Congressional Oversight Panel

May 7, 2009

MAY OVERSIGHT REPORT*

Executive Summary

Reviving Lending to Small Businesses and Families and the Impact of the TALF

*Submitted under Section 125(b)(1) of Title 1 of the Emergency Economic Stabilization Act of 2008, Pub. L. No. 110-343

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If small businesses and households are unable to spend, then both the depth and length of the country's economic trouble will be intensified. In the past, much of that spending has been supported by credit. Even after the widely reported credit slowdown in 2008, 40 percent of banks reported further tightening of small business lending standards in the first quarter of 2009 and no banks reported easing of standards. Meanwhile, consumer lending contracted at a rate of 3.5 percent. The Term Asset-Backed Securities Loan Facility (TALF) program is intended to support more lending by financing credit through asset-backed securities. These are securities that represent interests in pools of loans made to small businesses and households for purposes such as buying automobiles or funding college. Lenders collect these loans together and then sell interests in these pools of loans to investors. With the money they receive from investors purchasing the asset-backed securities, the lenders have more money available to make more loans.

The Department of the Treasury's new initiative through TALF raises two important questions:

- Is the TALF program well-designed to help market participants meet the credit needs of households and small businesses?
- Even if the program is well-designed, is it likely to have a significant impact on the access to credit of small businesses and consumers?

The first question is whether the TALF program is well-designed to attract new capital. The program should be attractive to investors in asset-backed securities. The investors must contribute a portion of the purchase price for the securities (5-16 percent in the May offering), with the government financing the remainder. If the securities increase in value, the investors reap a substantial portion of that benefit. If, however, the securities decline in value, the investors could default on the government loans, forfeiting their investment but leaving the taxpayers to absorb any remaining losses with only the collateral to cover the loan amount. On the other hand, there are also some reasons why investors would not want to participate in the program. There are restrictions on sale of the securities, so that investors are "locked in" to their investment for a number of years. The interest rate payable on TALF loans may be higher than the investors could get from other lenders. There are also restrictions on the internal operations of participants, and investors fear that they may be subject to additional restrictions in the future. With these uncertainties, and the fact that so far there have been fewer issuances under the

* The Panel adopted this report with a 4-1 vote on May 6, 2009. Rep. Jeb Hensarling voted against the report. His additional view is available in Section Two of this report.

program than expected, it is not yet clear that the program has been well-designed to meet its purpose.

The second question is whether any securitization program, no matter how well designed, is likely to help market participants meet the credit needs of small businesses and households. While small businesses are experiencing significant credit constriction, it is not clear whether that constriction is primarily the product of reduced creditworthiness of borrowers or of tightening in bank lending. TALF cannot address the creditworthiness issue. It can provide more funds to the lenders for lending, but asset-backed securities have never been the source of significant funding for small businesses. This report raises the question of whether TALF will have a meaningful impact on small business credit.

Consumer lending raises a very different aspect of the question of the likely effect of TALF efforts. Leading into this recession, families were already awash in debt. Larger economic forces have left families with little savings, while declines in the value of housing and in the stock market have shrunk household net worth by 20 percent in just over a year. As wages have stagnated and unemployment has risen, the ability of households to manage ever-larger debt loads is increasingly unlikely. Any reduction in consumer lending may be the result of reduced demand as families try to cut costs or changes in banks' lending decisions as they assess the deteriorating creditworthiness of American households.

Despite these larger concerns, it is noteworthy that even with the sharp contraction in the securitization market, consumer lending has shown only a modest decrease, with a projected annualized downturn of 3.5 percent. The contraction has been exclusively in revolving debt (such as credit cards), not in installment loans (such as automobile and student loans). There is much discussion among finance professionals about the negative impact of the current contraction in the securitization market, but consumer loans do not seem to have been as strongly affected as mortgage loans.

Another issue that arises when discussing the revival of lending deals with the terms of small business and consumer lending. Recently, there have been reports of large increases in credit card rates by banks that are both Capital Purchase Program (CPP) recipients and originators of loans eligible to be sold under the TALF program, even for customers who have made all their payments according to the terms of their agreements. In the three month period from November 2008 to February 2009, interest rates on credit cards grew by 8.8 percent from 12.02 percent to 13.08 percent, while the cost of funds declined. This also raises the question: If a bank wants taxpayer support through the Troubled Asset Relief Program (TARP) or TALF, should the bank be obligated to go beyond what the law requires for consumer and small business lending standards?

The resolution of this question involves broader policy concerns. For some, Congress is the appropriate body to address consumer protections that are more stringent than current law;

additional conditions set by Treasury outside the legislative process could deter industry participation in TARP and TALF, undermining the program's goal of ensuring access to affordable credit for small businesses and consumers. Others are concerned that financial institutions should not take taxpayer support and then increase their interest rates on outstanding loans for many of the same taxpayers. The Panel takes no position on whether conditions should be placed on the terms of credit set by TARP recipients, but it hopes that the discussion provided here is useful to Congress.