

October 2010

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

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Why GAO Did This Study

Congress created the Troubled Asset Relief Program (TARP) to restore liquidity and stability in the financial system. The Department of the Treasury (Treasury), among other actions, established the Capital Purchase Program (CPP) as its primary initiative to accomplish these goals by making capital investments in eligible financial institutions. This report examines (1) the characteristics of financial institutions that received CPP funding and (2) how Treasury implemented CPP with the assistance of federal bank regulators. GAO analyzed data obtained from Treasury case files, reviewed program documents, and interviewed officials from Treasury and federal bank regulators.

What GAO Recommends

If Treasury administers programs containing elements similar to those of CPP, Treasury should implement a process for monitoring all applicants that regulators recommend for withdrawal to ensure that similar applicants are treated equitably. To improve monitoring of regulators' decisions on CPP repayments, Treasury should 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 agreed to consider our recommendations. We also received technical comments from the Federal Reserve, FDIC, OCC, and Treasury and incorporated them as appropriate.

View [GAO-11-47](#) or [key components](#).
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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

What GAO Found

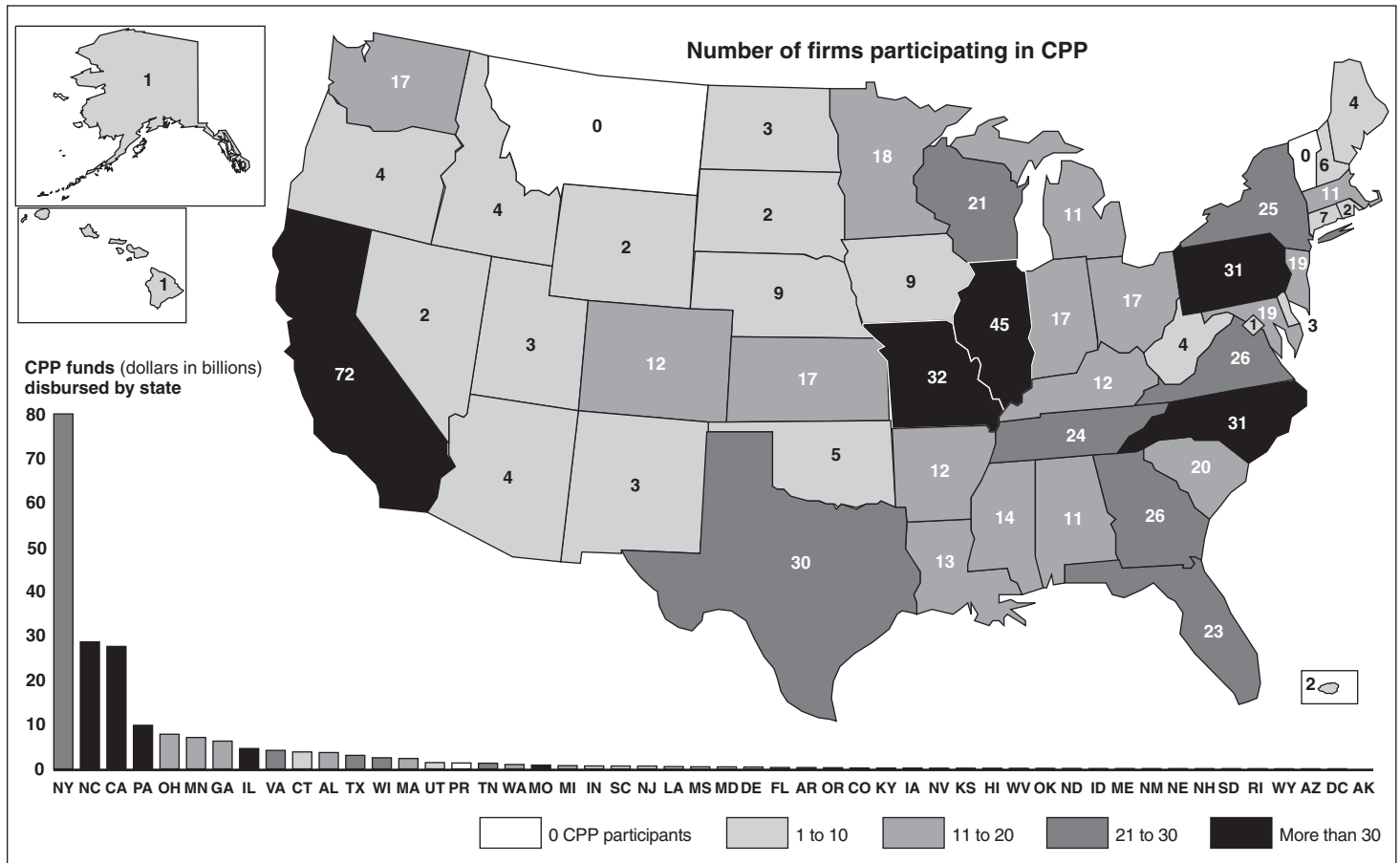
Institutions that received capital under CPP were diverse and generally exceeded eligibility guidelines, and while few institutions have failed, concerns remain about the growing numbers of institutions facing difficulties in paying dividend and interest payments to Treasury. Institutions that participated in CPP included roughly equal numbers of public and private firms of all sizes that were located throughout the country (see figure on next page). About half of CPP institutions that we reviewed were small—that is, had less than \$500 million in risk-weighted assets. However, 25 of the largest firms received almost 90 percent of all CPP funds, and 9 of those comprised almost 70 percent of all funds. Approved institutions had similar overall examination ratings from their regulators and generally were rated as satisfactory. For example, almost all of the institutions we reviewed had an overall examination rating that was satisfactory or better. Many of the examination ratings were over 1 year old, but Treasury and regulatory officials said they took various actions to mitigate any limitations related to older examination results, including using preliminary ratings from ongoing bank examinations. Financial performance ratios that Treasury and regulators also used to evaluate CPP applicants—such as risk-based capital and nonperforming loan ratios—varied by institution but typically were well within guidelines as defined by Treasury and regulatory capital standards. Institutions generally were well above the minimum levels of regulatory capital. However, we identified 66 institutions—12 percent of the firms we reviewed—that exhibited weaker financial conditions relative to those of other approved institutions, and Treasury or regulators raised concerns about the viability of a few of these institutions. For almost all of these weaker firms, Treasury or regulators identified factors—such as management quality or substantial capital levels—that mitigated the weaknesses and provided additional support for the approval of the CPP investment. Four CPP institutions have failed, but the number of firms exhibiting signs of financial difficulty—such as missing their dividend or interest payments—has increased over time. Specifically, the number of institutions that have not made a scheduled dividend or interest payment has increased from 8 for payments due in February 2009 to 123 for payments due in August 2010. Over this period, a total of 144 institutions did not make at least one payment by the end of the reporting period in which they were due, for a total of 413 missed payments. As of August 31, 2010, 79 institutions had missed three or more payments and 24 had missed five or more. Through August 31, 2010, the total amount of missed dividend and interest payments was \$235 million, although some institutions made their payments after the end of the reporting period.

The process Treasury established to invest in financial institutions included internal control procedures for approved applicants that enhanced consistency, but regulators' recommendations for application withdrawals and investment repayments received less oversight. Treasury relied on individual bank regulators to recommend applicants that it would consider for CPP investments and provided regulators with limited formal guidance on the factors to consider in evaluating the applicants. Because of the limited nature

of Treasury’s guidance, regulators used discretion and judgment in their assessments, which created the potential for inconsistency across regulators. Applicants that regulators recommended for approval received additional reviews as they moved through Treasury’s process. For some, this included a review by a council of regulators and all recommended applicants were reviewed by Treasury. These reviews promoted a more consistent evaluation of recommendations made by different regulators. However, regulators recommended that some applicants withdraw their applications and these institutions may not have benefited from the additional reviews if they withdrew their applications before reaching the council or Treasury. Furthermore, the regional offices of some regulators could—and did—recommend that applicants withdraw without centralized review within the agency. Because Treasury did not monitor which institutions regulators excluded from its program, or the reasons for their decisions, it could not fully ensure that regulators treated similar applicants consistently. Limited oversight of withdrawal recommendations also may pose challenges to any future Treasury program that may follow the CPP model, such as the Small Business Lending Fund—an initiative to increase credit for

small businesses through capital investments in certain financial institutions. Unless Treasury makes changes from the CPP model to include monitoring of withdrawal recommendations, such new programs may share the same increased risk of participants not being treated equitably. Treasury is required by statute to allow recipients to repay, subject to consultation with the federal banking regulators, but as with withdrawal recommendations, Treasury does not monitor or collect information or analysis supporting the regulators’ decisions. Regulators said that they evaluate repayment requests based on their supervisory guidelines for capital reductions. Also, in the absence of monitoring by Treasury, regulators have developed generally similar guidelines for evaluating repayment requests and established processes for coordinating repayment decisions that involve multiple regulators. However, without collecting information on or monitoring different regulators’ repayment decisions, Treasury has no basis for determining whether regulators evaluate similar institutions consistently and cannot provide feedback to regulators on the consistency of their decision making.

Number of Participants and Amount of CPP Investments, by State, December 29, 2009



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

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Abbreviations

ALLL	allowance for loan and lease losses
ARRA	American Recovery and Reinvestment Act of 2009
CAMELS	capital, asset quality, management, earnings, liquidity, and sensitivity to market risk
CDCI	Community Development Capital Initiative
CPP	Capital Purchase Program
CRA	Community Reinvestment Act
EESA	Emergency Economic Stabilization Act of 2008
NCUA	National Credit Union Administration
OCC	Office of the Comptroller of the Currency
OFS	Office of Financial Stability
OREO	other real estate owned
OTS	Office of Thrift Supervision
PFR	primary federal regulator
QFI	qualified financial institution
RWA	risk-weighted assets
SBLF	Small Business Lending Fund
SCAP	Supervisory Capital Assessment Program
SIGTARP	Office of the Special Inspector General for TARP
TARP	Troubled Asset Relief Program

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United States Government Accountability Office
Washington, DC 20548

October 4, 2010

Congressional Committees

From October 2008 through December 2009, the U.S. Department of the Treasury (Treasury) invested over \$200 billion in over 700 financial institutions as part of government efforts to stabilize U.S. financial markets and the economy.¹ These investments were made through the Capital Purchase Program (CPP), which was the initial and largest initiative under the Troubled Asset Relief Program (TARP).² Specifically, Treasury's authority under TARP enabled it to buy or guarantee up to almost \$700 billion of the "troubled assets" that were deemed to be at the heart of the crisis, including mortgages and mortgage-based securities, and any other financial instrument Treasury determined it needed to purchase to help stabilize the financial system, including equities.³ Treasury created CPP in October 2008 to provide capital to viable financial institutions through the purchase of preferred shares and subordinated debt. In return for its investments, Treasury would receive dividend or interest payments and warrants.⁴ The program was closed to new investments on December 31, 2009, after Treasury had invested a total of \$205 billion in 707 financial institutions over the life of the program. Since then, Treasury has continued to oversee its investments and collect dividend and interest payments. Some participants have repurchased their preferred shares or

¹Other government efforts to stabilize the financial system included Treasury's Targeted Investment Program, the Federal Deposit Insurance Corporation's Temporary Liquidity Guarantee Program and the Board of Governors of the Federal Reserve System's Term Asset-Backed Securities Loan Facility and emergency lending programs such as the Commercial Paper Funding Facility, the Primary Dealer Credit Facility, and the Term Securities Lending Facility.

²As 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 was signed into law on October 3, 2008 to help stem the worst financial crisis since the 1930s. EESA 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.

³Section 3(9) of the act, 12 U.S.C. § 5202(9). The act requires that the appropriate committees of Congress be notified in writing that the Secretary of the Treasury, after consultation with the Federal Reserve Chairman, has determined that it is necessary to purchase other financial instruments to promote financial market stability.

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

subordinated debt and left the program with the approval of their primary bank regulators.

Treasury has stated that it used CPP investments to strengthen financial institutions' capital levels rather than the purchases of troubled mortgage-backed securities and whole loans as initially envisioned under TARP because it saw these investments as a more effective mechanism to stabilize financial markets, encourage interbank lending, and increase confidence in lenders and investors. Treasury envisioned that the strengthened 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. Financial institutions interested in receiving CPP investments sent their applications directly to their primary federal banking regulators, which did the initial evaluations. Institutions were evaluated to determine their long-term strength and viability, and weaker institutions were encouraged by their regulators to withdraw their applications. The regulators provided Treasury's Office of Financial Stability (OFS) with recommendations approving or denying applications. OFS made the final decisions.

This report is based upon our continuing analysis and monitoring of Treasury's process for implementing the Emergency Economic Stabilization Act of 2008, (EESA), which provided GAO with broad oversight authorities for actions taken under TARP and requires that we report at least every 60 days on TARP activities and performance.⁵ To fulfill our statutorily mandated responsibilities, we have been monitoring and providing updates on TARP programs, including CPP, in several reports. This report expands on the previous work.⁶ Its objectives are to (1) describe the characteristics of financial institutions that received CPP

⁵Section 116 of EESA, 122 Stat. at 3783 (codified at U.S.C. § 5226).

⁶See GAO, *Troubled Asset Relief Program: Additional Actions Needed to Better Ensure Integrity, Accountability, and Transparency*, [GAO-09-161](#) (Washington, D.C.: Dec. 2, 2008); *Troubled Asset Relief Program: Status of Efforts to Address Transparency and Accountability Issues*, [GAO-09-296](#) (Washington, D.C.: Jan. 30, 2009); *Troubled Asset Relief Program: March 2009 Status of Efforts to Address Transparency and Accountability Issues*, [GAO-09-504](#) (Washington, D.C.: Mar. 31, 2009); *Troubled Asset Relief Program: June 2009 Status of Efforts to Address Transparency and Accountability Issues*, [GAO-09-658](#) (Washington, D.C.: Jun. 17, 2009); and *Troubled Asset Relief Program: One Year Later, Actions Are Needed to Address Remaining Transparency and Accountability Challenges*, [GAO-10-16](#) (Washington, D.C.: Oct. 8, 2009).

funding, and (2) assess how Treasury, with the assistance of federal bank regulators, implemented CPP.

