

Agency Comments

We provided a draft of this report to Treasury for its review and comment. Treasury provided written comments that we have reprinted in appendix II. In its written comments, Treasury generally concurred with our findings. Treasury noted that it had realized a positive return of $20.19 billion as of April1, 2014, and that 71 institutions remained in the program representing a remaining investment of $1.96 billion. Treasury also emphasized its commitment to keeping the public informed of its progress in winding down CPP.

We are sending copies of this report to the Special Inspector General for TARP, interested congressional committees and members, and Treasury. The report also is available at no charge on the GAO website at http://www.gao.gov.

If you or your staffs have any questions about this report, please contact A. Nicole Clowers at (202) 512-8678 or clowersa@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. GAO staff who made major contributions to this report are listed in appendix III.

A. Nicole Clowers

Director
Financial Markets and Community Investment

[27] See GAO-12-301, GAO-13-458.

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Chairwoman
The Honorable Richard C. Shelby
Vice Chairman
Committee on Appropriations
United States Senate

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The Honorable Dave Camp
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The Honorable Sander Levin
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House of Representatives

Appendix I: Objectives, Scope, and Methodology

The objectives of our report were to examine (1) the status of the Capital Purchase Program (CPP), including repayments and other proceeds, as well as investments outstanding; and (2) the financial condition of institutions remaining in CPP. To assess the status of CPP at the program level, we analyzed data from the Department of the Treasury (Treasury). In particular, we used Treasury's January 2014 Monthly Report to Congress to determine the dollar amounts of outstanding investments, the number of remaining and former participants, and the geographical distribution of each as of January 31, 2014.

To assess the financial condition of institutions that received investments under CPP, we used data from Treasury's Dividends and Interest reports from February 2009 through November 2013 to determine the extent to which participants had missed payments throughout the life of the program. To assess whether the upcoming 2014 increase in the dividend or interest rate on CPP securities was impacting CPP participants' efforts to exit the program and/or retire CPP securities, we sent an email containing two questions to all current CPP participants (89) and any past CPP participants that raised capital in calendar year 2013. The first question asked if the increase had impacted them (Yes or No) and, if yes, to describe actions taken. We sent the questionnaire to 104 institutions and received responses from 72. We used the "actions taken" responses to provide examples of how the increase in the dividend or interest rate on CPP securities is impacting CPP participants. We defined current CPP participants to be those institutions that Treasury classifies as "full investment outstanding; warrants outstanding," "full investment outstanding; warrants not outstanding," and "sold in part, warrants outstanding" in its November 20, 2013 TARP transaction report. We identified those CPP participants that raised capital in calendar year 2013 using the SNL database.

We also obtained from the Federal Deposit Insurance Corporation (FDIC) summary information on its quarterly problem bank list to show the trend of CPP institutions appearing on the list from December 2008 through December 2013. We used financial measures for depository institutions that we had identified in our previous reporting on CPP. These measures help demonstrate an institution's financial health as it relates to a number of categories, including profitability, asset quality, capital adequacy, and loss coverage. We obtained such financial data for depository institutions using a private financial database provided by SNL Financial that contains publicly filed regulatory and financial reports. We merged the data with SNL Financial's CPP participant list to create the three comparison groups—remaining CPP institutions, former CPP institutions, and a non-CPP group comprised of all institutions that did not participate in CPP.

We analyzed financial data on the 83 institutions remaining in CPP as of January 31, 2014, and 482 former CPP institutions that exited CPP through full repayments, conversion to the Small Business Lending Fund, or Treasury's sale of its investments through an auction, accounting for 565 of the 707 CPP participants. We identified the 83 institutions remaining in CPP as of January 31, 2014, using Treasury's January 2014 Monthly Report to Congress. The 142 CPP institutions our analysis excluded had no data available in SNL Financial, had been acquired, or were defunct. We compared the remaining and former CPP institutions to a non-CPP group of 7,177 active financial institutions for which financial information was available. We chose to present median values. Financial data were available from SNL Financial for 440 of the 565 CPP institutions, and we accounted for the remaining 125 institutions using SNL Financial information for the holding company or its largest subsidiary. Although this approach has limitations such as excluding other financial subsidiaries, we deemed it to be sufficient for the purpose of our work. All financial information reflects quarterly regulatory filings on December 31, 2013, unless otherwise noted. We downloaded all financial data from SNL Financial on March 4, 2014. Finally, we leveraged our past reporting on the Troubled Asset Relief Program (TARP), as well as that of the Special Inspector General for TARP, as appropriate.

