I. INTRODUCTION

This Second Tranche Report to Congress (Second Tranche Report) is the second report under section 105(b) of the Emergency Economic Stabilization Act of 2008 (EESA). The Second Tranche Report satisfies the requirements for reporting at the $150 billion cumulative commitment level and is required because Treasury has made funding commitments of approximately $158.5 billion under EESA. Treasury will submit the next tranche report when the commitment level reaches the $200 billion level.

The Second 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

Treasury has announced two programs to purchase troubled assets under EESA, the Capital Purchase Program (CPP) and the Systemically Significant Failing Institution Program (SSFI). Treasury published the program description for the CPP on October 14, 2008, and completed its first transactions under that program on October 28, 2008. We reported on these transactions, which totaled $125 billion, in the First Tranche Report on November 4. Treasury completed a second set of transactions under the CPP on November 14, 2008, bringing the total amount of funds committed under the CPP program to $158.5 billion. We discuss these recent transactions in this report.

On November 10, Treasury announced an agreement in principle for a $40 billion purchase of preferred shares of American International Group, Inc. (AIG) under the SSFI program. Concurrent with publishing this report, Treasury published a description of the SSFI program on its web site. Since the transaction has not been completed as of the time of this report, we will discuss the SSFI Program and the AIG transaction in the next tranche report, when Treasury reaches the $200 billion level.
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 and stabilize the financial system. 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.

Through November 14, Treasury has signed final agreements with 30 financial institutions. On October 28, 2008, Treasury completed capital purchase transactions with 8 of these institutions for a total of $115 billion. Treasury completed capital purchase transactions with an additional 21 institutions on November 14, 2008 for a total of $33.5 billion. Funding of the capital purchase transaction for the thirtieth institution will be made sometime before January 31, 2009 in the amount of $10 billion. A report listing each of these transactions has been published on Treasury’s web site.

All commitments thus far under the CPP have been with financial institutions whose stock is traded on national securities exchanges. The terms of the program for non-publicly held financial institutions (excluding S corporations and Mutual Organizations) whose stock is not traded on national securities exchanges were released on November 17 and these institutions have until December 8 to apply. The application process – with standardized forms and standardized review – encourages banks and thrifts of all sizes to participate in the CPP. 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. These amounts are determined at the discretion of the Treasury reflecting the recommendations of the Federal banking agency.

Treasury has worked with the Federal banking agencies to establish streamlined evaluation procedures; this means that all Federal banking agencies use a standardized process to review all applications to ensure consistency. Once a regulator has reviewed an application, it sends 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 reviews it and decides whether or not to make the capital purchase. Treasury values the expertise of the Federal banking agencies, and gives considerable weight to their recommendations. Consistent with the provisions of EESA, all transactions are publicly announced within 2 business days 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. The federal regulatory agencies issued a joint interagency statement on November 12 with respect to lending to creditworthy borrowers.

Treasury has offered the same basic terms to all financial institutions participating in the CPP. Because of the differences between publicly-traded and non-publicly traded financial institutions, there are separate term sheets for each type of financial institution. Treasury, in consultation with the Federal banking regulators, set the preferred stock coupon rate at 5 percent for the first five-years after purchase 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, and limits on the institution’s ability to repurchase other preferred and common shares within 3 years after the Treasury investment. In addition, pursuant to EESA requirements, under terms applicable to publicly held financial institutions, Treasury also receives warrants for common shares in participating institutions to allow the taxpayer to benefit from any appreciation in the market value of the institution. Under terms applicable to non-publicly held financial institutions, Treasury receives warrants for preferred shares that bear dividends at a rate of 9% per annum. Institutions that sell shares to the government also 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 through November 14 as released on November 17, 2008. Appendix 2 contains the CPP term sheet for non-publicly held financial institutions.

### III. ASSESSMENT OF CURRENT MEASURES AND THE CHALLENGES AHEAD

#### Impact of the Transactions

Treasury’s initial objective has been to stabilize the financial system and the CPP, in conjunction with the FDIC’s guarantee of certain financial institution debt, has been essential in accomplishing that objective. Capital purchases are clearly powerful in terms of impact per dollar invested. More capital enables banks to withstand losses as they write down or sell troubled assets and stronger capitalization is also vital to increasing lending, an essential element for economic recovery. Through the CPP, we have added over $158 billion into the banking system’s capital structure.
Treasury has moved rapidly to review applications and make investments in federally regulated banks and thrifts. In one month, Treasury completed transactions with 30 financial institutions. We have granted preliminary approval of applications for dozens of additional institutions as well and are working with these institutions to complete the legal agreements and fund the investments. A term sheet for non-publicly traded financial institutions (excluding S corporations and Mutual Organizations) has been released and there is continued interest in participating in the CPP from financial institutions of all sizes.

**Challenges That Lie Ahead and Additional Actions**

Since initiating the CPP, Treasury has been examining a wide range of ideas that can further strengthen the financial system and revive lending to support the broader economy. Because the system remains fragile, systemic failures must be prevented as illustrated by the AIG announcement.

Treasury has three critical priorities for investing the remaining TARP funds. We will continue to reinforce the stability of the financial system, so that banks and other institutions are able to support economic recovery and growth. For example, approaches are being evaluated that will leverage TARP funding through matching investments. We are also exploring ways to support markets for securitizing credit outside the banking system. This vital market has, for all practical purposes, ground to a halt. With the Federal Reserve, Treasury is exploring the development of a liquidity facility for highly rated asset-backed securities. In addition, we are evaluating ways to reduce the risk of foreclosure. Treasury will continue its efforts to support the variety of programs across government that are already well underway.