To meet the report's objectives, we reviewed Treasury's case files for CPP institutions that were funded through April 30, 2009, and other supporting documentation such as records of meetings and transaction reports. We collected and analyzed information from the case files, including data on the characteristics of institutions that participated in CPP, such as risk-weighted assets, examination ratings, and selected financial ratios.⁷ We also gathered information on the process that Treasury and regulators used to evaluate CPP applications. We reviewed program documents and interviewed officials from OFS who were responsible for processing applications and repayment requests to obtain their views on CPP implementation. Additionally, we interviewed officials from the four federal banking regulators—the Federal Deposit Insurance Corporation (FDIC), the Office of the Comptroller of the Currency (OCC), the Board of Governors of the Federal Reserve System (Federal Reserve), and the Office of Thrift Supervision (OTS)—to obtain information on their process for reviewing CPP applications and repayment requests. Further, we collected and reviewed program documents from the bank regulators, including their policies and procedures, guidance documents, and analysis summaries. Finally, we reviewed relevant laws (e.g., EESA) as well as relevant reports by GAO, the Office of the Special Inspector General for TARP (SIGTARP), the FDIC Office of Inspector General, and the Federal Reserve Office of Inspector General. This report is part of our coordinated work with SIGTARP and the inspectors general of the federal banking agencies to oversee TARP and CPP. The offices of the inspectors general of FDIC, Federal Reserve, and Treasury and SIGTARP have all completed work or have work under way at their respective agencies reviewing CPP's implementation. In coordination with the other oversight agencies and offices and to avoid duplication, we primarily focused our audit work (including our review of agency case files) on the phases of the CPP process from the point at which the regulators transmitted their recommendations to Treasury.

We conducted this performance audit from May 2009 to September 2010 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient,

⁷Risk-weighted assets are the total assets and off-balance-sheet items held by an institution that are weighted for risk according to the federal banking agencies' regulatory capital standards.

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

CPP was the primary initiative under TARP for stabilizing the financial markets and banking system. Treasury created the program in October 2008 to stabilize the financial system by providing capital on a voluntary basis to qualifying regulated financial institutions through the purchase of senior preferred shares and subordinated debt.⁸ On October 14, 2008, Treasury allocated \$250 billion of the \$700 billion in overall TARP funds for CPP but adjusted its allocation to \$218 billion in March 2009 to reflect lower estimated funding needs based on actual participation and the expectation that institutions would repay their investments. The program was closed to new investments on December 31, 2009, and, in total, Treasury invested \$205 billion in 707 financial institutions over the life of the program. Through June 30, 2010, 83 institutions had repaid about \$147 billion in CPP investments, including 76 institutions that repaid their investments in full.

Under CPP, qualified financial institutions were eligible to receive an investment of between 1 and 3 percent of their risk-weighted assets, up to a maximum of \$25 billion.⁹ In exchange for the investment, Treasury generally received shares of senior preferred stock that were due to pay dividends at a rate of 5 percent annually for the first 5 years and 9 percent annually thereafter.¹⁰ In addition to the dividend payments, EESA required the inclusion of warrants to purchase shares of common stock or preferred stock, or a senior debt instrument to give taxpayers additional protection against losses and an additional potential return on the investments. Institutions are allowed to repay CPP investments with the approval of their primary federal bank regulators and afterward to repurchase warrants at fair market value.

⁸For purposes of CPP, qualifying financial institutions generally include stand-alone U.S.-controlled banks and savings associations, as well as bank holding companies and most savings and loan holding companies.

⁹In May 2009, Treasury increased the maximum amount of CPP funding that small financial institutions (qualifying financial institutions with total assets less than \$500 million) may receive from 3 percent of risk-weighted assets to 5 percent of risk-weighted assets.

¹⁰For certain types of institutions known as S corporations, Treasury received subordinated debt rather than preferred shares to preserve these institutions' special tax status.

While this was Treasury's program, the federal bank regulators played a key role in the CPP application and approval process. The federal banking agencies that were responsible for receiving and reviewing CPP applications and recommending approval or denial were the

- **Federal Reserve**, which supervises and regulates banks authorized to do business under state charters and that are members of the Federal Reserve System, as well as bank and financial holding companies;¹¹
- **FDIC**, which provides primary federal oversight of any state-chartered banks insured by FDIC that are not members of the Federal Reserve System;
- **OCC**, which is responsible for chartering, regulating, and supervising commercial banks with national charters; and
- **OTS**, which charters federal savings associations (thrifts) and regulates and supervises federal and state thrifts and savings and loan holding companies.¹²

Treasury, in consultation with the federal banking regulators, developed a standardized framework for processing applications and disbursing CPP funds. Treasury encouraged financial institutions that were considering applying to CPP to consult with their primary federal bank regulators.¹³ The bank regulators also had an extensive role in reviewing the applications of financial institutions applying for CPP and making recommendations to Treasury. Eligibility for CPP funds was based on the regulator's assessment of the applicant's strength and viability, as measured by factors such as examination ratings, financial performance ratios, and other mitigating factors, without taking into account the potential impact of TARP funds. Institutions deemed to be the strongest, such as those with the highest examination ratings, received presumptive approval from the banking

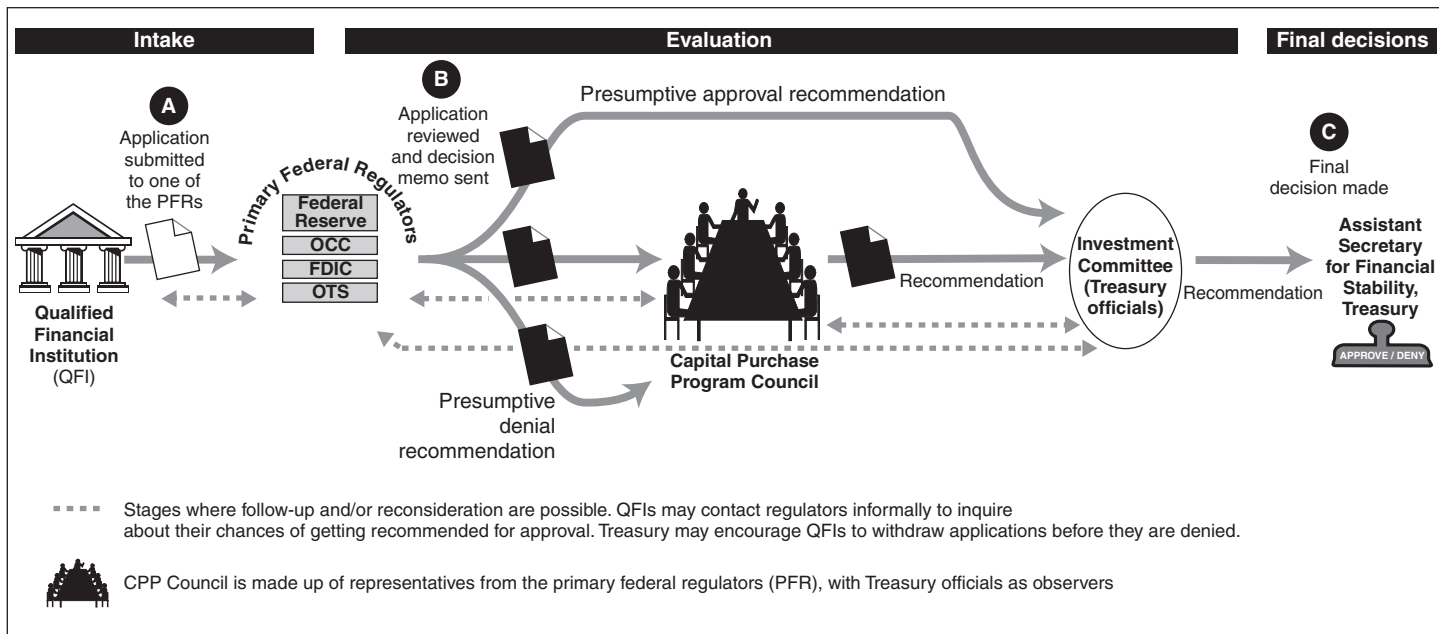
¹¹Bank holding companies are entities that own or control one or more U.S. commercial banks. Financial holding companies are a subset of bank holding companies that may engage in a wider range of activities.

¹²The Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, Title III, 124 Stat. 1376, 1520 (2010), includes provisions to abolish OTS and allocate its functions among the Federal Reserve, OCC, and FDIC.

¹³The primary federal regulator is generally the regulator overseeing the lead bank of the institution. Where the institution is owned by a bank holding company, the primary federal regulator also consults with the Federal Reserve.

regulators, and their applications were forwarded to Treasury. Institutions with lower examination ratings or other concerns that required further review were referred to the interagency CPP Council, which was composed of representatives from the four banking regulators, with Treasury officials as observers. The CPP Council evaluated and voted on the applicants, and applications from institutions that received “approval” recommendations from a majority of the regulatory representatives were forwarded to Treasury. Treasury provided guidance to regulators and the CPP Council to use in assessing applicants that permitted consideration of factors such as signed merger agreements or confirmed investments of private capital, among other things, to offset low examination ratings or other weak attributes. Finally, institutions that the banking regulators determined to be the weakest and ineligible for a CPP investment, such as those with the lowest examination ratings, were to receive a presumptive denial recommendation. Figure 1 provides an overview of the process for assessing and approving CPP applications.

Figure 1: Process for Accepting and Approving CPP Applications



Sources: GAO analysis; Treasury; Art Explosion (images).

Note: If the applicant was a bank holding company, an application was submitted to both the applicant’s holding company regulator and the regulator of the largest insured depository institution controlled by the applicant.

The banking regulator or the CPP Council sent approval recommendations to Treasury's Investment Committee, which comprised three to five senior Treasury officials, including OFS's chief investment officer (who served as the committee chair) and the assistant secretaries for financial markets, economic policy, financial institutions, and financial stability at Treasury. After receiving recommended applications from regulators or the CPP Council, OFS reviewed documentation supporting the regulators' recommendations but often collected additional information from regulators and the council before submitting applications to the Investment Committee. The Investment Committee could also request additional analysis or information in order to clear any concerns before deciding on an applicant's eligibility. After completing its review, the Investment Committee made recommendations to the Assistant Secretary for Financial Stability for final approval. Once the Investment Committee recommended preliminary approval, Treasury and the approved institution initiated the closing process to complete the legal aspects of the investment and disburse the CPP funds.

At the time of the program's announced establishment, nine major financial institutions were initially included in CPP.¹⁴ While these institutions did not follow the application process that was ultimately developed, Treasury included these institutions because federal banking regulators and Treasury considered them to be essential to the operation of the financial system, which at the time had effectively ceased to function. At the time, these nine institutions held about 55 percent of U.S. banking assets and provided a variety of services, including retail and wholesale banking, investment banking, and custodial and processing services. According to Treasury officials, the nine financial institutions agreed to participate in CPP in part to signal the importance of the program to the stability of the financial system. Initially, Treasury approved \$125 billion in capital purchases for these institutions and completed the transactions with eight of them on October 28, 2008, for a total of \$115 billion. The remaining \$10 billion was disbursed after the merger of Bank of America Corporation and Merrill Lynch & Co., Inc., was completed in January 2009.

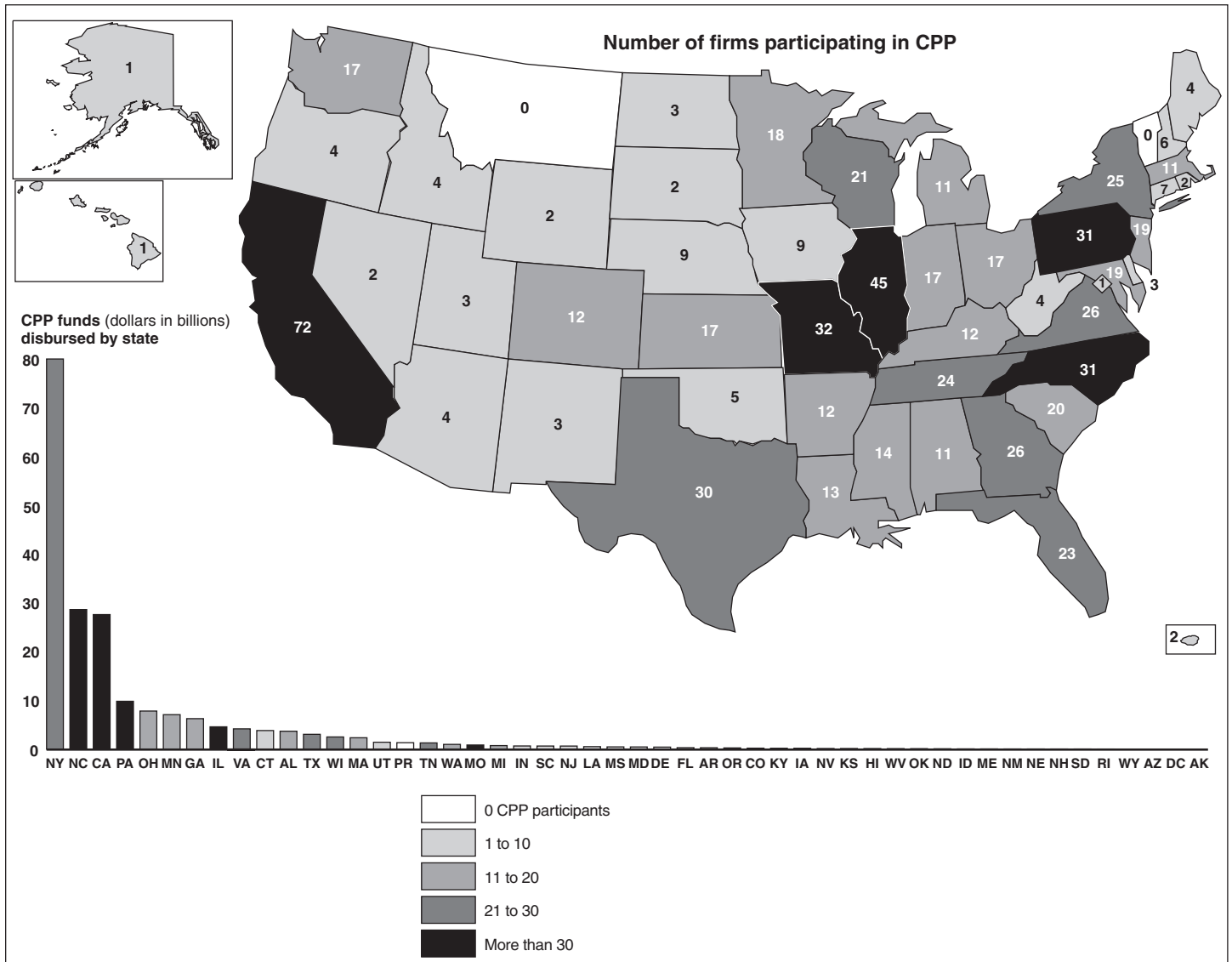
¹⁴The nine major financial institutions were Bank of America Corporation; Citigroup, Inc.; JPMorgan Chase & Co.; Wells Fargo & Company; Morgan Stanley; The Goldman Sachs Group, Inc.; The Bank of New York Mellon Corporation; State Street Corporation; and Merrill Lynch & Co., Inc.

