

**UNITED STATES DEPARTMENT OF THE TREASURY
TRANCHE REPORT TO CONGRESS
NOVEMBER 4, 2008**

I. INTRODUCTION

This *First Tranche Report to Congress* (First Tranche Report) is the first report under section 105(b) of the Emergency Economic Stabilization Act of 2008 (EESA). This First Tranche Report is in satisfaction of the requirements for reporting at the \$50 billion and \$100 billion commitment levels, because Treasury has made in one round of funding commitments of approximately \$125 billion under EESA. Treasury will submit the next tranche report when commitment levels reach the \$150 billion level.

The First Tranche Report addresses the following six areas as required by EESA section 105(b)(1):

- A description of all the transactions made during the reporting period.
- A description of the pricing mechanism for the transactions.
- A justification of the price paid for, and other financial terms associated with, the transactions.
- A description of the impact of the exercise of such authority on the financial system.
- A description of challenges that remain in the financial system, including any benchmarks yet to be achieved.
- An estimate of additional actions under the authority provided pursuant to EESA that may be necessary to address such challenges.

II. TRANSACTION INFORMATION BY PROGRAM

On October 14, 2008, Treasury published the program description for the Capital Purchase Program (CPP) and made available \$250 billion of purchase authority for the CPP. Treasury has committed 100 percent of the dollars at the \$50 billion and \$100 billion commitment levels under the CPP. These commitment levels were reached on October 28, 2008.

As of the date of this First Tranche Report, no purchases or commitments to purchase have been made under any other program established under EESA.

Capital Purchase Program

The purpose of the CPP is to encourage U.S. financial institutions to build their capital base, which in turn will increase the capacity of those institutions to lend to U.S. businesses and consumers and to support the U.S. economy. The terms of the investment limit certain uses of capital by the issuer, including most repurchases of company stock, and increases in dividends. Under this voluntary program, Treasury will purchase up to \$250 billion of senior preferred shares on standardized terms, which will include warrants for future Treasury purchases of

common stock. The CPP is available to qualifying U.S. controlled banks, savings associations, and certain bank and savings and loan holding companies engaged solely or predominately in financial activities permitted under the relevant law.

To date, Treasury has signed final agreements with 9 financial institutions holding 50 percent of all U.S. deposits. On October 28, 2008, Treasury settled capital purchase transactions with 8 of these institutions for a total of \$115 billion. Settlement of the capital purchase transaction for the last institution will be made sometime before January 31, 2009.

Treasury announced the CPP on October 14, 2008. On October 20, 2008, Treasury announced a streamlined, systematic process for all publicly organized financial institutions wishing to access funds through the CPP. Treasury will post an application form and term sheet for privately held eligible institutions and establish a reasonable application deadline for private institutions.

This process for publicly organized financial institutions – with standardized forms and standardized review – encourages banks and thrifts of all sizes to participate in the CPP. Treasury worked closely with the four Federal banking agencies to finalize both the application process and a standardized evaluation process. To apply for the CPP, financial institutions review the program information on the Treasury website and then consult with their Federal banking agency. After this consultation, institutions submit an application to that same Federal banking agency. The minimum subscription amount available to a participating institution is 1 percent of risk-weighted assets. The maximum subscription amount is the lesser of \$25 billion or 3 percent of risk-weighted assets.

Treasury has worked with the Federal banking agencies to establish streamlined evaluations; this means that all Federal banking agencies will use a standardized process to review all applications to ensure consistency. Once a regulator has reviewed an application, it will send the application along with its recommendation to the Office of Financial Stability at Treasury. Once Treasury receives the application with the Federal banking agency's recommendation, Treasury will review it and decide whether or not to make the capital purchase. Treasury welcomes the expertise of the Federal banking agencies, and will give considerable weight to their recommendations. Consistent with the provisions of EESA, all transactions will be publicly announced within 48 hours of completion. Treasury will not, however, announce any applications that are withdrawn or denied.

Treasury created the CPP to encourage U.S. financial institutions to obtain capital to strengthen the financial system and increase the flow of financing to U.S. businesses and consumers. In order for the CPP to achieve its objective, a broad class of financial institutions must participate. Therefore, Treasury is making capital temporarily available on attractive terms to a broad array of banks and thrifts, so they can provide credit to our economy. Treasury, in consultation with the Federal banking regulators, set a preferred stock coupon rate at 5 percent over the first five-year period in order to encourage financial institutions across the country to utilize this program. The dividend rate steps up to 9 percent after five years. The terms of the preferred shares contain certain provisions to protect the taxpayer. These terms include a restriction on paying dividends for both preferred shares equal or junior to Treasury's investment and common shares unless the institution is currently paying full dividends to Treasury (subject to certain exceptions), a

restriction on increasing common dividends for 3 years, and limits on the ability to repurchase other preferred and common shares within 3 years. In addition, pursuant to EESA requirements, Treasury will also receive warrants for common shares in participating institutions to allow the taxpayer to benefit from any appreciation in the market value of the institution. Institutions that sell shares to the government accept restrictions on executive compensation promulgated under EESA during the period that Treasury holds equity issued through the CPP. Treasury expects all participating institutions to increase their lending activities in a safe and sound manner to benefit U.S. businesses and consumers.

Appendix 1 contains the detailed transaction report released on October 29, 2008. Appendix 2 contains the term sheet for publicly traded banks.

III. ASSESSMENT OF CURRENT MEASURES AND THE CHALLENGES AHEAD

Impact of the Transactions

Treasury acted aggressively to implement the CPP to provide market stability and strengthen financial institutions across the country. As banks and institutions are reinforced and supported with taxpayer funds, Treasury expects they will increase lending to support the American people and the U.S. economy. With the additional capital, it is in the now-strengthened institutions' best financial interests to increase lending.

It is premature to assess the impact of the CPP, because less than half of the funds for this program have been invested, and those funds were invested only one week ago. Nevertheless, Treasury is encouraged by recent signs of improvement in the markets and in the confidence in our financial institutions. Policy measures implemented by Treasury, the Federal Reserve, the Federal Deposit Insurance Corporation, other U.S. policymakers and our counterparts around the world have helped relieve some pressures in the funding market.

Several funding market indicators, including the London Interbank Offered Rates (LIBOR), have experienced improvements since the passage and implementation of EESA and other policy actions. In the longer term credit markets, however, conditions remain quite challenging, and U.S. companies continue to find it difficult to issue long-term debt at attractive rates.

Challenges That Lie Ahead

Although actions announced to date have had a positive effect on the market, challenges remain. Equity, credit, and funding markets remain under considerable strain, as banks have been forced to reduce their leverage dramatically and have lowered their risk appetite. In addition, the primary and secondary mortgage finance markets are impaired by reduced liquidity.

Treasury is committed to deploying the TARP aggressively and is actively considering additional programs to strengthen financial institutions, restore the flow of lending, and address the many challenges to our financial markets posed by the ongoing housing correction. Treasury has policy teams examining several different areas that show promise for helping to strengthen our financial markets and preserve home ownership. In particular, Treasury will continue efforts to

ensure loan modifications are sustainable; to reach and communicate with borrowers effectively; to help borrowers avoid default; and to address high Real Estate Owned (REO) and vacancy rates, some of the factors destabilizing neighborhoods.

Programs will be designed to include requirements on executive compensation and warrants as appropriate to ensure compliance with EESA statutory provisions. To date, no final decisions have been made regarding actions that Treasury might take in any of these areas. Treasury will take additional steps to restore financial market stability in a clear and efficient manner while ensuring that the taxpayer is properly protected.