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April 2, 2009

The Honorable Barney Frank
Chairman, House Financial Services Committee
House of Representatives
Washington, D.C. 20515-6143

[cc: to Representatives Kucinich, Jordan, Bachmann, …]

Dear Chairman Frank:

I am writing in reference to recent letters from a number of members of Congress requesting detailed information on individual credit extensions under a number of Federal Reserve facilities. In particular, a number of congressmen have requested information such as the names of each party receiving funds, the dates of all transactions, the amounts of transactions; the names of counterparties and amounts of all subsequent transactions between the party receiving Federal Reserve credit and their counterparties; the current disposition of the funds; the current value of collateral; and any financial gains or losses by transaction. Some letters have also asserted that the Federal Reserve's lending programs pose significant risks of waste, fraud, abuse and loss to the taxpayer.

As you know, the Federal Reserve is a strong proponent of transparency; as a public institution, we believe that transparency is important in establishing appropriate accountability to the Congress and the American people. Regarding our lending programs, the Federal Reserve now provides regular updates to the Congress every 60 days on all lending programs utilizing section 13(3) lending authorities. And very recently, we have developed a new section of the Federal Reserve's website that provides a wealth of information on our balance sheet, including detailed information on all of our liquidity programs, collateral and risk management practices, and a variety of other topics. We plan to continue to expand the range of information made available to the public on this website.

In the current economic circumstances, the Federal Reserve is committed to utilizing all available tools at its disposal to address the severe distress in financial markets and to foster economic recovery. Our various liquidity programs are an essential element in this effort. Through these programs, we have provided liquidity support to a number of critical financial markets and institutions. In particular, these programs have provided an important liquidity backstop for depository institutions, allowing them to extend credit to households and businesses with confidence they will have access to funding. Our lending programs for primary dealers have similarly supported their market activities in ways that have benefitted households and businesses by preventing a further tightening of credit market conditions. We have also established lending programs in support of money market mutual funds and the commercial paper market. These programs were essential in short circuiting the run on money funds observed in the fall of last year and the resulting severe disruption in commercial paper markets. Absent these programs, many businesses would have been constrained in their access to short-term funding and would have been forced to lay off workers and take other drastic actions to address funding shortfalls. Most recently, the Federal Reserve has launched the Term Asset Backed Securities Loan Facility (TALF) program, again with the aim of encouraging credit flows to households and businesses. The Federal Reserve and Treasury are working together to expand that program in ways that can further address the strains in credit markets, support the flow of credit to households and businesses, and stimulate economic growth. As you know, these programs are a facet of a broader governmental effort to strengthen the financial system and spur economic activity.

In all of its lending programs, the Federal Reserve exercises great care to guard against losses and thereby reduce risks to the taxpayer. In our lending to depository institutions, the Federal Reserve closely monitors the financial and supervisory condition of potential borrowers. In doing so, we maintain close contacts with other federal banking regulators. We lend only against sound collateral and we revalue collateral on a regular basis to reflect market conditions. In addition, we apply appropriate haircuts to different classes of collateral to provide an extra layer of protection in our lending. Moreover, we closely monitor collateral that is pledged to secure loans and can request that the borrower substitute collateral if necessary. Banks generally pledge a very large volume of collateral at the Federal Reserve, far exceeding the amounts borrowed. For example, as of mid-February depository institutions had pledged nearly $2 trillion in collateral in total, substantially more than the amount of aggregate lending to all depository institutions, which amounted to about $500 billion. Our lending to depository institutions is with recourse to the borrower beyond the specific collateral pledged. The Federal Reserve closely monitors the financial condition of borrowers while they are borrowing to ensure that all borrowing is within the limits established by the Federal Deposit Insurance Corporation Improvement Act (FDICIA). For all these reasons, our lending programs for depository institutions are very safe.