CPP Institutions Were Diverse and with Some Exceptions Met CPP Guidelines, but More Institutions Are Showing Signs of Financial Difficulties

The institutions that received CPP capital investments varied in terms of ownership type, location, and size. The 707 institutions that received CPP investments were split almost evenly between publicly held and privately held institutions, with slightly more private firms.¹⁵ They included state-chartered and national banks and U.S. bank holding companies located in 48 states, the District of Columbia, and Puerto Rico (see fig. 2). Most states had fewer than 20 CPP firms, but 13 states had 20 or more. California had the most, with 72, followed by Illinois (45), Missouri (32), North Carolina (31), and Pennsylvania (31). Montana and Vermont were the only 2 states that did not have institutions that participated in CPP.

¹⁵Under CPP program guidelines, a public institution is a company (1) whose securities are traded on a national securities exchange and (2) that is required to file, under the federal securities laws, periodic reports such as the annual and quarterly reports with either the Securities and Exchange Commission or a primary federal bank regulator. A privately held institution is a company that does not meet the definition of a public institution. Institutions traded in over-the-counter markets had the option to participate under the terms for private institutions.

Figure 2: Number of Participants and Amount of CPP Investments by State as of December 31, 2009



Source: GAO analysis of OFS data; Map Resources (map).

The total amount of CPP funds disbursed to institutions also varied by state. The amount of CPP funds invested in institutions in most states was less than \$500 million, but institutions in 17 states received more than \$1 billion each. Institutions in states that serve as financial services centers

such as New York and North Carolina received the most CPP funds.¹⁶ The median amount of CPP funds invested in institutions by state was \$464 million.

The size of CPP institutions also varied widely. The risk-weighted assets of firms we reviewed that were funded through April 30, 2009, ranged from \$10 million to \$1.4 trillion.¹⁷ However, most of the institutions were relatively small. For example, about half of the firms that we reviewed had risk-weighted assets of less than \$500 million, and almost 70 percent had less than \$1 billion. Only 30 percent were medium to large institutions (more than \$1 billion in risk-weighted assets). Because the investment amount was tied to the firm's risk-weighted assets, the amount that firms received ranged widely, from about \$300,000 to \$25 billion. The average investment amount for all of the 707 CPP participants was \$290 million, although half of the institutions received less than \$11 million. The 25 largest institutions received almost 90 percent of the total amount of CPP investments, and 9 of these firms received almost 70 percent of the funds.

Regulatory Examinations Found That the Financial Condition of Most CPP Institutions Was At Least Satisfactory

The characteristics Treasury and regulators used to evaluate applicants indicated that approved institutions had bank or thrift examination ratings that generally were satisfactory, or within CPP guidelines.¹⁸ Treasury and regulators used various measures of institutional strength and financial condition to evaluate applicants. These included supervisory examination ratings and financial performance ratios assessing an applicant's capital

¹⁶The top 5 states receiving the most CPP investments were New York (\$80,194,291,000), North Carolina (\$28,695,010,000), California (\$27,667,578,000), Pennsylvania (\$9,848,886,000), and Ohio (\$7,840,580,000). The states receiving the least amount of CPP investments were Alaska (\$4,781,000), the District of Columbia (\$6,000,000), Arizona (\$8,047,000), Wyoming (\$8,100,000), and Rhode Island (\$31,065,000).

¹⁷The dates of the risk-weighted assets were from 2008, although dates were not available for 161 of the 567 firms we reviewed.

¹⁸FDIC was the primary regulator for most of the institutions that participated in CPP—424 firms, or 60 percent of those we reviewed. The Federal Reserve was the primary regulator for 112 firms, or 16 percent; OCC was the primary regulator for 116, or 16 percent; and OTS for 55, or 8 percent.

adequacy and asset quality.¹⁹ While some examination results were more than a year old, regulatory officials told us that they had taken steps to mitigate the effect of these older ratings, such as collecting updated information.

Examination Ratings

Almost all of the 567 institutions we reviewed had overall examination ratings for their largest bank or thrift that were satisfactory or better (see fig. 3).²⁰ The CAMELS ratings range from 1 to 5, with 1 indicating a firm that is sound in every respect, 2 denoting an institution that is fundamentally sound, and 3 or above indicating some degree of supervisory concern. Of the CPP firms that we reviewed, 82 percent had an overall rating of 2 from their most recent examination before applying to CPP, and an additional 11 percent had the strongest rating. Seven percent had an overall rating of 3 and no firms had a weaker rating. We also found relatively small differences in overall examination ratings for institutions by size or ownership type. For example, institutions that were above and below the median risk-weighted assets of \$472 million both had average overall ratings of about 2. Also, public and private firms both had average overall examination ratings of about 2.

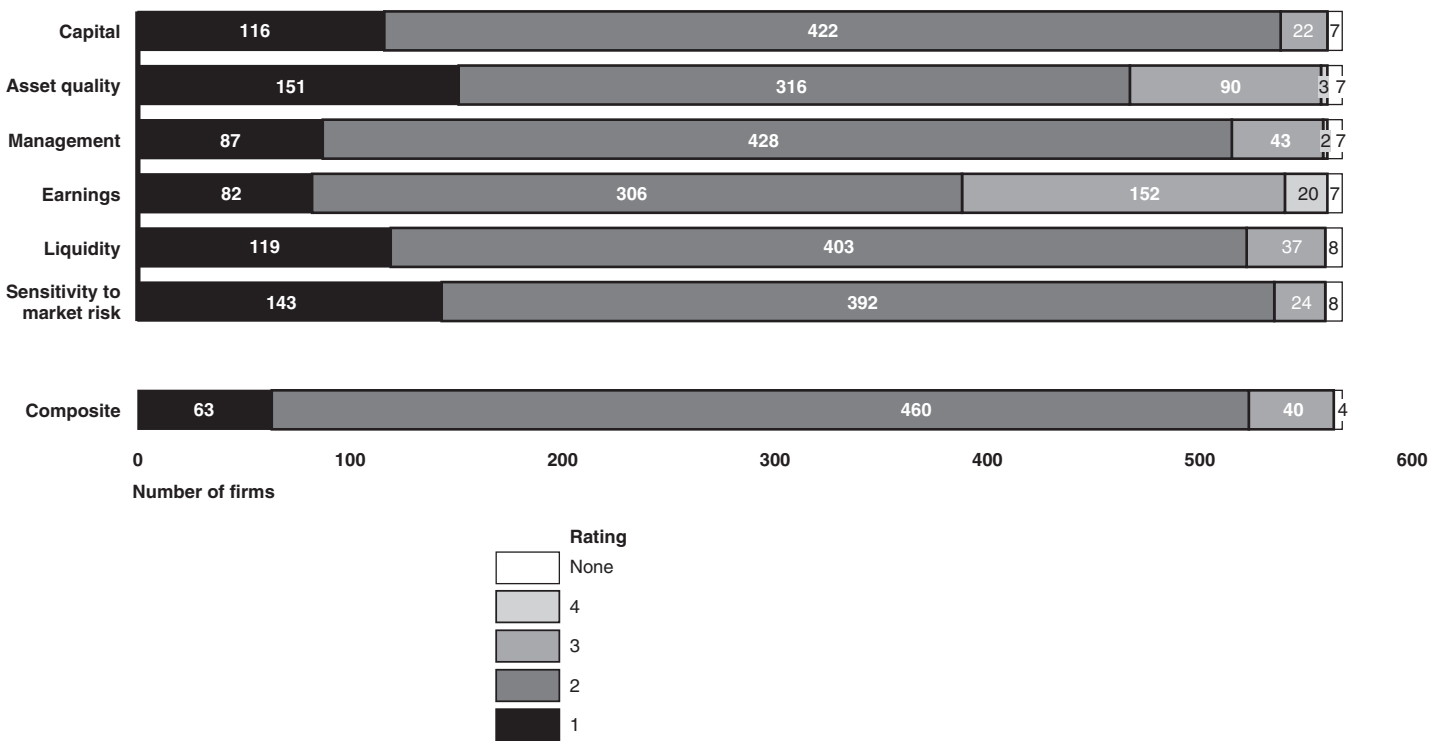
Bank or thrift examination ratings for individual components—such as asset quality and liquidity—exhibited similar trends. In particular, each of the individual components had an average rating of around 2. Institutions tended to have weaker ratings for the earnings component, which had an average of 2.2, than for the other components, which averaged between 1.8 and 1.9. Public and private institutions exhibited similar results for the average component ratings, although private institutions tended to have stronger ratings on all components except for earnings and sensitivity to

¹⁹The federal banking agencies assign a supervisory rating when they conduct examinations of a bank or thrift's safety and soundness. The numerical ratings range from 1 to 5, with 1 being the strongest and 5 the weakest. The ratings—referred to as CAMELS—assess six components of an institution's financial health: capital, asset quality, management, earnings, liquidity, and sensitivity to market risk. Treasury instructed regulators to consider CAMELS ratings, among other indicators, in making approval recommendations. Treasury and regulators also identified six performance ratios for evaluating applicants. Three of the ratios related to regulatory capital levels—Tier 1 risk-based capital ratio, total risk-based capital ratio, and Tier 1 leverage ratio. The other three ratios measured certain classes of assets—including classified assets, nonperforming loans, and construction and development loans—as a share of capital and reserves.

²⁰SunTrust Banks, Inc., and Bank of America Corporation each received two CPP investments in separate transactions. Therefore, the number of unique institutions receiving CPP investments through April 30, 2009 is 565.

market risk. Differences in average ratings by bank size also were small. For example, smaller institutions had stronger average ratings for the capital and asset quality components, but larger institutions had stronger average ratings for earnings and sensitivity to market risk.

Figure 3: CAMELS Overall and Component Ratings Used to Evaluate CPP Institutions Funded through April 30, 2009



Source: GAO analysis of OFS documentation.

Note: The dates of CAMELS examination ratings span from December 2006 to December 2008. Dates were missing for 104 of the institutions that we reviewed. Institutions were identified as having no rating if we did not find the information in our review of Treasury’s case files. This does not necessarily indicate that the institution had no examination rating. Some newly chartered institutions (de novos) did not have examination ratings completed at the time of the application.

Holding companies receiving CPP investments typically also had satisfactory or better examination ratings. The Federal Reserve uses its own

rating system when evaluating bank holding companies.²¹ Almost 80 percent of holding companies receiving CPP funds had an overall rating of 2 (among those with a rating), and an additional 14 percent had an overall rating of 1. The individual component ratings for holding companies (for example, for risk management, financial condition, and impact) also were comparable with overall ratings, with most institutions for which we could find a rating classified as satisfactory or better. Specifically, over 90 percent of the ratings for each of the components were 1 or 2, with most rated 2.

Many examination ratings were more than a year old, a fact that could limit the degree to which the ratings accurately reflect the institutions' financial condition, especially at a time when the economy was deteriorating rapidly. Specifically, about 25 percent of examination ratings were older than 1 year prior to the date of application, and 5 percent were more than 16 months old. On average, examination ratings were about 9 months older than the application date. Regulators used examination ratings as a key measure of an applicant's financial condition and viability, and the age of these ratings could affect how accurately they reflect the institutions' current state. For example, assets, liabilities, and operating performance generally are affected by the economic environment and depend on many factors, such as institutional risk profiles. Stressed market conditions such as those existing in the broad economy and financial markets during and before CPP implementation could be expected to have negative impacts on many of the applicants, making the age of examination ratings a critical factor in evaluating the institutions' viability. Further, some case decision files for CPP firms were missing examination dates. Specifically, 104 applicants' case decision files out of the 567 we reviewed lacked a date for the most recent examination results.

