Discussion of:
The U.S. Treasury's Capital Purchase Program: Selection and Investor Reaction
Kenneth A. Carow and Valentina Salotti
(2011 Dec 15 version)

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February 23, 2012 MFA

Quick summary of the paper

- **Question of the study:**
  What were the determinants of fund allocation under the **Capital Purchase Program (CPP)** of **Troubled Asset Relief Program (TARP)**?

- **Data:**
  SNL Financial, public announcements on CPP participation up to 2009 December 31, some market performance indicators.

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Key results:

- Assume all weak firms apply, Treasury decides. Strong firms get accepted, if applied.
- Among the weak firms, the strongest ones are more likely to be 'approved' and have positive abnormal returns on the announcement date.
- Among the healthy firms, firms with lowest levels of capital 'choose' to participate, with insignificant negative abnormal returns.
- Policy recommendation: healthy firms should be allowed to receive funds as unsecured debt.

Weak firm: low tier-1 capital, high non-performing assets, low z-score.

Comments/questions: Defining weak

- Relevant, interesting, timely research question, nice execution.

- Definition of weak/healthy is not clear/uniform throughout the paper:
  - weak, stronger financial prospects, higher viability.
  - 'Viability' very confusing (level of non performing assets). Why viable firms don't get funding on the market?
  - ...weak firms as measured by non-performing assets...

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Comments/questions: Assumptions

- Very strong assumption that all weak seek assistance.
- Are there weak institutions that announced that they will not participate in CPP?
- Inconsistency: assume all weak firms apply, but make a weaker assumption regarding strong firms - 'some apply'.
- Clarify: Why would a healthy firm apply? Observations of strong firms applying - evidence of involuntary action?

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Comments/questions: Hypotheses

- Comment on H1b: even if there is a strong certification effect, H1b implicitly assumes that other effects (restrictions on compensation/dividend etc.) are outweighed. Evidence?
- Why H2a is only for healthier firms? Doesn't the same apply for riskier firms (without assuming that all weak firms apply)?
- H2b needs a bit more explanation. Not clear what mechanism authors have in mind.

Other comments/questions

- CPP participants have less asset risk but more bankruptcy risk. One would think that the two go hand in hand. Explanation?
- Coefficient for NPA is significantly negative for financially weak firms, but insignificant for healthy firms. Nonlinearity?
- Alternative explanation of excess returns: Some firms undervalued (due to liquidity shock), some overvalued. Monetary easing: undervalued firms appreciate, overvalued (cash-rich) depreciate...

Other comments/questions

- Not convinced that the Treasury makes the final decision for the weak firms. Your evidence: NPA significant and capital being insignificant...
- On excess returns you have 3 categories: healthy, weak, and middle. Why not use the same?
- Most institutions did not make announcement of not participating in CPP. But Bayazitova and Shivdasani (2012) show that not only institutions announced not participating in CPP but they applied, got approved, and said no!

Recommendations

- Should contrast more with Bayazitova and Shivdasani (2012, RFS) to bring out the key contributions. Maybe can improve the analysis based on (what seems to be) better data collected by BS (2012)?
- BS (2012) claim that CPP had little meaningful certification effects. Main contribution of this paper is in showing certification effects, thus need to explain why a different result obtains using mostly the same data.
- Weighted regression by the size of the CPP subscription?

Recommendations

Complexity/SIFIs:

- Government intervention (capping CEO compensation, etc) more likely for large firms than for small.
- Complex firms are more likely to participate (lots of branches, etc.) CPP participants twice larger than non participants.

Liquidity:

- Wholesale funding seems to be very important - while deposits are the same, loan levels are larger for participants. Most likely most of that funding is short term... therein lies the need for participation.
- Liquidity concerns are the key (as found by the authors) - CPP participants have significantly lower short term liquidity.
- Some 'healthy' institutions where in dear need for cash. Liquidity concerns were the primary reason for participating, not 'funding issuance of new mortgages'.

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Recommendations

- Credit risk measured by non-performing assets... what about loan loss reserves?
- Maybe use loan loss provisions as a measure of expected credit losses? (But should be the same, given that NPA should correlate a lot).
- Results on excess returns compared to Cornett and Tehranian (1994) [voluntary common stock issuance bears negative stock returns]. How comparable or not is preferred stock issuance?
- Better explanation why unsecured debt is better? How does that alleviate debt overhang problem?