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Highlights

Highlights of GAO-10-25, a report to congressional committees

TROUBLED ASSET RELIEF PROGRAM

Treasury Needs to Strengthen Its Decision-Making Process on the Term Asset-Backed Securities Loan Facility

Why GAO Did This Study

The Term Asset-Backed Securities Loan Facility (TALF) was created by the Board of Governors of the Federal Reserve System (Federal Reserve) to help meet consumer and small business credit needs by supporting issuance of asset-backed securities (ABS) and commercial mortgage-backed securities (CMBS). This report assesses (1) the risks TALF-eligible assets pose to the Troubled Asset Relief Program (TARP), (2) Department of the Treasury's (Treasury) role in decision making for TALF, and (3) the condition of securitization markets before and after TALF. GAO reviewed program documents, analyzed data from prospectuses and other sources, and interviewed relevant agency officials and TALF participants.

What GAO Recommends

Treasury should (1) give increased attention to reviewing risks posed by CMBS, (2) strengthen its TALF decision-making process, and (3) determine which data are needed to track the management and sale of assets TALF borrowers might surrender. To enable more effective review of TARP, Congress also should grant GAO authority to audit Federal Reserve TALF operational and administrative activities. Treasury appreciated GAO's recommendations but said GAO understated TALF's success and overstated the risk of CMBS. The Federal Reserve disagreed that there are limitations on GAO's authority to audit TALF activities. GAO continues to believe that its depiction of TALF is accurate and its recommended actions are necessary to strengthen the oversight and operations of TALF.

View GAO-10-25 or key components.
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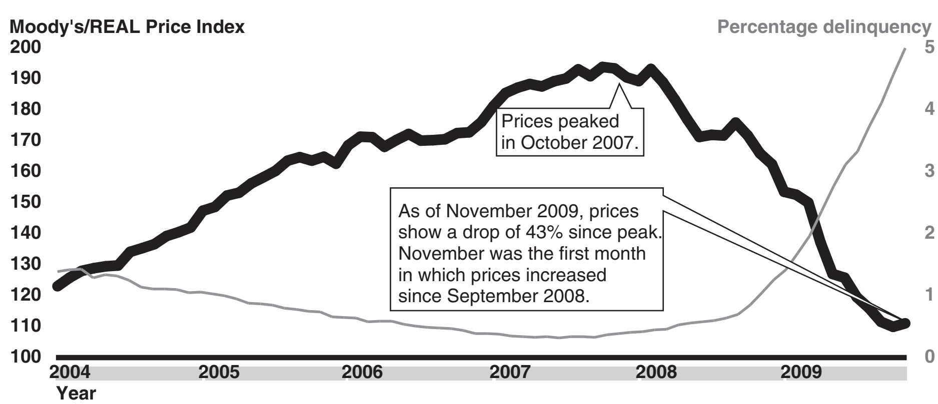
What GAO Found

TALF contains a number of risk management features that in turn likely reduce the risk of loss to TARP funds, but risks remain. TALF was designed to reopen the securitization markets in an effort to improve access to credit for consumers and businesses. The Federal Reserve Bank of New York (FRBNY), which manages TALF, is authorized to lend up to $200 billion to certain eligible borrowers in return for collateral in the form of securities that are forfeited if the loans are not repaid. To assist in this effort, Treasury has pledged $20 billion of TARP funds in the form of credit protection to the program in the event the loans are not repaid. As of December 2009, FRBNY has made about $61.6 billion in TALF loans, of which $47.5 billion remained outstanding. For most TALF-eligible collateral, FRBNY will stop providing new TALF loans in March 2010, while new-issue CMBSs will be accepted as collateral on new TALF loans through June 2010. Treasury and FRBNY analyses project minimal, if any, use of TARP funds for TALF-related losses, and Treasury currently anticipates a profit. While GAO found that the overall risks TALF poses to TARP funds are likely minimal, GAO analyses showed that CMBSs potentially pose higher risk of loss than ABSs. As shown in figure 1, ongoing uncertainty in the commercial real estate market and TALF exposure to legacy CMBSs warrant ongoing monitoring. Finally, TALF may present risks beyond the potential risks to TARP, such as the risk that FRBNY might fail to identify material noncompliance with program requirements by TALF participants. Because the Federal Reserve views TALF as a monetary policy tool, however, statutory limitations on GAO's authority prohibited GAO from auditing FRBNY's role in administering TALF.

Figure 1: Commercial Real Estate Prices and CMBS Delinquencies from January 2004 through October 2009