Treasury and regulatory officials told us that they took various actions to collect information on applicants' current condition and to mitigate any limitations of older examination results. Efforts to collect additional information on the financial condition of applicants included waiting for results of scheduled examinations or relying on preliminary CAMELS

²¹The Federal Reserve assigns each bank holding company a composite rating (C) based on an evaluation of its managerial and financial condition and an assessment of future potential risk to its subsidiary bank or thrift. The main components of the rating system represent risk management (R), financial condition (F), and potential impact (I) of the holding company and nonbank or nonthrift subsidiaries on the bank or thrift. Examiners assign ratings based on a 1-to-5 numeric scale. A 1 indicates the highest rating, strongest performance and practices, and least degree of supervisory concern; a 5 indicates the lowest rating, weakest performance, and highest degree of supervisory concern.

exam results, reviewing quarterly financial results such as recent information on asset quality, and sometimes conducting brief visits to assess applicants' condition. Officials from one regulator explained that communication with the agency's regional examiners and bank management on changes to the firm's condition was the most important means of allaying concerns about older examination results. However, officials from another regulator stated that they did use older examination ratings, depending on the institution's business model, lending environment, banking history, and current loan activity. For example, the officials said they would use older ratings if the institution was a small community bank with a history of conservative underwriting standards and was not lending in a volatile real estate market.

As with the examination ratings, almost all of the institutions we reviewed had a rating for compliance with the Community Reinvestment Act (CRA) of satisfactory or better.²² Over 80 percent of firms received a satisfactory rating and almost 20 percent had an outstanding rating. Only two institutions had an unsatisfactory rating. Average CRA ratings also were similar across institution types and sizes.

Performance Ratios

Performance ratios for the CPP firms we reviewed varied but typically were well within CPP guidelines. In assessing CPP applicants, Treasury and regulators focused on a variety of ratios based on regulatory capital levels, and institutions generally were well above the minimum required levels for these ratios.²³ Regulators generally used performance ratio information from regulatory filings for the second or third quarters of 2008. Two of these ratios are based on a key type of regulatory capital known as Tier 1, which includes the core capital elements that are considered the most reliable and stable, primarily common stock and certain types of preferred stock. Specifically, for the Tier 1 risk-based capital ratio, banks or thrifts and holding companies had average ratios

²²Federal banking regulators also examine the institutions they supervise to determine their compliance with CRA. Congress enacted CRA in 1977 to encourage depository institutions to help meet the credit needs of the communities in which they operate, including low- and moderate-income neighborhoods. A CPP applicant's CRA rating is another factor that Treasury instructed the federal banking regulators to consider in making approval recommendations.

²³The minimum amount of regulatory capital is the amount required by bank regulators for an institution to be considered adequately capitalized for purposes of prompt corrective action. Prompt corrective action is a supervisory framework for banks that links supervisory actions closely to a bank's capital ratios. Under prompt corrective action, institutions below this threshold are considered undercapitalized.

that were more than double the regulatory minimum of 4 percent with only one firm below that minimum level. Further, only two institutions were below 6.5 percent (see fig. 4).²⁴ Although almost all firms had Tier 1 risk-based capital ratios that exceeded the minimum level, the ratios ranged widely, from 3 percent to 43 percent.²⁵ Similarly, banks or thrifts and holding companies had average Tier 1 leverage ratios that were more than double the required 4 percent, and only 3 firms were below 4 percent.²⁶ The ratios also ranged widely, from 2 percent to 41 percent. Finally, for the total risk-based capital ratio, banks or thrifts and holding companies had average ratios of 12 percent, well above the 8 percent minimum, and only two firms were below 8 percent.²⁷ These ratios ranged from 4 percent to 44 percent.

Asset-based performance ratios for most CPP institutions also generally remained within Treasury's guidelines, although more firms did not meet the criteria for these ratios than did not meet the criteria for capital ratios. Treasury and the regulators established maximum guideline amounts for the three performance ratios relating to assets that they used to evaluate applicants. These ratios measure the concentration of troubled or risky assets as a share of capital and reserves—classified assets, nonperforming loans (including non-income-generating real estate, which is typically acquired through foreclosure), and construction and development loans. For each of these performance ratios, both the banks or thrifts and holding companies had average ratios that were less than half of the maximum guideline, well within the specified limits. For example, banks/thrifts and holding companies had average ratios of 25 and 32 percent, respectively,

²⁴The Tier 1 risk-based capital ratio is defined as Tier 1 capital as a share of risk-weighted assets (RWA). Tier 1 capital consists of core elements such as common stock, noncumulative perpetual preferred stock, and minority interests in consolidated subsidiaries. Risk-weighted assets are on- and off-balance sheet assets adjusted for their risk characteristics.

²⁵Some of the CPP institutions we reviewed were newly chartered banks, referred to as de novo institutions. In their early years of operation, de novo banks may have high amounts of capital relative to their assets and low levels of nonperforming loans as they extend credit to new clients and grow their loan portfolios. One such bank that opened the same year it applied for CPP accounted for the highest regulatory capital ratios in each of the three categories (Tier 1 risk-based capital ratio, Tier 1 leverage ratio, and total risk-based capital ratio).

²⁶The Tier 1 leverage ratio is defined as Tier 1 capital as a share of average total consolidated assets.

²⁷The total risk-based capital ratio is defined as total capital as a share of risk-weighted assets. Total capital includes Tier 1 capital and Tier 2 capital, or supplementary capital.

for classified assets, which had a maximum guideline of 100 percent. The substantial majority of banks or thrifts and holding companies also were well below the maximum guidelines for the asset ratios. For example, almost 90 percent of banks/thrifts and over 80 percent of holding companies had classified assets ratios below 50 percent. However, while only 3 firms missed the guidelines for any of the capital ratios, 38 banks/thrifts and holding companies missed the nonperforming loan ratio, 8 missed the construction and development loan ratio, and 1 missed the classified assets ratio.

Figure 4: Bank or Thrift and Holding Company Performance Ratios Used to Evaluate CPP Institutions Funded through April 30, 2009



Source: GAO analysis of OFS documentation.

Note: The dates of performance ratios for all but one bank and one holding company were from 2008. The “allowance for loan and lease losses” (ALLL) is an account maintained by financial institutions to cover expected losses in their loan and lease portfolios. The “other real estate owned” (OREO) is an account used for examination and reporting purposes that primarily includes real estate owned by a financial institution as a result of foreclosure.

Treasury and Bank Regulators Took Steps to Help Ensure That CPP Applicants Met Guidelines for Viability

A small group of CPP participants exhibited weaker attributes relative to other approved institutions (see table 1). For most of these cases, Treasury or regulators described factors that mitigated the weaknesses and supported the applicant's viability. Specifically, we identified 66 CPP institutions—12 percent of the firms we reviewed—that either (1) did not meet the performance ratio guidelines used to evaluate applicants, (2) had an unsatisfactory overall bank or thrift examination rating, or (3) had a formal enforcement action involving safety and soundness concerns.²⁸ We use these attributes to identify these 66 firms as marginal institutions, although the presence of these attributes does not necessarily indicate that a firm was not viable or that it was ineligible for CPP participation.²⁹ However, they generally may indicate firms that either had weaker attributes than other approved firms or required closer evaluation by Treasury and regulators. Nineteen of the institutions met multiple criteria, including those that missed more than one performance ratio for the largest bank/thrift or holding company. The most common criteria for the firms identified as marginal was an unsatisfactory overall examination rating or an unsatisfactory nonperforming loan ratio. A far smaller number of firms exceeded the construction and development loan ratio or had experienced a formal enforcement action related to safety and soundness concerns. One bank and two holding companies missed the capital or classified assets ratios.

²⁸At the initiation of CPP, Treasury and regulators defined acceptable levels for the three performance ratios relating to asset quality (classified assets ratio, nonperforming loan and real estate-owned ratio, and construction and development loan ratio). The criteria for the three performance ratios relating to capital levels (Tier 1 risk-based capital ratio, total risk-based capital ratio, and the Tier 1 leverage ratio) are based on regulatory minimums for an institution to be considered adequately capitalized. For the leverage ratio, we used the minimum level that applies to most banks and bank holding companies (4 percent), although regulators applied a lower level to banks and bank holding companies with strong examination ratings. Banks with overall unsatisfactory examination ratings are those with a composite CAMELS rating weaker than 2. We reviewed enforcement actions available through regulators' Web sites to determine whether actions were formal or informal, active at the time of CPP approval, or related to compliance or safety and soundness.

²⁹Treasury and regulatory officials said that they did not have absolute criteria for evaluating CPP applicants and did not make approval decisions solely on the basis of specific quantitative measurements. Treasury and regulatory officials explained that they also relied on their judgment and familiarity with the firms they supervised.

Table 1: Number of Institutions Participating in CPP That Exhibited Weak Characteristics Prior to Approval

Characteristic	Number of institutions exhibiting the characteristic
Overall CAMELS bank examination rating of 3, 4, or 5	40
Active, formal safety-and-soundness-related enforcement action	5
Tier 1 risk-based capital ratio less than 4 percent	1
Total risk-based capital ratio less than 8 percent	1
Tier 1 leverage ratio less than 4 percent	3
Classified assets ratio greater than 100 percent ^{ia}	1
Nonperforming loan ratio greater than 40 percent ^b	38
Construction and development loans/total risk-based capital ratio greater than 300 percent	8
Total institutions exhibiting characteristics	66^c

Source: GAO analysis of OFS documentation.

^aClassified assets / (net Tier 1 capital + ALLL).

^b(Nonperforming loans + OREO) / (Net Tier 1 capital + ALLL).

^cTotal does not add because 19 firms exhibited multiple characteristics.

In their evaluations of CPP applicants, Treasury and regulators documented their reasons for approving institutions with marginal characteristics. They typically identified three types of mitigating factors that supported institutions' overall viability: (1) the quality of management and business practices; (2) the sufficiency of capital and liquidity; and (3) performance trends, including asset quality. The most frequently cited attributes related to management quality and capital sufficiency.

High-quality management and business practices. In evaluating marginal applicants, regulators frequently considered the experience and competency of the applicants' senior management team. Officials from one bank regulator said that they might be less skeptical of an applicant's prospects if they believed it had high-quality management. For example, they used their knowledge of institutions and the quality of their management to mitigate economic concerns for banks in the geographic areas most severely affected by the housing market decline. Commonly identified strengths included the willingness and ability of management to respond quickly to problems and concerns that regulators identified such as poor asset quality or insufficient capital levels. The evaluations of several marginal applicants described management actions to aggressively address asset quality problems as an indication of an institution's ability to

resolve its weaknesses. Regulators also had a positive view of firms whose boards of directors implemented management changes such as replacing key executives or hiring more experienced staff in areas such as credit administration. Finally, regulators evaluated the quality of risk management and lending practices in determining management strength.

Capital and liquidity. Regulators often reviewed the applicant's capital and liquidity when evaluating whether an institution's weaknesses might affect its viability. In particular, regulators and Treasury considered the sufficiency of capital to absorb losses from bad assets and the ability to raise private capital. As instructed by Treasury guidance, regulators evaluated an institution's capital levels prior to the addition of any CPP investment. Although an institution might have high levels of nonperforming loans or other problem assets, regulators' concerns about viability might be eased if it also had a substantial amount of capital available to offset related losses. Likewise, capital from private sources could shore up an institution's capital buffers and provide a signal to the market that it could access similar sources if necessary.

When evaluating the sufficiency of a marginal applicant's capital, regulators also assessed the amount of capital relative to the firm's risk profile, the quality of the capital, and the firm's dependence on volatile funding sources. Institutions with a riskier business model that included, for instance, extending high-risk loans or investing in high-risk assets generally would require higher amounts of capital as reserves against losses. Conversely, an institution with a less risky strategy or asset base might need somewhat less capital to be considered viable. Regulators reviewed the quality of a firm's capital because some forms of capital, such as common shareholder's equity, can absorb losses more easily than other types, such as subordinated debt or preferred shares, which may have restrictions or limits on their ability to take losses.³⁰ Finally, regulators considered the nature of a firm's funding sources. They viewed firms that financed their lending and other operations with stable funding sources, such as core deposit accounts or long-term debt, as less risky than firms that obtained financing through brokered deposits or wholesale

³⁰For example, holders of subordinated debt have a claim on the firm's assets, and institutions issuing subordinated debt have an obligation to repay those funds, even though holders of the subordinated debt may have a lower priority for repayment than depositors or senior debt holders in the event of an insolvency or bank seizure. Institutions do not have an obligation to repay funds received from purchasers of their common stock or certain types of preferred stock.

funding, which could be more costly or might need to be replaced more frequently.

Performance trends. Regulators also examined recent trends in performance when evaluating marginal applicants. For example, regulators considered strong or improving trends in asset quality, earnings, and capital levels, among others, as potentially favorable indicators of viability. These trends included reductions in nonperforming and classified assets, consistent positive earnings, reductions in commercial real estate concentrations, and higher net interest margins and return on assets. In some cases, regulators identified improvements in banks' performance through preliminary examination ratings. Officials from one bank regulator stated that the agency refrained from making recommendations until it had recent and complete examination data. For example, if an examination was scheduled for an applicant that had raised regulatory concerns or questions, the agency would wait for the updated results before completing its review and making a recommendation to Treasury.

Some Firms Were Approved despite Questions about Their Ongoing Viability

Regulators and Treasury raised specific questions about the viability of a small number of institutions that ultimately were approved and received their CPP investments between December 19, 2008, and March 27, 2009. Most of the questions about viability involved poor asset quality, such as nonperforming loans or bad investments, and lending that was highly concentrated in specific product types, such as commercial real estate (see table 2). For these institutions, various mitigating factors were used to provide support for the firm's ultimate approval. For example, regulators and Treasury identified the addition of private capital, strong capital ratios, diversification of lending portfolios, and updated examination results as mitigating factors in approving the institutions. One of these institutions had weaker characteristics than the others, and regulators and Treasury appeared to have more significant concerns about its viability. Ultimately, regulators and the CPP Council recommended approval of this institution based, in part, on criteria in Section 103 of EESA, which requires Treasury to consider providing assistance to financial institutions having certain attributes such as serving low- and moderate-income populations and having assets less than \$1 billion.

