CONGRESSIONAL OVERSIGHT PANEL

Elizabeth Warren, Chair | Sen. John E. Sununu | Rep. Jeb Hensarling | Richard H. Neiman | Damon Silvers

March 20, 2009

The Honorable Timothy F. Geithner
Secretary of the Treasury
United States Department of the Treasury
Room 3330
1500 Pennsylvania Avenue, N.W.
Washington, D.C. 20220

Dear Mr. Secretary:

I am writing to you because the Congressional Oversight Panel (the "Panel"), is concerned about the terms and operation of the Term Asset-Backed Loan Facility (the "TALF").[1] More specifically, the Panel is concerned that the TALF appears to involve substantial downside risk and high costs for the American taxpayer. Equally important, the TALF appears potentially to subsidize the continuation of financial instruments and arrangements whose failure was a primary cause of the current economic crisis. In addition, the Panel is concerned because documents currently posted on the Treasury's website describing the terms of operation of the TALF and press reports about the content of those terms as they are to be implemented by the Federal Reserve Bank of New York (the "New York Fed") contradict each other.

I am therefore requesting that you answer the questions posed in this letter so that the Panel may fulfill its Congressionally-mandated oversight function. The Panel was established by section 125 of the Emergency Economic Stabilization Act of 2008, Pub. L. No. 110-343 ("EESA"). The information sought by this letter is necessary for the Panel to carry out section 125 of EESA, and this information request is made pursuant to section 125(e)(3) of EESA. Your prompt response to the Panel's requests is greatly appreciated.

The operation of the TALF is explained in documents (the "TALF Documents") issued on March 3, and March 17, 2009, by one or more of the Federal Reserve Bank of

[1] The launch of the TALF was announced jointly by the Board of Governors of the Federal Reserve System (the "Federal Reserve Board") and the Department of the Treasury (the "Treasury") on March 3, 2009. U.S. Department of the Treasury, Board of Governors of the Federal Reserve System, *Joint Press Release* (Mar. 3, 2009) (online at www.federalreserve.gov/newsevents/press/monetary/20090303a.htm).

New York (the "New York Fed"), the Federal Reserve Board, and the Treasury.[2] The TALF Documents describe a mechanism for "facilitating the issuance of asset-backed securities" ("ABS") involving pools of, *inter alia*, credit card, automobile, student, and small business loans. The Documents explain that the TALF will provide 90 per cent non-recourse financing, through one or more special purpose vehicles established by the New York Fed and funded by the New York Fed and the Treasury, for the direct purchase of ABS by investors. The TALF Terms impose several conditions on eligibility that are seemingly designed to avoid some of the abuses of the securitization process that helped produce the financial meltdown.

Notwithstanding the TALF Documents on the official website, the *Wall Street Journal* reported on March 14, 2009, that the New York Fed has agreed to what appears to be a fundamental alteration in the TALF and delayed the start of TALF auctions for several days for that reason. According to the *Journal*:

> "Wall Street dealers, including J.P. Morgan Chase & Co. and Barclays PLC's Barclays Capital, have created vehicles to participate in the TALF that would allow investors in the program *to circumvent many of the restrictions laid out by the Fed. The vehicles resemble collateralized debt obligations, or CDOs, and use some of the financial engineering that was partially responsible for the collapse of the credit markets.* (Emphasis supplied.)
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> "Under the new proposal, a bank such as Barclays or J.P. Morgan would set up a trust to buy securities with money borrowed from the Fed. The trust would then sell investors securities in the trust. Those securities would give returns similar to the TALF loan, but without the strings attached.

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[2] The TALF Documents are: (i) Federal Reserve Bank of New York, *Term Asset-Backed Securities Loan Facility: Terms and Conditions* (Effective Mar. 3, 2009) (the "TALF Terms") (online at www.newyorkfed.org/markets/talf_terms.html); (ii) Federal Reserve Bank of New York, *Term Asset-Backed Securities Loan Facility (TALF) Frequently Asked Questions, Effective March 17, 2009,* (the "TALF FAQs") (online at www.newyorkfed.org/markets/talf_faq.htm); (iii) U.S. Department of the Treasury, *The Consumer and Business Lending Initiative, A Note on Efforts to Address Securitization Markets and Increase Lending* (Mar. 3, 2009) (online at www.treasury.gov/press/releases/reports /talf_white_paper.pdf); and (iv) U.S. Department of the Treasury, *Guidelines for the Consumer and Business Lending Initiative (CBLI) Program* (Mar. 3, 2009) (online at www.treasury.gov/press/releases/reports/talf_white_paper.pdf).