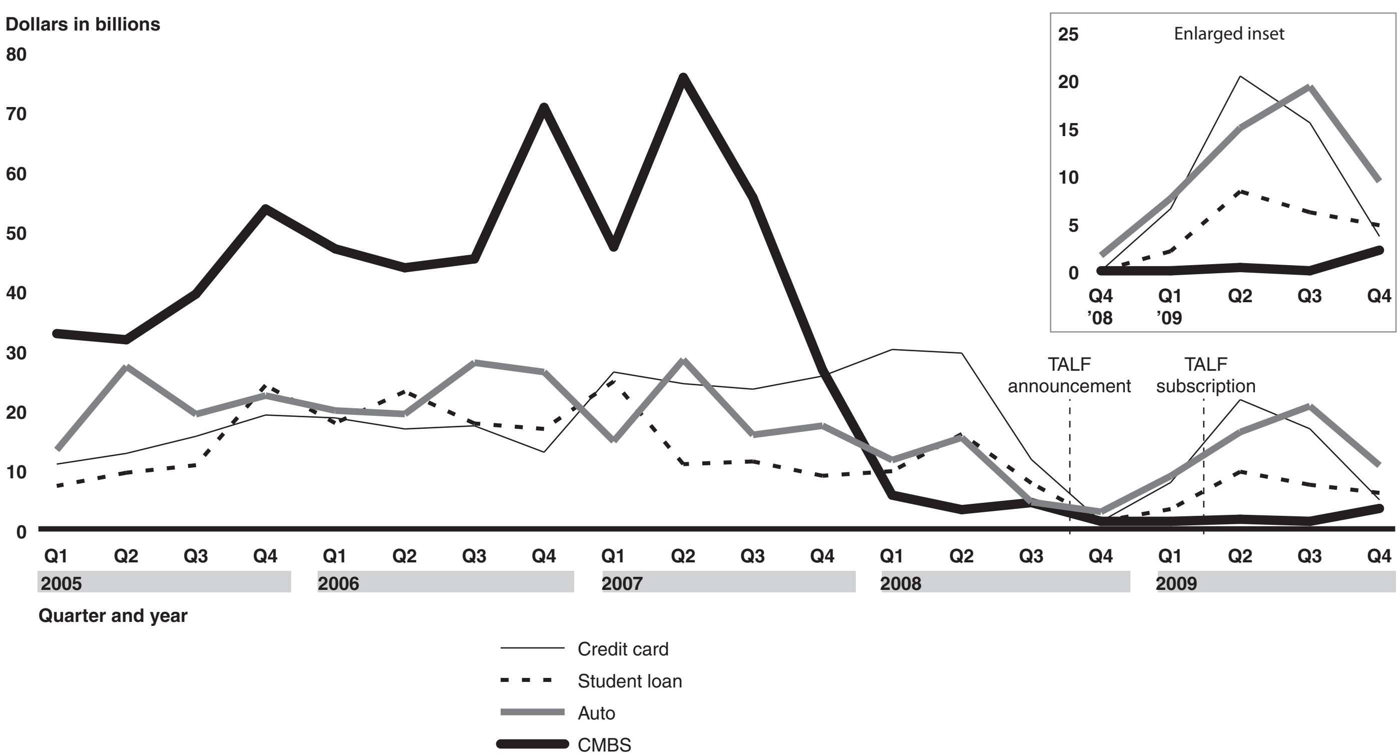
Source: GAO presentation of Moody's/REAL Commercial Property Price Index and Moody's CMBS Delinquency Tracker data.

Note: Moody's/REAL Commercial Property Price Index is a report showing the change in commercial real estate asset sales. Moody's CMBS Delinquency Tracker is a monthly report showing delinquency rates for commercial mortgage-backed securities.

Treasury has not fully documented its rationale, as part of its decision-making processes, for reaching final decisions related to the risks of TALF—including decisions involving other agencies. For example, the outcomes of Treasury's internal analysis of the amount of equity that TALF borrowers should hold in TALF ABS collateral, along with other TALF program terms, sometimes differed from FRBNY's. However, there was no clear documentation or explanation of how the discrepancies were resolved or how final decisions were made with FRBNY. Documenting the rationale and basis for these decisions would increase transparency and strengthen internal controls for TALF decision-making processes. Moreover, a sound decision-making process would help ensure that TALF objectives are being met and that it is functioning as intended. Unless Treasury documents the basis for major program decisions that it made with the Federal Reserve, it cannot demonstrate accountability for meeting the goals of TALF and could unnecessarily place TARP funds at risk.

FRBNY, in consultation with Treasury, monitors various economic indicators to measure TALF's impact. Our analysis of such indicators—including securitization volumes, interest rates, and TALF loan volume trends—suggests that the securitization markets improved for the more frequently traded TALF-eligible sectors after the program's first activity in March 2009, which is illustrated in figure 2. Figure 2 also shows that ABS issuances in all of the most liquid TALF-eligible sectors dropped sharply in 2008 from their peak levels in 2006 and 2007. Consumer credit rates have not changed significantly since TALF started. FRBNY officials said that it is possible that without TALF, interest rates on loans to consumers and small businesses would be much higher than they are now. While Treasury bears the first-loss risk from any assets that TALF borrowers might surrender in conjunction with unpaid loans, it has not developed measures to analyze and publicly report on the potential purchase, management, and sale of such assets. Without such a plan Treasury cannot measure TALF's success in meeting its goals under TARP with respect to any collateral that is placed in TALF LLC. Finally, without a plan for communicating the findings that result from tracking and analyzing such metrics, Treasury may not fully inform the public of how the assets are managed and financed, undermining Treasury's efforts to be fully transparent about TARP activities.

Figure 2: Fluctuations in ABS Issuances, First Quarter of 2005 through the Fourth Quarter of 2009



Source: GAO analysis of Thomson Reuters IFR Markets data.