Executive pay limits narrowed scope of TARP banking rescue

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A study of 263 publicly traded banks approved for the Troubled Asset Relief Program finds that 35 banks may have rejected TARP dollars because of limits the program imposed on CEO pay, researchers report in the Journal of Banking, Finance & Accounting. Ultimately, the pay provisions may have limited the scope of the $400 billion program.

The executive pay provisions of the TARP – the Troubled Asset Relief Program – stoked controversy. Bankers claimed the rules would thwart their efforts to attract and retain the best executives. But the pay rules may have had an unintended benefit of reducing the scope of the program, researchers say.

A newly published report in the *Journal of Banking,* Finance *& Accounting* finds that pay provisions did discourage some banks from participating in TARP, which was intended to help banks weather the 2008-2009 financial crisis, according to researchers Mary Ellen Carter of Boston College, Brian Cadman, of the University of Utah, and Luann J. Lynch, of the University of Virginia.

Examining 263 publicly traded banks that were approved for TARP, the new study found that 35 banks rejected the funds and that this decision was related to higher levels of CEO pay. But this decision didn't seem to hurt them – they fared just as well as their peers that did take TARP money. As a result, the pay provisions in TARP may have deterred banks that didn't really need the money from taking it.

The study also suggests that from a personal standpoint bankers may have been right to worry about TARP's pay limits: banks that took the funds did see higher executive turnover than those that didn't. But their performance didn't suffer. Banks that turned down TARP money—often derisively referred to as "bailouts"— did just as much lending afterwards and had just as much financial strength, measured in terms of capital ratios, as those that accepted it.

"While we don't know exactly why these banks refused the funds, we do know that some high-profile bankers complained that the pay restrictions were onerous. Our study suggests that TARP may have been better designed than bankers would have you believe," Carter said. "The restrictions gave financial incentives for bank executives to think carefully about participating and, if they did participate, to get out from underneath the program as quickly as possible."

TARP was, perhaps, the most controversial of the many policy measures undertaken during the financial crisis. The U.S. government originally budgeted $700 billion and ultimately paid out about $400 billion to shore up the U.S. financial system. Some viewed the program as corporate welfare while others saw it as creeping socialism. Nobody, but the bankers who needed the money, seemed to like it much. But in the end, TARP appears to have succeeded: banks, for the most part, survived the crisis and are paying back the money.

More information: onlinelibrary.wiley.com/doi/10 … 57.2012.02307.x/full

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