Table 2: Mitigating Factors for Viability Concerns Identified by Regulators or Treasury

Eligibility or viability concerns	Mitigating factors
<ul style="list-style-type: none"> • Very high commercial real estate concentration • High construction and development loan concentration • State of bank's lending market • Poor performance ratios • Nonperforming loans • Precarious financial position • Elimination of capital by investment losses • Continual subpar management ratings • Questionable viability without CPP funds • Unsatisfactory management responsiveness • High commercial real estate exposure • Potential impairment in mortgage servicing assets • Viability of business plan given the current industry turmoil • Overall credit quality • Viability questionable without additional capital • Ability to improve operating performance • Proportion of non-owner-occupied commercial real estate 	<ul style="list-style-type: none"> • Preliminary examination results • Relative strength of local market area • Management strong and conservative • Strong capital position • Bank committed to raising additional capital • Private capital investment • Aggressive in recognizing losses • Relatively strong capital ratios • Fannie Mae and Freddie Mac investment losses • Favorable capital treatment • Bank profitable with strong capital • Commercial real estate portfolio diversified by product type • Condition due to investment rather than loan losses • Conservative underwriting standards • Low construction and development loans • Special consideration based on provisions in statute • Approval conditioned upon planned issuance of additional equity capital • Improved effectiveness of servicing rights hedging program • Recent examination rating of composite 2 • Strong loan review and approval procedures • Low ratios of classified and nonperforming loans

Source: GAO analysis of OFS documentation.

A Growing Number of CPP Firms, Including Many That Had Identified Weaknesses, Have Exhibited Signs of Financial Difficulty

Through July 2010, 4 CPP institutions had failed, but an increasing number of CPP firms have missed their scheduled dividend or interest payments, requested to have their investments restructured by Treasury, or appeared on FDIC's list of problem banks.³¹ First, the number of institutions missing the dividend or interest payments due on their CPP investments has increased steadily, rising from 8 in February 2009 to 123 in August 2010, or 20 percent of existing CPP participants.³² Between February 2009 and August 2010, 144 institutions did not pay at least one dividend or interest payment by the end of the reporting period in which they were due, for a total of 413 missed payments.³³ As of August 31, 2010, 79 institutions had missed three or more payments and 24 had missed five or more. Through August 31, 2010, the total amount of missed dividend and interest payments was \$235 million, although some institutions made their payments after the scheduled payment date. Institutions are required to pay dividends only if they declare dividends, although unpaid cumulative dividends accrue and the institution must pay the accrued dividends before making dividend payments to other types of shareholders in the future, such as holders of common stock. Federal and state bank regulators also may prevent their supervised institutions from paying dividends to preserve their capital and promote their safety and soundness. According to the standard terms of CPP, after participants have missed six dividend payments—consecutive or not—Treasury can exercise its right to appoint two members to the board of directors for that institution. In May 2010, the first CPP institution missed six dividend payments, but as of August 2010, Treasury had not exercised its right to appoint members to its board of directors. An additional seven institutions missed their sixth dividend payment in August 2010. Treasury officials told us that they are developing a process for establishing a pool of potential

³¹Under the 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 investment in the form of subordinated debt and pay Treasury interest rather than dividends.

³²The following number of institutions missed their scheduled dividend or interest payments by due date: February 2009–8, May 2009–18, August 2009–34, November 2009–54, February 2010–79, May 2010–97, and August 2010—123.

³³CPP 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 first CPP dividend and interest payments were due in February 2009, for a total of seven possible payments due through August 2010. The reporting period ends on the last day of the calendar month in which the dividend or interest payment is due. Some institutions made their dividend or interest payments after the end of the reporting period.

directors that Treasury could appoint on the boards of institutions that missed at least six dividend payments. They added that these potential directors will not be Treasury employees and would be appointed to represent the interests of all shareholders, not just Treasury. Treasury officials expect that any appointments will focus on banks with CPP investments of \$25 million or greater, but Treasury has not ruled out making appointments for institutions with smaller CPP investments. We will continue to monitor and report on Treasury's progress in making these appointments in future reports.

Although none of the 4 institutions that have failed as of July 31, 2010, were identified as marginal cases, 39 percent of the 66 approved institutions with marginal characteristics have missed at least one CPP dividend payment, compared with 20 percent of CPP participants overall. Through August 2010, 26 of the 144 institutions that had missed at least one dividend payment were institutions identified as marginal. Of these 26 marginal approvals, 20 have missed at least two payments, and 14 have missed at least four. Several of the marginal approvals also have received formal enforcement actions since participating in CPP. As of April, regulators filed formal actions against nine of the marginal approvals, including four cease-and-desist orders and four written agreements.³⁴ Seven of these institutions also missed at least one dividend payment. However, none of the approvals identified as marginal had filed for bankruptcy or were placed in FDIC receivership as of July 31, 2010.³⁵

Second, since June 2009, at least 16 institutions have formally requested that Treasury restructure their CPP investments, and most of the institutions have made their requests in recent months.³⁶ Specifically, as of July, 9 of the 11 requests received this year were received since April.

³⁴One firm identified as a marginal approval has had two formal enforcement actions since receiving its CPP investment—one each from FDIC and the Federal Reserve.

³⁵Four CPP institutions have filed for bankruptcy protection or had regulators place their banking subsidiary in receivership—UCBH Holdings Inc., CIT Group Inc., Pacific Coast National Bancorp, and Midwest Banc Holdings. However, none of these firms failed to meet the CPP program guidelines or other criteria used to identify institutions with weak characteristics.

³⁶The information on restructured CPP investments does not include Citigroup, which exchanged its CPP shares for financial instruments that converted to common shares in September 2009. Treasury said that it does not include Citigroup because it received investments under several TARP programs in addition to CPP such as the Targeted Investment Program and it is monitored separately within Treasury.

Treasury officials said that institutions have pursued a restructuring primarily to improve the quality of their capital and attract additional capital from other investors. Treasury has completed six of the requested restructurings and entered into agreements with 2 additional institutions that made requests. According to officials, Treasury considers multiple factors in determining whether to restructure a CPP investment. These factors include the effect of the proposed capital restructuring on the institution's Tier 1 and common equity capital and the overall economic impact on the U.S. government's investment. The terms of the restructuring agreements most frequently involve Treasury exchanging its CPP preferred shares for either mandatory convertible preferred shares—which automatically convert to common shares if certain conditions such as the completion of a capital raising plan are met—or trust preferred securities—which are issued by a separate legal entity established by the CPP institution.

Finally, the number of CPP institutions on FDIC's list of problem banks has increased. At December 31, 2009, there were 47 CPP firms on the problem list. This number had grown to 71 firms by March 31, 2010, and to 78 at June 30, 2010. The FDIC tracks banks that it designates as problem institutions based on their composite examination ratings. Institutions designated as problem banks have financial, operational, or managerial weaknesses that threaten their continued viability and include firms with either a 4 or 5 composite rating.

While Treasury's Processes Included Multiple Reviews of Approved CPP Applicants, Certain Operational Control Weaknesses Offer Lessons Learned for Similarly Designed Programs

Reviews of regulators' approval recommendations helped ensure consistent evaluations and mitigate risk from Treasury's limited guidance for assessing applicants' viability. Reviews of regulators' recommendations to fund institutions are an important part of CPP's internal control activities aimed at providing reasonable assurance that the program is performing as intended and accomplishing its goals.³⁷ The process that Treasury and regulators implemented established centralized control mechanisms to help ensure consistency in the evaluations of approved applicants. For example, regulators established their own processes for evaluating applicants, but they generally had similar structures including initial contact and review by regional offices followed by additional centralized review at the headquarters office for approved institutions. FDIC, OTS, and the Federal Reserve conducted initial evaluations and prepared the case decision memos at regional offices (or Reserve Banks in the case of the Federal Reserve), while the regulators' headquarters (or Board of Governors) performed secondary reviews and verification. At OCC, district offices did the initial analysis of applicants and provided a recommendation to headquarters, which prepared the case decision memo using input from the district. All of the regulators also used review panels or officials at headquarters to review the analyses and recommendations before submission to the CPP Council or Treasury.

Applicants recommended for approval by regulators also received further evaluation at the CPP Council or Treasury. Regulators sent to the CPP Council applications that they had approved but that had certain characteristics identified by Treasury as warranting further review by the council. These characteristics included indications of relative weakness, such as unsatisfactory examination ratings and performance ratios. At the council, representatives from all four federal bank regulators discussed the viability of applicants and voted on recommending them to Treasury for approval. As Treasury officials explained, the CPP Council was the deliberative forum for addressing concerns about marginal applicants whose eligibility for CPP was unclear. The council's charter describes its purpose as acting as an advisory body to Treasury for ensuring that CPP guidelines are applied effectively and consistently across bank regulators and applicants. By requiring the regulators to reach consensus when recommending applicants whose approval was not straightforward, the

³⁷See GAO, *Standards for Internal Control in the Federal Government*, [GAO/AIMD-00-21.3.1](#) (Washington, D.C.: Nov. 1, 1999).

CPP Council helped ensure that the final outcome of applicants was informed by multiple bank regulators and generally promoted consistency in decision making.

After regulators or the CPP Council submitted a recommendation to Treasury, the applicant received a final round of review by Treasury's CPP analysts and the Investment Committee. CPP analysts conducted their own reviews of applicants and the case files forwarded from the regulators, including the case decision memos. They collected additional information for their reviews from regulators' data systems and publicly available sources and also gathered information from regulators to clarify the analysis in the case files. According to Treasury officials, the CPP analysts were experienced bank examiners serving on detail from each of the bank regulators except OCC. Treasury officials explained that CPP analysts did not make decisions about preliminary approvals or preliminary disapprovals. Only the Investment Committee made those decisions.

In the final review stage, the Investment Committee evaluated all of the applicants forwarded by regulators or the CPP Council. On the basis of its review of the regulators' recommendations and analysis and additional information collected by Treasury CPP analysts, the Investment Committee recommended preliminary approval or denial to applicants, subject to the final decision of the Assistant Secretary for Financial Stability. By reviewing and issuing a preliminary decision on all forwarded applicants, the Investment Committee represented another important control, much like the CPP Council. Unlike the CPP Council, however, the Investment Committee deliberated on all applicants referred by regulators rather than just those meeting certain marginal criteria.

The reviews by the CPP Council, analysts at OFS, and the Investment Committee were important steps to limit the risk of inconsistent evaluations by different regulators. This risk stemmed from the limited guidance that Treasury provided to regulators concerning the application review process. Specifically, the formal written guidance that Treasury initially provided to regulators consisted of broad high-level guidance, which was supplemented with other informal guidance to address specific

concerns.³⁸ The written guidance provided by Treasury established the institution's strength and overall viability as the baseline criteria for the eligibility recommendation.³⁹ Regulators said that while the guidance was useful in providing a broad framework or starting point for their reviews, they could not determine an applicant's viability using Treasury's written guidance alone. Officials from several regulators said that they also relied on regulatory experience and judgment when evaluating CPP applicants and making recommendations to Treasury. Treasury officials told us that they believed they were not in a position to provide more specific guidance to regulators on how to evaluate the viability of the institutions they oversaw. Treasury officials further explained that with many different kinds of institutions and unique considerations, regulators needed to make viability decisions on an individual basis.

A 2009 audit by the Federal Reserve's Inspector General (Fed IG) assessing the Federal Reserve's process and controls for reviewing CPP applications similarly found that Treasury provided limited guidance in the early stages of the program regarding how to determine applicants' viability.⁴⁰ As a result, the Federal Reserve and other regulators developed their own procedures for analyzing CPP applications. The report also found that formal, detailed, and documented procedures would have provided the Federal Reserve with additional assurance that CPP applications would be analyzed consistently and completely. However, the multiple layers of reviews involving the regulators, the CPP Council, and Treasury staff helped compensate for the risk of inconsistent evaluation of applicants that received recommendations for CPP investments. The Fed IG recommended that the Federal Reserve incorporate lessons learned from the CPP application review process to its process for reviewing

³⁸In addition to the limited formal guidance, Treasury subsequently provided regulators with informal and case-specific guidance using e-mails and conference calls. For example, Treasury held regular weekly conference calls with the bank regulators to discuss concerns about specific applicants and also broader process and policy issues such as commercial real estate exposures.

³⁹The guidance identified other factors for consideration, such as the existence of a signed merger agreement involving the institution or a confirmed private equity investment. Finally, the guidance document defined three categories for regulators to use in classifying applicants that were based on examination ratings (such as the CAMELS ratings), the age of the ratings, and financial performance ratios (including capital and asset quality ratios).

⁴⁰Board of Governors of the Federal Reserve System Office of Inspector General, *Audit of the Board's Processing of Applications for the Capital Purchase Program under the Troubled Asset Relief Program*, (Washington, D.C.: Sept. 30, 2009).

repurchase requests. The Federal Reserve generally agreed with the report's findings and recommendations.

Treasury and the Regulators' Documentation of Approval Decisions Improved as the Program Matured

As Treasury fully implemented its CPP process, it and the regulators compiled documentation of the analysis supporting their decisions to approve program applicants. For example, regulators consistently used a case decision memo to provide Treasury with standard documentation of their review and recommendations of CPP applicants. This document contained basic descriptive and evaluative information on all applicants forwarded by regulators, including identification numbers, examination and compliance ratings, recent and post-investment performance ratios, and a summary of the primary regulator's evaluation and recommendation. Although the case decision memo contained standard types of information, the amount and detail of the information that regulators included in the form evolved over time. According to regulators and Treasury, they engaged in an iterative process whereby regulators included additional information after receiving feedback from Treasury on what they should describe about their assessment of an applicant's viability. For example, regulators said that often Treasury wanted more detailed explanations for more difficult viability decisions. According to bank regulatory officials, other changes included additional discussion of specific factors relevant to the viability determination, such as information on identified weaknesses and enforcement actions, analysis of external factors such as economic and geographic influences, and consideration of nonbank parts of holding companies. Treasury officials explained that as CPP staff learned about the types of information the Investment Committee wanted to see, they would communicate it to the regulators for inclusion in case decision memos.