We determined that the financial information used in this report, including CPP program data from Treasury and financial data on institutions from SNL Financial, was sufficiently reliable to assess the condition and status of CPP and institutions that participated in the program. For example, we tested the Office of Financial Stability's internal controls over financial reporting as they relate to our annual audit of the office's financial statements and found the information to be sufficiently reliable based on the results of our audits of fiscal years 2009, 2010, 2011, and 2012 financial statements for TARP.[1] We have assessed the reliability of SNL Financial data—which are obtained from financial statements submitted to the banking regulators—as part of previous studies and found the data to be reliable for the purposes of our review. We verified that no changes had been made that would affect the data's reliability.

We conducted this performance audit from December 2013 to April 2014 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

[1]See GAO, *Financial Audit: Office of Financial Stability (Troubled Asset Relief Program) Fiscal Years 2012 and 2011 Financial Statements*, GAO-13-126R (Washington, D.C.: Nov. 9, 2012); *Financial Audit: Office of Financial Stability (Troubled Asset Relief Program) Fiscal Years 2011 and 2010 Financial Statements*, GAO-12-169 (Washington, D.C.: Nov.10, 2011); *Financial Audit: Office of Financial Stability (Troubled Asset Relief Program) Fiscal Years 2010 and 2009 Financial Statements*, GAO-11-174 (Washington, D.C.: Nov.15, 2010); and *Financial Audit: Office of Financial Stability (Troubled Asset Relief Program) Fiscal Year 2009 Financial Statements*, GAO-10-301 (Washington, D.C.: Dec. 9, 2009).

Appendix II: Comments from the Office of Financial Stability

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

April 1, 2014

A. Nicole Clowers
Director
Financial Markets and Community Investment
U.S. Government Accountability Office
441 G. Street, NW
Washington, DC 20548

Dear Ms. Clowers:

I write in response to your draft report regarding the Capital Purchase Program (CPP) entitled *Status of the Wind Down of the Capital Purchase Program*. The Department of the Treasury (Treasury) appreciates the work of the Government Accountability Office (GAO) in reviewing this program under the Troubled Asset Relief Program (TARP). We separately provided technical comments to your team. This letter provides our official comments to the draft report.

The draft report provides a valuable snapshot of CPP and the institutions that remain in the program. As of the first quarter of 2014, taxpayers have realized a nearly $28.31 billion positive return on their investments through TARP's bank programs – almost $273.42 billion through repayments, dividends, interest, and other income, compared to the $245.1 billion invested in those institutions. The draft report notes Treasury estimated a lifetime gain of $16.1 billion for CPP in November 2013. As of today's date, Treasury has recovered $225.09 billion on an initial CPP investment of $204.9 billion, representing a positive return of $20.19 billion. In addition, only 71 of the 707 CPP participants remain in the program, representing a remaining Treasury investment of $1.96 billion.

Treasury has been winding down CPP through a three-pronged strategy that involves (1) waiting for repayments from those institutions who can repay in the near future, (2) selling through competitive auctions investments in institutions that cannot repay in the near future, and (3) restructuring some of those investments in limited cases in order to protect the taxpayers' interest. During this wind-down process, we remain committed to keeping the public informed of our progress.

Treasury values GAO's review of CPP and looks forward to continuing to work with you and your team as we move forward.

Sincerely,

Timothy J. Bowler
Acting Assistant Secretary
Office of Financial Stability

Appendix III: GAO Contact and Staff Acknowledgments

GAO Contact

A. Nicole Clowers, (202) 512-8678 or clowersa@gao.gov

Staff Acknowledgments

In addition to the contact named above, Karen Tremba (Assistant Director), Emily Chalmers, William Chatlos, Chris Forys, Matthew Keeler, Risto Laboski, Marc Molino, and Patricia Moye made significant contributions to this report.

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