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Did TARP Work?

By Erika Morphy

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WASHINGTON, DC-The Troubled Asset Relief Program has been deemed a success-if not a necessary evil. Many of the larger banks have repaid the Treasury, in some cases such as Bank of America, to the taxpayers' profit. Smaller banks, as a **recent report described** [http://news/1683_1683/washington/300357-1.html], have not been as successful.

With the government discussing how to disengage itself from its extraordinary rescue efforts of 2008 and 2009, a look at how its most fundamental program-TARP-really worked is in order.

Linus Wilson, assistant professor of finance at the University of Louisiana at Lafayette, has been following this issue. He tells GlobeSt.com that while TARP recipients are indeed better capitalized than they were in 2008 they are not necessarily safe again.

"Yes, they have raised a lot of capital and they have been doing better in terms of market capitalization and bond yields although stocks have not performed as well," says Wilson. "But are they safe? It appears to me even after the capital they have they are not as well capitalized compared to many of their competitors."

Also, he adds, the incentives for poorly capitalized banks are perverse-even if they can raise capital they might not want to because the returns to equity holders are often greater if they ride it out. Of course, a lot of times they aren't able to ride it out-and then fail.

How this translates to lending for commercial real estate depends on many factors, Wilson says. An overlevered bank that is capitalized with preferred stock, for example, will still have poor incentive to lend because managers tend to maximize the value of common stock, not preferred stock. Preferred stock is the capitalization vehicle most often used in TARP. Thankfully, he adds, "regulators have come to the view that common stock is a better form of capital than preferred stock and have been using that in their stress tests."