Our review of CPP case files indicated that some case decision memos were incomplete and missing important information, but typically only for applicants approved early in the program. For instance, several case decision memos contained only one or two general statements supporting viability, largely for the initial CPP firms.⁴¹ Eventually, the case decision memos included several paragraphs, and some contained multiple pages, with detailed descriptions of the applicant's condition and viability

⁴¹For example, one memo stated only "Confirmed Category 1 institution. Recommend Approval." Others stated "Category 1 institution; approved under 12 USC 1823(c)(4) systemic risk exception."

assessment. Most of the cases in which the regulator did not explain its support for an applicant's viability occurred in the first month of the program. Some case decision memos lacked other important information, although these memos also tended to be from early in the program. For example, multiple case decision memos were missing either an overall examination rating, all of the component examination ratings, or a performance ratio related to capital levels. Most or all of those were approved prior to December 2008. Further, 104 of 567 case files we reviewed lacked examination ratings dates, and almost all of these firms were approved before the end of December 2008. Missing CRA dates, which occurred in 214 cases, exhibited a similar pattern.

For applications that regulators sent to Treasury with an approval recommendation, Treasury staff used a "team analysis" form to document their review before submitting the applications to the Investment Committee for its consideration. According to Treasury officials, the team analysis evolved over time as CPP staff became more experienced and different examiners made their own modifications to the form. For example, as the CPP team grew in size, additional fields were added to document multiple levels of review by other examiners. As with the case decision memos, the consistency of information in the team analysis improved with time. For instance, team analysis documents did not include calculations of allowable investment amounts for almost 60 files that we reviewed that Treasury had approved by the end of December 2008. Finally, a small number of case files did not contain an award letter, but all of those approvals had also occurred before the end of December 2008.

Treasury and regulators compiled meeting minutes for the CPP Council and Investment Committee, although they did not fully document some early Investment Committee meetings. The minutes described discussions of policy and guidance related to TARP and CPP and also the review and approval decisions for individual applicants. However, records do not exist for four meetings of the Investment Committee that occurred between October 23, 2008, and November 12, 2008. According to Treasury, no minutes exist for those meetings. We did not find any missing meeting minutes for the CPP Council, although at the early meetings, regulators did not collect the initials of voting members to document their recommendations to approve or disapprove applicants they reviewed. Within several weeks however, regulators began using the CPP Council review decision sheets to document council members' votes in addition to the meeting minutes.

Treasury's Implementation Process Limited Its Ability to Oversee Regulators' Recommendations for Applicant Withdrawals

Although the multiple layers of review for approved institutions enhanced the consistency of the decision process, applicants that withdrew from consideration in response to a request from their regulator received no review by Treasury or other regulators. To avoid a formal denial, regulators recommended that applicants withdraw when they were unable to recommend approval or believed that Treasury was unlikely to approve the institution. Some regulators said that they also encouraged institutions not to formally submit applications if approval appeared unlikely. Applicants could insist that the regulator forward their application to the CPP Council and ultimately to the Investment Committee for further consideration even if the regulator had recommended withdrawal. However, Treasury officials said that they did not approve any applicants that received a disapproval recommendation from their regulator or the CPP Council. Regulators also could recommend that applicants withdraw after the CPP Council or Investment Committee decided not to recommend approval of their application. One regulator stated that all the applicants it suggested withdraw did so rather than receive a formal denial. Treasury officials also said that institutions receiving a withdrawal recommendation generally withdrew and that no formal denials were issued.

Almost half of all applicants withdrew from CPP consideration before regulators forwarded their applications to the CPP Council or Treasury. Regulators had recommended withdrawal in about half of these cases where information was available. Over the life of the program, regulators received almost 3,000 CPP applications, about half of which they sent to the CPP Council or directly to Treasury (see table 3). The remaining applicants withdrew either voluntarily or after receiving a recommendation to withdraw from their regulator. Three of the regulators—OCC, OTS, and the Federal Reserve—indicated that about half of their combined withdrawals were the result of their recommendations. FDIC, which was the primary regulator for most of the applicants, did not collect information on the reasons for applicants' withdrawals.⁴² According to Treasury officials, those applicants that chose to withdraw voluntarily did so for various reasons, including uncertainty over future program requirements and increased confidence in the financial condition

⁴²As part of its review of FDIC's processing of CPP applicants, FDIC's Office of Inspector General evaluated the reasons for application withdrawals that occurred as of December 10, 2008, and found that 42 percent had been suggested to withdraw by FDIC regional offices. The remainder withdrew voluntarily. See FDIC Office of Inspector General, *Controls Over the FDIC's Processing of Capital Purchase Program Applications from FDIC-Supervised Institutions*, EVAL-09-004 (Arlington, VA.: Mar. 20, 2009).

of banks. In addition to institutions that withdrew after applying for CPP, Treasury officials and officials from a regulator indicated that some firms decided not to formally apply after discussing their potential application with their regulator. However, regulators did not collect information on the number of firms deciding not to apply after having these discussions.

Table 3: Withdrawals by CPP Applicants before Submission to CPP Council or Treasury as of December 31, 2009

Bank regulator	Total applications received	Voluntary withdrawal	Recommended withdrawal	Total applications sent to CPP Council or Treasury
FDIC	1,814	Not available	Not available	917
Federal Reserve	342	42	82	218
OCC	442	93	130	219
OTS	297	131	40	126
Total	2895	Not available	Not available	1,480

Sources: FDIC, Federal Reserve, OCC, and OTS.

Note: Of the total 1,480 applications sent to the CPP Council or Treasury, Treasury ultimately received 1,403 applications. These 1,403 applications resulted in 738 CPP transactions (for 707 institutions because some institutions submitted multiple applications), 658 withdrawals, and 7 applications that were not approved.

Although applications recommended for approval received multiple reviews and were coordinated among regulators and Treasury, each regulator made its own decision on withdrawal recommendations. Most regulators conducted initial reviews of applicants at their regional offices, and staff at these offices had independent authority to recommend withdrawal for certain cases. Regulatory officials said that regional staff (including examiners and more senior officials) made initial assessments of applicants' viability using Treasury guidelines and would recommend withdrawal for weak firms with the lowest examination ratings that were unlikely to be approved.⁴³ Applicants that received withdrawal recommendations might have had weak characteristics relative to those of other firms and might have received a denial from Treasury. But following regulators' suggestions to withdraw before referral to the CPP Council or

⁴³We did not examine regulators' files on withdrawn applicants to identify actual instances of inconsistencies to avoid duplication of work conducted by SIGTARP and agency inspectors general that reviewed CPP implementation at their respective agencies.

Treasury, or to not apply, ensured that they would not receive the centralized reviews that could have mitigated any inconsistencies in their initial evaluations. Further, while regulators had panels or senior officials at their headquarters offices providing central review of approved applicants, most of the regulators allowed their regional offices to recommend withdrawal for weaker applicants or encourage such applicants not to apply, thereby limiting the benefit of that control mechanism. Allowing regional offices to recommend withdrawal without any centralized review may increase the risk of inconsistency within as well as across regulators. In its report on the processing of CPP applications, the FDIC Office of Inspector General found that one of FDIC's regional offices suggested that three institutions withdraw from consideration that were well capitalized and technically met Treasury guidelines.⁴⁴ Regional FDIC management cited poor bank management as the primary concern in recommending that the institutions withdraw. The report concluded that the use of discretion by regional offices in recommending that applicants withdraw increased the risk of inconsistency. The report made two recommendations to enhance controls over the process for evaluating applications: (1) forwarding applications recommended for approval that do not meet one or more of Treasury's criteria to the CPP Council for additional review and (2) requiring headquarters review of institutions recommended for withdrawal when the institutions technically meet Treasury's criteria. In commenting on the report, FDIC concurred with the recommendations.

Treasury did not collect information on applicants that had received withdrawal recommendations from their regulators or on the reasons for these decisions. According to Treasury officials, Treasury did not receive, request, or review information on applicants that regulators recommended to withdraw and thus could not monitor the types of institutions that regulators were restricting from the program or the reasons for their decisions. The officials said that Treasury did not collect or review information on withdrawal recommendations in part to minimize the potential for external parties to influence the decision-making process. However, such considerations did not prevent Treasury from reviewing information on applicants that regulators recommended for approval, and concerns about external influence could also be addressed directly through additional control procedures rather than by limiting the ability to

⁴⁴FDIC Office of Inspector General, *Controls Over the FDIC's Processing of Capital Purchase Program Applications from FDIC-Supervised Institutions*.

collect information on withdrawal recommendations. The lack of additional review outside of the individual regulator or oversight of withdrawal requests by Treasury presents the risk that applicants may not have been evaluated in a consistent fashion across regulators. As the agency responsible for implementing CPP, it is equally beneficial for Treasury to understand the reasons that regulators recommended applicants withdraw from the program as it is for Treasury to understand the reasons regulators recommended approval. Collecting and reviewing information on withdrawal requests would have served as an important control mechanism and allowed Treasury to determine whether leaving certain applicants out of CPP was consistent with program goals. It also would have allowed Treasury to determine whether similar applicants were evaluated consistently across different regulators in terms of their decisions to recommend withdrawal.

Treasury has indicated that it may use the CPP model for new programs to stimulate the economy and improve conditions in financial markets, and unless corrective actions are taken, such programs may share the same increased risk of similar participants not being treated consistently. Specifically, in February 2010, Treasury announced terms for a new TARP program—the Community Development Capital Initiative (CDCI)—to invest lower-cost capital in Community Development Financial Institutions that lend to small businesses. According to Treasury and regulatory agency officials, Treasury modeled its implementation of the CDCI program after the process it used for CPP, with federal bank regulators—in this case including the National Credit Union Administration (NCUA)—conducting the initial reviews and making recommendations. The CDCI program also uses a council of regulators to review marginal approvals, and an Investment Committee at Treasury reviews all applicants recommended by regulators for approval. As in the case of CPP, control mechanisms exist for reviewing approved applicants, but no equivalent reviews are done for applicants that receive withdrawal recommendations. Thus, the CDCI structure could raise similar concerns about a lack of control mechanisms to mitigate the risk of inconsistency in evaluations by different regulators. The deadline for financial institutions to apply to participate in the CDCI was April 30, 2010, and all disbursements or exchanges of CPP securities for CDCI securities must be completed by September 30, 2010.

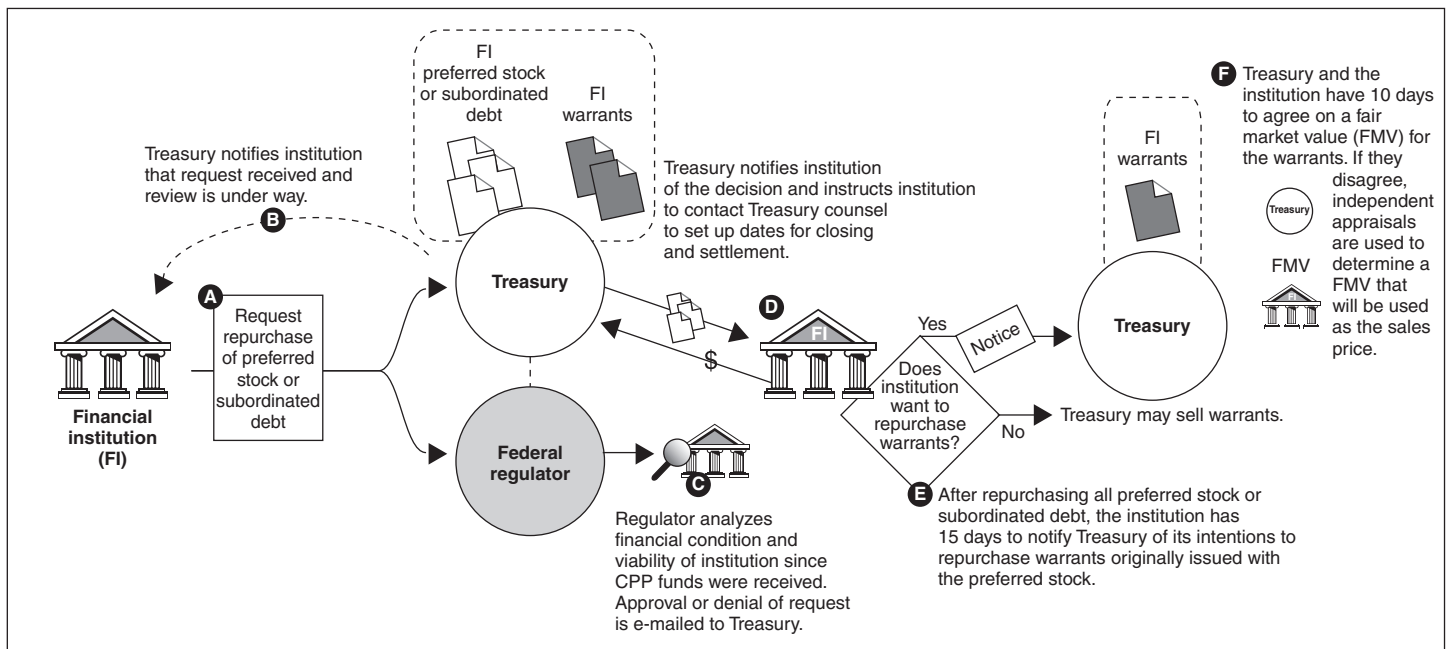
The Small Business Jobs Act of 2010, enacted on September 27, 2010, established a new Treasury program—the Small Business Lending Fund (SBLF)—to invest up to \$30 billion in small institutions to increase small business lending.⁴⁵ Treasury may choose to model the new program’s implementation on the CPP process, as it did with the CDCI. Treasury is required to consult with the bank regulators to determine whether an institution may receive a capital investment, and Treasury officials have indicated that they would likely rely on regulators to determine applicants’ eligibility. Unless Treasury also takes steps to coordinate and monitor withdrawal requests by regulators, the disparity that existed in CPP between the control mechanisms for approved applicants and those receiving withdrawal recommendations may persist in this new program, potentially resulting in similar applicants being treated differently.