"The dealers say they could create markets for these derivative securities to trade, and a presentation by Barclays says they may be rated by credit-ratings companies and listed on the Irish Stock Exchange, a home for many CDOs."[3]

Questions.

1. Please explain in detail why the Treasury and the Federal Reserve Board believe it is wise to commit billions of dollars to rebuild the market for collateralized debt obligations and the redistribution and subdivision of interests in asset pools, in light of the risks posed for the financial system by these arrangements."

2. The thrust of the TALF appears to be to attract investors with large pools of capital, such as hedge funds, to the ABS market by allowing them to purchase ABS on a highly leveraged basis with risk of loss largely transferred to the taxpayer directly or, through the Federal Reserve System, indirectly, in a manner that confers substantial benefits on these private investors who have little at stake. Please explain in detail the rationale for such a transfer of risk to the taxpayers with so much of the benefit transferred to private investors and please provide the facts and figures that support this rationale.

3. Is the report in the *Wall Street Journal* substantially correct? If so, please explain in detail how the final terms, details, and structure of the financing vehicles that are treated as eligible for the TALF will reflect the investment vehicles and packaging and repackaging of ABS described in the *Wall Street Journal* article, and, as part of that explanation, please explain in detail the extent to which the new financing structures differ from those involved in the mortgage-backed securities markets before March 2008. If not, please explain why not, citing specific provisions of the TALF Documents.

4. To the extent that the TALF Documents will permit the financing and investment structures reported in the *Wall Street Journal*, when will Treasury make public revised TALF Documents to reflect such structures? Given the Administration's expressed commitment to transparency about the terms and implementation of the TARP, please explain why it is appropriate to make changes in the terms of the TALF without making those changes public sufficiently in advance of the effective date of the changes to permit Congressional and public response?

5. Two conditions of eligibility described in the TALF Documents appear to have been directed against specific abuses of the mortgages-backed securities market. These are the bar against third party guarantees (such as, presumably, credit default swaps) of ABS to obtain TALF financing and the ban on such financing for ABS composed of loans originated or securitized by the borrower or an affiliate of the borrower. According to the *Wall Street Journal*, those conditions have recently been

[3] Liz Rappaport, *TALF is Reworked After Investors Balk*, The Wall Street Journal, at B4 (Mar. 14, 2009) (the "Wall Street Journal Article").

weakened or abandoned. Please explain if this report is accurate and, if it is, why Treasury would take such steps.

6. According to the TALF Documents made available online, the TALF is "intended to make credit available to consumers and small businesses on more favorable terms by facilitating the issuance of asset-backed securities (ABS) and improving the market conditions for ABS more generally."[4] Please provide a detailed description of the "current market conditions for ABS." In addition, please provide detailed data indicating the dollar levels of securitization, on a month-by-month basis from January 2007 through January 2009, for each of the categories of loans whose ABS may be purchased with TALF financing.

7. The TALF Documents indicate that only the purchase of AAA-rated ABS will be eligible for TALF financing. To what extent does the assignment of an AAA rating to such ABS mean that the ABS should be priced at their face value (minus the amount of any discount or the effect of any other collateral or financing requirement or financing cost)? To the extent that such assets are priced as described in the preceding sentence, please explain in detail why the provision of non-recourse financing by the New York Fed and the Treasury is necessary to stimulate the market for the loans involved.

8. Consistent failures of the credit rating agencies were a significant factor in the sales of mortgage-backed securities that helped produce the financial meltdown. In light of these failures, please explain why reliance on credit ratings for the TALF is a reasonable basis on which to protect the taxpayers, regardless of the number of credit-ratings agencies whose opinions are required.

9. There is no indication in the TALF Documents that Treasury has imposed any substantive requirements on any class of loans that may be securitized and financed through the TALF. For example, there are no limits on credit card or student loan interest rates or fees, and no consumer protections against predatory practices of various kinds. What is the rationale for committing taxpayer dollars without conditioning use of those funds on fair treatment of taxpayers? Please explain your answer in detail.

10. Please explain why the Treasury and the Federal Reserve Board decided to use the TALF mechanism to stimulate lending for the classes of assets involved, rather than infusing additional funds into financial institutions for such lending.

11. What is the rationale for financing sale of securitized debt issued by U.S. subsidiaries of non-U.S. companies under the TALF?

[4] TALF Terms, at 1.

I would be happy to answer any questions that you may have about this letter. If you would prefer, a member of your staff can contact the Panel's Executive Director, Naomi Baum, at [redacted].

Kindly respond to the request for information contained in this letter within seven (7) calendar days from the date of this letter

Sincerely,

Elizabeth Warren
Chair
Congressional Oversight Panel