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Goldman Sachs, Morgan Stanley apply to repay TARP

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NEW YORK (AP) — The race to repay federal bailout money could end up reducing the amount that taxpayers eventually get back.

Some banks that want out of the Troubled Asset Relief Program may be allowed to buy back the government's investments at below-market prices. That could cut into taxpayers' potential profits by billions of dollars.

Goldman Sachs, Morgan Stanley and JPMorgan Chase&Co. have notified federal regulators of their interest in returning their share of the $700 billion bailout. Returning the money would let banks avoid restrictions on executive pay and hiring.

Approval for big banks to repay TARP funds could start in early June, a Federal Reserve official said on condition of anonymity because the applications are still being reviewed.

But before big banks can repay a penny and quit the bailout, they must agree to a price for the warrants the government received in return for the original loan. Those warrants gave the government the option to buy stock at a set price over 10 years.

Since the start, a key selling point for the bailout has been that, as the financial crisis eased and banks regained their health, taxpayers would get to go along for the ride and benefit from the stock gains.

So far, only one publicly traded bank, Old National in Evansville, Ind., has bought back its warrants after repaying TARP funds in March. Old National paid $1.2 million to the government, just over 1 percent of its $100 million capital injection.

That deal was a bargain for Old National, according to Linus Wilson, a finance professor at the University of Louisiana at Lafayette. His calculations put a market value on the warrants at $1.5 million to $6.9 million.

In all, Wilson estimates the warrants in the roughly 570 banks that have received about $198 billion in bailout money would be worth between $2.4 billion and $10.9 billion.

If the government sells for less, "that's definitely bad news for taxpayers," Wilson said. "We'd be better-served if the Treasury would hold out for a very good negotiated settlement or market the investments to third-party investors."
Old National CEO Bob Jones said his bank initially bid $600,000 for the warrants. Treasury rejected that figure before eventually agreeing to sell for twice the bank's original offer.

"We think we got a fair deal for everyone," Jones said, adding that his bank held TARP money for less than 90 days and paid $1.5 million in dividends. "We think the taxpayer got a good value for that short-term loan."

The Treasury began pumping billions into the banking system in October, as the financial crisis threatened to push the economy over the edge. Six months later, some banks are rushing to uncoil themselves with the government.

They worry the federal money carries too many strings and a nettlesome public stigma.
Another reason is that federal bailout money isn't cheap. Banks must pay a 5 percent annual dividend for the first five years. If they don't repay by then, the dividend rises to 9 percent — increasing the incentive for banks to cut ties with TARP.

Some banks think third-party estimates of the warrants' value exaggerate their worth, said Frederick Cannon, an analyst with Keefe, Bruyette&Woods who has represented a small bank that repaid TARP money but didn't buy back warrants. He wasn't allowed to identify the bank because he doesn't cover it for his research firm.

He said that under Treasury's method for valuing the warrants, market volatility drives the prices higher than banks think they're worth.

"The price being asked was too expensive" for the bank he represented to buy, Cannon said. "Because the market has been so volatile ... that increases the theoretical value of the warrants to a level banks think is too high."

Treasury spokesman Andrew Williams said the department would have a "robust process" for valuing the warrants. But he provided no details on how that would work.

Settling for less than market value would be an injustice to taxpayers who rescued the banks, said U.S. Rep. Brad Sherman, who voted against the bailout.

"We put up a lot of cash for the banks at the bleakest possible moment in our lifetimes," said the California Democrat.

"We took a huge risk. We're going to lose money on some of these investments. So why take your winning investments and give them away?"

But others say the sooner the government gets out of the banking sector, the better. Banks that repay TARP funds but don't buy back the government's warrants could remain subject to restrictions on executive pay and hiring.

"I don't think the banks are trying to shortchange taxpayers on the warrants," said Gerard Cassidy, a banking analyst at RBC Capital Markets. "They just want to get the government out of their boardrooms."
And not every bank that repays TARP wants the warrants back.

New York-based Signature Bank, one of a dozen smaller banks that have repaid TARP, said it has no intention of buying back the government's warrants.

"If our stock goes up year after year, they're going to be able sell those warrants for millions of dollars. They're truly valuable," said Signature Bank CEO Joseph DePaolo.

Others say there's another reason for the government to hang onto its stakes in the banking industry: **If the economy takes a turn for the worse, some banks "will be back" for more taxpayer money, said Daniel Alpert, managing director of investment bank Westwood Capital.**

"Taxpayers stepped in as lender and equity provider of last resort, and they took risks," Alpert said. "The way our system is supposed to work is, when you take risks you get rewards."