Treasury Does Not Monitor Regulators’ Decisions to Approve or Deny CPP Repayments

Treasury relies on decisions from federal bank regulators concerning whether to allow CPP firms to repay their investments, but as with withdrawal recommendations, it does not monitor or collect information on regulators’ decisions. The CPP institution submits a repayment request to its primary federal regulator and Treasury (see fig. 5). Bank regulatory officials explained that their agencies use existing supervisory procedures generally applicable to capital reductions as a basis for reviewing CPP repurchase requests and that they approach the decision from the perspective of achieving regulatory rather than CPP goals. Following their review, regulators provide a brief e-mail notification to Treasury indicating whether they object or do not object to allowing an institution to repay its CPP investment. Treasury, in turn, communicates the regulators’ decisions to the CPP firms.

⁴⁵Pub. L. No. 111-240, Title IV, Subtitle A, 124 Stat. 2504 (2010).

Figure 5: Investment Repayment Process for CPP



Sources: GAO (analysis); Art Explosion (images).

As of August 2010, 109 institutions had formally requested that they be allowed to repay their CPP investments, and regulators had approved over 80 percent of the requests (see table 4). According to Treasury officials, there have been no instances where Treasury has raised concerns about a regulator’s decision. Officials at the Federal Reserve—which is responsible for reviewing most CPP repayment requests because requests for bank holding companies go to the holding company regulator—explained that they had not denied any requests but had asked institutions to wait or to raise additional capital. In these cases, institutions typically had experienced significant deterioration since the CPP investment, raising concerns about the adequacy of their capital levels.

Table 4: Repayment Requests as of August 2010

Status of repayment request	Federal Reserve	FDIC	OCC	OTS	Total
Requests received	95	2	1	11	109
Recommended for approval	78	2	1	10	91
Not recommended for approval	17 ^a	0	0	1 ^b	18

Sources: Federal Reserve, FDIC, OCC, OTS

^aIncludes requests with a decision pending.

^bDecision pending.

Under the original terms of CPP, Treasury prohibited institutions from repaying their funds within 3 years unless the firm had completed a qualified equity offering to replace a minimum amount of the capital.⁴⁶ However, the American Recovery and Reinvestment Act of 2009 (ARRA) included provisions modifying the terms of CPP repayments. These provisions require that Treasury allow any institution to repay its CPP investment subject only to consultation with the appropriate federal bank regulator without considering whether the institution has replaced such funds from any other source or applying any waiting period.⁴⁷ Treasury officials indicated that, as a result of these restrictions, they did not provide guidance or criteria to regulators. The officials explained that even before the ARRA provisions limited Treasury’s role, the standard CPP contract terms allowed institutions to repay the funds at their discretion—subject to regulatory approval—as long as they completed a qualified equity offering or the 3-year time frame had passed. The officials said that the contract terms themselves helped ensure that CPP goals were achieved.

While the decision to allow repayment ultimately lies with the bank regulators, Treasury is not statutorily prohibited from reviewing their decision-making process and collecting information or providing feedback about the regulators’ decisions. The two regulators responsible for most repayment requests prepare a case decision memo to document their analysis that is similar to the memo they used to document their evaluations of CPP applicants, but Treasury and agency officials said that Treasury does not request or review the memo or other analyses supporting regulators’ decisions. One regulator indicated that it would provide Treasury with a brief explanation of the basis for its decisions to deny repayment requests and a brief discussion of the supervisory concerns raised by the proposed repayment. But Treasury officials stated that they did not review any information on the basis for regulators’

⁴⁶ A qualified equity offering is the sale and issuance of Tier 1 qualifying perpetual preferred stock, common stock, or a combination of such stock for cash. Under the original terms, CPP investments in the form of senior preferred shares could only be redeemed prior to 3 years from the date of investment with the proceeds of qualified equity offerings that resulted in aggregate gross proceeds to the financial institution of not less than 25 percent of the issue price of the senior preferred.

⁴⁷ Pub. L. No. 111-5, div. B, § 7001, 123 Stat. 115, 516 (2009). Section 7001 provides, in part, that “Subject to consultation with the appropriate Federal banking agency, if any...Treasury shall permit a TARP recipient to repay any assistance previously provided under the TARP to such financial institution, without regard to whether the financial institution has replaced the funds from any other source or to any waiting period.”

decisions to approve or deny repayment requests. Without collecting or monitoring such information, Treasury has no basis for considering whether decisions about similar institutions are being made consistently and thus whether CPP firms are being treated equitably. Furthermore, absent information on why regulators made repayment decisions, Treasury cannot provide feedback to regulators on the consistency of regulators' decision making for similar institutions as part of its consultation role.

Regulators Independently Developed Similar Guidelines for Evaluating Repurchase Requests and Processes for Coordinating Their Decisions without Treasury Guidance

Regulators have independently developed similar guidelines for evaluating repurchase requests and also established processes for coordinating decisions that involved multiple regulators, and Treasury officials stated that they did not provide input to these guidelines or processes. Regulators said that, in general, they considered the same types of factors when evaluating repayment requests that they considered when reviewing CPP applications. According to the officials, regulators follow existing regulatory requirements for capital reductions—including the repayment of CPP funds—that apply to all of their supervised institutions. In addition to following existing supervisory procedures, officials from the different banking agencies indicated that they also considered a broad set of similar factors, including the following:

- the institution's continued viability without CPP funds;
- the adequacy of the institution's capital and ability to maintain appropriate capital levels over the subsequent 1 to 2 years, even assuming worsening economic conditions;
- the level and composition of capital and liquidity;
- earnings and asset quality; and
- any major changes in financial condition or viability that had occurred since the institution received CPP funds.

Although regulators said that they considered similar factors in their evaluations, without reviewing any information or analysis supporting regulators' recommendations, Treasury cannot be sure that regulators are using these guidelines consistently for all repayment requests.

In addition to setting out guidelines for standard repayment requests, the Federal Reserve established a supplemental process to evaluate

repayment requests by the 19 largest bank holding companies that participated in the Supervisory Capital Assessment Program (SCAP).⁴⁸ As we reported in our June 2009 review of Treasury's implementation of TARP, the Federal Reserve required any SCAP institution seeking to repay CPP capital to demonstrate that it could access the long-term debt markets without reliance on debt guarantees by FDIC and public equity markets in addition to other factors.⁴⁹ As of September 16, 2010, four bank holding companies that participated in SCAP had not repurchased their CPP investment and one had not repaid funds from TARP's Automotive Industry Financing Program.⁵⁰

Bank regulators said that they also shared their repayment process documents with each other to enhance the consistency of their evaluations and recommendations. For example, the Federal Reserve designed a repayment case decision memo that documents the review of repayment requests and the factors considered in making the decision and shared it with other regulators to promote consistency in their reviews. Officials from OTS explained that they used the Federal Reserve's repurchase case decision memo as the framework for their document while adding certain elements specific to thrifts such as confirmation that FDIC concurrence was received for thrift holding companies with state bank subsidiaries regulated by FDIC. Bank regulatory officials also stated that bank regulators discussed the repayment process during their weekly conference calls on CPP-related topics. OCC also prepares a memo to document its review of repurchase requests that differs from the form used by the Federal Reserve and OTS; however, it contains similar elements such as an explanation of the analysis and the basis for the

⁴⁸SCAP was an effort initiated in February 2009 by the Federal Reserve and other federal banking regulators to conduct a comprehensive simultaneous assessment of the capital held by the 19 largest bank holding companies. It was designed as a forward-looking exercise intended to help regulators gauge the extent of additional capital necessary to keep the institutions strongly capitalized and able to lend even if economic conditions were worse than had been expected.

⁴⁹For more information, see GAO-09-658.

⁵⁰The four CPP firms that participated in SCAP and had not repaid the capital as of September 16, 2010 were Fifth Third Bancorp, KeyCorp, Regions Financial Corporation, and SunTrust Banks, Inc. The fifth firm was GMAC, which received TARP funds through the Automotive Industry Financing Program, which Treasury established in December 2008 to help stabilize the U.S. automotive industry and avoid disruptions that would pose systemic risk to the nation's economy. Citigroup, Inc., exchanged its CPP shares for financial instruments that converted to common shares in September 2009, and Treasury has begun the process of selling its shares of Citigroup, Inc., common stock.

decision. Finally, FDIC officials said that they followed existing procedures for capital retirement applications from FDIC-supervised institutions that included safety and soundness considerations.

Bank regulators also established processes for coordinating repayment decisions for CPP firms with a holding company and subsidiary bank supervised by different regulators. For example, Federal Reserve officials said that if a holding company it supervised that had a subsidiary bank under another regulator requested to repay CPP funds, the agency would consult with the subsidiary's regulator before making a final decision. The officials stated that if the regulator of the subsidiary bank objected to the Federal Reserve's preliminary decision, the regulators would try to reach a consensus. However, as regulator of the holding company that received the CPP investment, the Federal Reserve has the ultimate responsibility for making the decision as it is considered the primary federal regulator in such cases. According to Federal Reserve officials, when OTS is the primary regulator of a subsidiary thrift, it provides a repayment case decision memo to the Federal Reserve for it to consider as it evaluates the repayment request. OCC also provides the Federal Reserve with its analysis of any subsidiary bank for which it is the primary regulator, and FDIC identifies certain individuals who provide their recommendation and are available to discuss the decision. OTS performs a similar coordination role for CPP repayment requests that involve thrift holding companies with nonthrift financial subsidiaries. However, if Treasury does not collect information on or monitor the processes regulators use to make their repayment decisions, Treasury cannot provide any feedback to regulators on the extent to which they are coordinating their decisions.

Conclusions

Approved CPP applicants generally had similar examination ratings and other strength characteristics that exceeded guidelines. However, a smaller group of firms had weaker characteristics and were approved after consideration of mitigating factors by regulators and Treasury. The ability to approve institutions after consideration of mitigating factors illustrates the importance of including controls in the review and selection process to provide reasonable assurance of the achievement of program goals and consistent decision making.

While Treasury established such controls for applicants that regulators recommended for approval, Treasury's process was inconsistent in the control mechanisms that existed for applicants that regulators recommended to withdraw from program consideration. These institutions did not benefit from the multiple levels of review that Treasury

and regulators applied to approved applicants. For example, regulators could decide independently which applicants they would recommend to withdraw and may have considered mitigating factors differently. Treasury did not collect information on these firms or the reasons for regulators' decisions. Without mechanisms such as those that exist for approved applicants to control for the risk of inconsistent evaluations across different regulators, Treasury cannot have reasonable assurance that all similar applicants were treated consistently or that some potentially eligible firms did not end up withdrawing after following the advice of their regulator. Treasury officials explained their desire to conduct adequate due diligence on all applicants recommended for approval, but as Treasury is the agency responsible for implementing CPP, understanding the reasons that regulators recommended applicants withdraw would have been equally beneficial for Treasury. Collecting and reviewing information on withdrawal requests would allow Treasury to determine whether applicants that were left out of CPP were evaluated consistently across different regulators and conformed to Treasury's goals for the program.

Although Treasury is no longer making investments in financial institutions through CPP, it may continue to use the process as a model for similar programs as it has for the CDCI program. One such program is the SBLF, which Congress authorized in September 2010. SBLF contains elements similar to those of CPP and requires Treasury to administer the program with bank regulators. Unless Treasury makes changes to the CPP model to include monitoring and reviews of withdrawal recommendations, these new programs may share the same increased risk of similar participants not being treated consistently that existed in CPP.

As with the approval process, agencies are expected to establish control mechanisms to provide reasonable assurance that program goals are being achieved. Treasury has not established mechanisms to monitor, review, or coordinate regulators' decisions on repayment requests because, in its view, it lacks the authority to do so and is limited to carrying out regulators' decisions regarding the institution making the request. However, Treasury is not precluded from providing feedback to help ensure that regulators are treating similar institutions consistently when considering their repayment requests. Although regulators said that they consider similar factors when evaluating CPP firms' repayment requests, without collecting information on how and why regulators made their decisions, Treasury cannot verify the degree to which regulators' decisions on requests to exit CPP actually were based on such factors.

Recommendations for Executive Action

If Treasury administers programs containing elements similar to those of CPP, such as the SBLF, we recommend that Treasury apply lessons learned from the implementation of CPP and enhance procedural controls for addressing the risk of inconsistency in regulators' decisions on withdrawals. Specifically, we recommend that the Secretary of the Treasury direct the program office responsible for implementing SBLF to establish a process for collecting information from bank regulators on all applicants that withdraw from consideration in response to a regulator's recommendation, including the reasons behind the recommendation. We also recommend that the program office evaluate the information to identify trends or patterns that may indicate whether similar applicants were treated inconsistently across different regulators and take action, if necessary, to help ensure a more consistent treatment.

As part of its consultation with regulators on their decisions to allow institutions to repay their CPP investments to Treasury, and to improve monitoring of these decisions, we recommend that the Secretary of the Treasury direct OFS to periodically collect and review certain information from the bank regulators on the analysis and conclusions supporting their decisions on CPP repayment requests and provide feedback for the regulators' consideration on the extent to which regulators are evaluating similar institutions consistently.