The Federal Reserve employs similar risk controls in our lending programs to nondepository institutions. For the Primary Dealer Credit Facility (PDCF), collateral is marked to market on a daily basis and haircuts are applied as an extra layer of protection. For the Term Securities Lending Facility (TSLF), the Federal Reserve accepts only investment-grade securities and again revalues the securities on a daily basis and applies haircuts as an extra layer of protection. In both these facilities, the Federal Reserve has recourse to the borrower beyond the specific collateral pledged. Moreover, the Federal Reserve closely monitors the financial condition of primary dealers and consults with other supervisory agencies in this process. For the Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility (AMLF), we lend only for short terms to institutions in sound financial condition against highly rated asset-backed commercial paper. For the Commercial Paper Funding Facility (CPFF), we accept only highly rated short-term commercial paper, and borrowers pay an upfront fee to cover potential losses; unsecured commercial paper acquired in the CPFF is subject to an additional fee, guarantee, or collateral requirements. For the Term Asset-Backed Securities Loan Facility (TALF), we accept only AAA-rated asset-backed securities and substantial haircuts are applied.

Our analysis indicates that it is very unlikely that the federal government will incur losses in any of the liquidity programs established for nondepository institutions.

Publicly releasing information on individual transactions of the type requested by various members of Congress would seriously undermine our liquidity programs. As I have discussed on previous occasions, it is absolutely essential that participants in our liquidity programs remain confident that their usage of these programs will be held in confidence. If borrowers instead fear that market participants and others may learn about their usage of these programs, they will be less inclined to borrow with serious repercussions for financial markets and the economy. This is not just a theoretical possibility. When the strains in financial markets erupted in August of 2007, the Federal Reserve took actions to make it easier and less costly for banks to borrow term funds under the existing primary credit program. But banks were quite reluctant to utilize the primary credit program out of concern that their borrowing would be discovered by market participants and interpreted as a sign of financial weakness. Indeed, that stigma rendered the primary credit program largely ineffective in countering the liquidity pressures at that time, and prompted the Federal Reserve to establish the Term Auction Facility and other programs to more directly address liquidity pressures. Releasing information on individual borrowing transactions to the public would almost certainly stigmatize all of our liquidity programs. The resulting concerns about liquidity and rollover risks would constrain access to funding for many borrowers, leading to a further tightening in the terms of credit for households and businesses and a scaling back in other activities that contribute to economic activity and employment. Asset prices, including home values, would decline, further exacerbating the economic difficulties that we now face. For all these reasons, I believe strongly that releasing information of the type requested would be inconsistent with the Federal Reserve's statutory mandate to pursue maximum employment and stable prices.

The Federal Reserve recognizes its obligation as a steward of public resources. It is worth noting in this regard that our liquidity programs are not being financed out of tax revenues or additional federal debt. Rather, our liquidity programs are currently being financed through the creation of additional reserve balances that are held by depository institutions. These reserve balances will be extinguished when the economy recovers and the liquidity programs are unwound.

We make every effort to eliminate the potential for waste, fraud, and abuse and cost to the taxpayer. Auditors at each Reserve Bank assess risks, internal controls and governance processes and report their findings directly to the audit committee of the Reserve Bank Boards of Directors. Reserve Banks voluntarily comply with the requirements of the Sarbanes-Oxley Act involving internal controls. The Board conducts regular reviews of Reserve Bank operations in its System oversight capacity. The Federal Reserve is also subject to extensive external review; as of March, the General Accounting Office was conducting 20 audits of the Federal Reserve System, many of which were requested by members of Congress. The Federal Reserve produces detailed financial statements that are audited by independent outside auditors and made available to the Congress and to the public annually. The Federal Reserve's audited financial statements for 2008—prepared by Deloitte and Touche—will be made public later this month. The Federal Reserve also closely reviews its risks and internal controls. The Federal Reserve Office of the Inspector General (OIG) conducts independent reviews of the System and provides a semiannual report to Congress. The OIG is currently in the preliminary stage of a review of Federal Reserve liquidity programs.

In summary, the Federal Reserve has been transparent about its liquidity programs and has been subject to considerable oversight. We also believe that it would be inappropriate and indeed damaging to publicly release the detailed information on our liquidity programs that has been requested by various members of Congress. However, notwithstanding these concerns, if the Congress believes that gaining access to such detailed information is essential, we could explore ways that such information could be provided on a confidential basis with appropriate controls. If this option is of interest, I would suggest that members of our staffs meet soon to discuss this issue and develop a mutually acceptable approach.

Thank you for your assistance in this matter.

Sincerely,