Agency Comments and Our Evaluation

We provided a full draft of this report to Treasury for its review and comment. We received written comments from the Assistant Secretary for Financial Stability. These comments are summarized below and reprinted in appendix III. In addition, we received technical comments on this draft from the Federal Reserve, FDIC, OCC, and Treasury, which we incorporated as appropriate. In its written comments, Treasury agreed to consider our recommendation to review information on applicants that regulators recommend to withdraw from program consideration if Treasury implements a similar program in the future. Treasury stated that the system used to evaluate CPP applicants balanced the objectives of ensuring consistent treatment for all applicants while also utilizing the independent judgment of federal banking regulators. Treasury suggested that ensuring regulators hold regular discussions about their standards could be an additional action to help ensure consistency in regulators' reviews. As we note in the report, Treasury implemented multiple layers of review for approved institutions to enhance the consistency of the decision process. However, applicants that withdrew from consideration in response to a request from their regulator received no review by Treasury or other regulators. Although CPP is no longer making any new

investments, the passage of the SBLF, which, according to Treasury officials, would also rely on regulators to determine applicants' eligibility, presents an opportunity for Treasury to address this area of concern. We continue to believe that unless Treasury takes steps to monitor and provide feedback on regulators' withdrawal requests, applicants that receive withdrawal recommendations under this new program may not be treated consistently and equitably.

Treasury stated that our second recommendation—to review information on regulators' decisions on repayment requests and provide feedback to regulators—also raises questions about how to balance the goals of consistency and respect for the independence of regulators. However, Treasury acknowledged the potential value of our recommendation and agreed to consider ways to address it in a manner consistent with these considerations. Specifically, Treasury noted that while it is prohibited from imposing standards for repayment as a result of statutory changes to its authority under EESA, it did help facilitate meetings among regulators to discuss when CPP participants would be allowed to repay their investments. Finally, Treasury explained that it does not receive confidential supervisory information about CPP participants on a regular basis, which could limit any information collection envisioned by our recommendation. However, as we noted in the report, the two regulators with responsibility for most CPP repayment requests document their analysis in a manner similar to what regulators provided to Treasury when recommending CPP applicants, but Treasury does not review this information.

We are sending copies of this report to the Congressional Oversight Panel, Financial Stability Oversight Board, Special Inspector General for TARP, interested congressional committees and members, Treasury, the federal banking regulators, and others. The report also is available at no charge on the GAO Web site at <http://www.gao.gov>.

If you or your staff have any questions about this report, please contact me at williamso@gao.gov or (202) 512-8678. 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 IV.



Orice Williams Brown
Director, Financial Markets
and Community Investment

List of Committees

The Honorable Daniel K. Inouye
Chairman
The Honorable Thad Cochran
Vice Chairman
Committee on Appropriations
United States Senate

The Honorable Christopher J. Dodd
Chairman
The Honorable Richard C. Shelby
Ranking Member
Committee on Banking, Housing, and Urban Affairs
United States Senate

The Honorable Kent Conrad
Chairman
The Honorable Judd Gregg
Ranking Member
Committee on the Budget
United States Senate

The Honorable Max Baucus
Chairman
The Honorable Charles E. Grassley
Ranking Member
Committee on Finance
United States Senate

The Honorable David R. Obey
Chairman
The Honorable Jerry Lewis
Ranking Member
Committee on Appropriations
House of Representatives

The Honorable John M. Spratt, Jr.
Chairman
The Honorable Paul Ryan
Ranking Member
Committee on the Budget
House of Representatives

The Honorable Barney Frank
Chairman
The Honorable Spencer Bachus
Ranking Member
Committee on Financial Services
House of Representatives

The Honorable Sander M. Levin
Acting Chairman
The Honorable Dave Camp
Ranking Member
Committee on Ways and Means
House of Representatives

Appendix I: Objectives, Scope, and Methodology

The objectives of our report were to (1) describe the characteristics of financial institutions that received funding under the Capital Purchase Program (CPP), and (2) assess how the Department of the Treasury (Treasury), with the assistance of federal bank regulators, implemented CPP.

To describe the characteristics of financial institutions that received CPP funding, we reviewed and analyzed information from Treasury case files on all of the 567 institutions that received CPP investments through April 30, 2009.¹ We gathered information from the case files using a data collection survey that recorded our responses in a database. Multiple analysts reviewed the collected information, and we performed data quality control checks to verify its accuracy. We used the database to analyze the characteristics of CPP applicants including their supervisory examination ratings, financial performance ratios, and regulators' assessments of their viability, among other things. We spoke with Treasury and regulatory officials about their processes for evaluating applicants, in particular about actions they took to collect up-to-date information on firms' financial condition. We also collected and analyzed information from the records of the CPP Council and Investment Committee meetings to understand how the committees evaluated and recommended approval of CPP applicants. Additionally, we collected limited updated information on all CPP institutions approved through December 31, 2009—for example, their location, primary federal regulator, ownership type, and CPP investment amount—from Treasury's Office of Financial Stability (OFS) and from publicly available reports on OFS's Web site to present characteristics for all approved institutions. To describe how Treasury and regulators assessed firms with weaker characteristics, we collected information on the reasons regulators approved these firms and the concerns regulators raised about their eligibility from case files and records of committee meetings. To describe enforcement actions that regulators took against these institutions, we reviewed publicly available documents on formal enforcement actions from federal bank regulators' Web sites. We also collected information on CPP firms that missed their dividend or interest payments or restructured their CPP investments from OFS and publicly available reports on its Web site. Finally, we collected information from the Federal Deposit Insurance Corporation (FDIC) on the number of CPP firms added to its list of problem banks.

¹In total, Treasury invested in 707 financial institutions through December 31, 2009, when it closed CPP to new investments.

To assess how Treasury implemented CPP with the assistance of federal bank regulators, we reviewed Treasury’s policies, procedures, and guidance related to CPP, including nonpublic documents and publicly available material from the OFS Web site. We met with OFS officials to discuss how they evaluated applications and repayment requests and coordinated with regulators to decide on these applications and requests. We interviewed officials from FDIC, the Office of the Comptroller of the Currency (OCC), Office of Thrift Supervision (OTS), and the Board of Governors of the Federal Reserve System (Federal Reserve) to obtain information on their processes for reviewing and providing recommendations on CPP applications and repayment requests. We also discussed the guidance and communication they received from Treasury and their methods of formulating their CPP procedures. Additionally, we collected and analyzed program documents from the bank regulators, including policies and procedures, guidance documents, and summaries of their evaluations of applications and repayment requests. We also gathered data from regulators on applicants that withdrew from CPP consideration—including the reason for withdrawing—and on the number of repayment requests and their outcomes. We reviewed relevant laws, such as the Emergency Economic Stabilization Act of 2008 and the American Recovery and Reinvestment Act of 2009, to determine the impact of statutory changes to Treasury’s authority. To assess how Treasury and regulators documented their decisions to approve CPP applicants, we analyzed information from case files and CPP Council and Investment Committee meeting minutes to identify how consistently Treasury and regulators included relevant records of their reviews and decision-making processes. We also discussed with Treasury and regulatory officials the key forms they used to document their decisions and the evolution of these forms over time. To assess Treasury programs that were modeled after CPP, we collected and reviewed publicly available documents from Treasury and interviewed Treasury officials to discuss the nature of these programs—including the Community Development Capital Initiative (CDCI) and Small Business Lending Fund (SBLF)—and plans for implementing them. Finally, we met with the Federal Reserve’s Office of Inspector General to learn about its work examining the Federal Reserve’s CPP process and reviewed its report and other reports by GAO, the Special Inspector General for the Troubled Asset Relief Program (SIGTARP), and the FDIC Office of Inspector General.

This report is part of our coordinated work with SIGTARP and the inspectors general of the federal banking agencies to oversee TARP and CPP. The offices of the inspectors general of FDIC, Federal Reserve, and Treasury and SIGTARP have all completed work or have work under way

reviewing CPP's implementation at their respective agencies. In coordination with the other oversight agencies and offices and to avoid duplication, we primarily focused our audit work (including our review of agency case files) on the phases of the CPP process from the point at which the regulators transmitted their recommendations to Treasury.

We conducted this performance audit from May 2009 to September 2010 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.

Appendix II: Information on Processing Times for the Capital Purchase Program

In general, the time frame for the Department of the Treasury and regulators to complete the evaluation and funding process for Capital Purchase Program applicants increased based on three factors. First, smaller institutions had longer processing time frames than larger firms. The average number of days between a firm's application date and the completion of the CPP investment increased steadily based on the firm's size as measured by its risk-weighted assets. The smallest 25 percent of firms we reviewed had an average processing time of 100 days followed by 83 days for the next largest 25 percent of firms. The two largest quartiles of firms had average processing times of 72 days and 53 days respectively. Also, it took longer to complete the investment for smaller firms, as the average time between preliminary approval and disbursement increased as the institution size decreased. Second, private institutions took longer for Treasury and regulators to process than public firms. The average and median processing time frames from application through disbursement of funds was about 6 weeks longer for private firms than for public firms. As with the trend for smaller institutions, private institutions had longer average time frames between preliminary approval and disbursement. Third, when Treasury returned an application to regulators for additional review, it took an average of about 2 weeks to receive a response from regulators. On average, Treasury preliminarily approved these applicants after an additional 3 days of review.

Firms that applied earlier had shorter average processing times—from application to disbursement—than firms that applied in later months. The average time from application through disbursement was 70 days for firms that applied in October, 82 days for firms that applied in November, and 89 for those that applied in December. Also, public firms tended to apply earlier than private firms and larger firms tended to apply earlier than smaller firms. For example, 62 percent of firms that applied in October were public, while 93 percent of firms that applied in December were private—a trend that largely resulted from the later release of program term sheets for the privately held banks. Likewise, 61 percent of firms that applied in October were the largest firms and 84 percent of firms that applied in December were the smallest firms. Because larger firms and public firms also had shorter average processing time frames than smaller and private firms, this may explain why firms that applied earlier had shorter processing times than those that applied later in the program.

The overall process for most firms, from when they applied to when they received their CPP funds, took 2 1/2 months. There were many interim steps within this broad process that can shorten or lengthen the overall time frame. For example, in our June 2009 report on the status of

Treasury's implementation of the Troubled Asset Relief Program, we reported that the average processing days from application to submission to Treasury varied among the different regulators from 28 days to 57 days.¹ Also, Treasury preliminarily approved most firms within 5 weeks from application. The Investment Committee approved most firms the same day it reviewed them; however, it generally took longer to approve firms with the lowest examination ratings, resulting in a longer average review time frame. As previously mentioned, firms that Treasury returned to regulators for additional review took longer to receive Treasury's preliminary approval, and these firms tended to be those with lower examination ratings. Once Treasury preliminarily approved an applicant, it took an average of 33 days to complete the investment. As with the trends for the overall processing time frames, the final investment closing and disbursement took longer for smaller institutions and private institutions.

¹See [GAO-09-658](#).

Appendix III: Comments from the Department of the Treasury's Office of Financial Stability



ASSISTANT SECRETARY

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

September 17, 2010

Thomas J. McCool
Director, Center for Economics
Applied Research and Methods
U.S. Government Accountability Office
441 G Street, N.W.
Washington, D.C. 20548

Dear Mr. McCool:

The Department of the Treasury (Treasury) appreciates the opportunity to review the GAO's latest draft report on Treasury's Troubled Asset Relief Program (TARP), titled *Opportunities to Apply Lessons Learned from the Capital Purchase Program to Similarly Designed Programs and to Improve the Repayment Process* (Draft Report). Much in the Draft Report, the product of a 15-month review by a talented and professional GAO staff, is likely to be beneficial if any future programs are modeled after the Capital Purchase Program (CPP).

The GAO's recommendations are that Treasury should monitor and evaluate the actions of the federal banking regulators with respect to CPP funding and repayment. First, the GAO recommends that Treasury monitor decisions made by federal banking regulators not to recommend an institution for funding in order to ensure that similar applicants are treated equitably. The goal of insuring consistent treatment is one with which no one would disagree. We also believe that the independent judgment of the federal banking regulators was of great value to the CPP process and would be of great value in any similar program in the future. The system that was used to evaluate and approve CPP applications balanced these objectives. In particular, we believe that having certain applications reviewed by a council of all four regulators, the meetings of which Treasury attended as a nonvoting member, served to help ensure consistency. The use of standardized applications and further review by a Treasury investment committee also helped achieve consistency. As you know, we have followed a similar approval process for the Community Development Capital Initiative. Nevertheless, we are happy to consider the GAO's suggestion should there be a similar program in the future. Ensuring that there are regular discussions among the regulators regarding their standards, which could be done at "council" meetings or otherwise, could be another way to address the GAO's concern.

The second recommendation is that Treasury should monitor and evaluate the regulators' decisions on CPP repayments. This recommendation also raises the issues of how to balance the goals of consistency and respecting the independence of the regulators. As you know, the Emergency Economic Stabilization Act of 2008 was amended to override contractual provisions in the CPP contracts which required Treasury's consent before an institution could repay unless certain standards were met. Instead, the law provides that Treasury shall permit a TARP recipient to repay "subject to consultation with the appropriate Federal banking agency." The

**Appendix III: Comments from the Department
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law explicitly provides that this right to repay is "without regard to whether the financial institution has replaced such funds from any other source or to any waiting period". In light of this change in the law, Treasury cannot dictate standards for repayment. However, Treasury helped facilitate meetings among the regulators in the spring of 2009 at which they discussed what would be the standards for permitting TARP recipients to repay.

The recommendation that Treasury "collect information" on regulators decisions and "provide feedback on the extent to which regulators are evaluating similar institutions consistently" must be considered in this context. Among the benefits of having the appropriate regulator perform such assessments are that the relevant examiners are the most familiar with the institutions and are free to make the decisions in an independent manner. Moreover, Treasury does not receive confidential supervisory information about CPP recipients on a regular basis, which would limit any information collection contemplated by the GAO.

Nevertheless, we recognize the value of the objective you propose, and we will consider ways to address that objective in a manner consistent with the law, the principles of regulatory independence, and the need to treat supervisory information confidentially.

We look forward to continuing to work with you and your team as we continue our efforts to stabilize our financial system.

Sincerely,



Herbert M. Allison, Jr.
Assistant Secretary for Financial Stability

Appendix IV: GAO Contact and Staff Acknowledgments

GAO Contact

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Staff Acknowledgments

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