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CONGRESSIONAL OVERSIGHT PANEL
MAY OVERSIGHT REPORT

REVIVING LENDING TO SMALL BUSINESSES AND FAMILIES AND THE IMPACT OF THE TALF

[GRAPHIC] [TIFF OMITTED]

May 7, 2009.--Ordered to be printed

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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CONGRESSIONAL OVERSIGHT PANEL
Panel Members
Elizabeth Warren, Chair
Sen. John Sununu
Rep. Jeb Hensarling
Richard H. Neiman
Damon Silvers

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EXECUTIVE SUMMARY

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.

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* 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.

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 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.

SECTION ONE: REVIVING LENDING TO SMALL BUSINESSES AND FAMILIES AND THE IMPACT OF THE TALF

A. Introduction

Since the financial crisis began, the connection between ``Wall Street'' and ``Main Street'' has been a constant concern. The TARP, and the Administration's broader Financial Stability Plan, will be successful only if they can revive lending on economically appropriate terms to meet the credit needs of the American people. These needs include credit for small businesses, and credit card, student, and auto (and similar) loans for families.

Treasury has recognized that restoring such lending has multiplier effects throughout the economy:

> Restarting our economy and job creation requires * * * ensuring through our new Financial Stability Plan that businesses with good ideas have the credit to grow and expand, and working families can get the affordable loans they need to meet their economic needs and power an economic recovery.\1\

\1\ U.S. Department of the Treasury, Fact Sheet: Financial Stability Plan (Feb. 10, 2009) (online at www.financial stability.gov/docs/ fact-sheet.pdf) (hereinafter ``Treasury Fact Sheet'').

And since their inception, efforts to rescue the financial system and restore health to the economy have emphasized the restoration of lending, and hence credit availability, in several ways.

Treasury's original focus--used to justify passage of the TARP--was removing illiquid mortgage-based assets that were ``parked, or frozen, on the balance sheets of banks and other financial institutions, preventing them from financing productive loans.'' \2\ In early October 2008, soon after the enactment of TARP,\3\ Treasury moved instead to more drastic action to improve bank balance sheets by making direct capital

infusions to provide funds for lending and restore credit availability under the CPP, Systemically Significant Failing Institutions Program (SSFI), Targeted Investment Program (TIP), and Capital Assistance Program (CAP).

\2\ U.S. Department of the Treasury, Remarks of Secretary Paulson on Comprehensive Approach to Market Developments (Sept. 19, 2008) (online at www.financialstability.gov/latest/hp1149.html). The plan to free bank balance sheets of the overhang of poor loans made during the real estate bubble has been reborn in the Public-Private Investment Program, announced on March 23, 2009. See U.S. Department of the Treasury, Treasury Department Releases Details on Public Private Partnership Investment Program (Mar. 23, 2009) (online at www.treas.gov/press/releases/tg65.htm).

\3\ Congress provided Treasury the authority to establish TARP in the Emergency Economic Stabilization Act of 2008 (EESA), Pub. L. No. 110-343.

In late November 2008, the Federal Reserve Board announced the creation of a new initiative aimed at securitization markets, the TALF, which it described as ``a facility that will help market participants meet the credit needs of households and small businesses by supporting the issuance of asset-backed securities (ABS) collateralized by student loans, auto loans, credit card loans, and loans guaranteed by the Small Business Administration (SBA).'' \4\

\4\ Board of Governors of the Federal Reserve System, Press Release (Nov. 25, 2008) (online at www.federalreserve.gov/newsevents/press/monetary/20081125a.htm).

A week earlier, the Interim Assistant Secretary of the Treasury for Financial Stability, Neel Kashkari, had noted that ``[t]he consumer securitization market appears to be a promising opportunity'' and that re-starting these markets ``would help bring down rates of auto loans, credit cards and student loans and could be achieved with a more modest allocation from the TARP.'' \5\ Over the ensuing months Treasury and the Federal Reserve Board have emphasized revival of the securitization markets, not simply basic bank lending, to restore the flow of credit to businesses and families.

\5\ U.S. Department of the Treasury, Remarks of Interim Assistant Secretary Neel Kashkari on Implementation of the Emergency Economic Stabilization Act (Nov. 19, 2008) (online at www.financialstability.gov/latest/hp1281.html).

In the last 25 years, securitization has played an increasing role in the financing of government-guaranteed SBA and family lending; its impact is not uniform--for example most small business loans are not securitized. The TALF originally allocated up to $200 billion to provide highly advantageous loans--loans that shift most of the risk to the taxpayer--to bring investors back into those markets to buy securities backed by small business and family loans. 90 percent of the funding for this initiative comes from the Federal Reserve System (with a ten percent back-up from the TARP). Yet despite the availability of loans from the Federal Reserve Bank of New York (FRBNY) on those favorable terms, investor demand for TALF loans has only begun to move toward expected levels in the third month of TALF offerings.

Understanding the reasons for the TALF's sluggish start requires examining the program's design and the investment and loan markets it tries to bring together. On a more basic level, evaluating efforts to revive credit availability for small businesses and families through the TALF requires understanding those borrowers themselves.

These issues are the subjects of the Panel's May oversight report. The report looks first at the credit needs of small business and household borrowers and the problems they face in trying to obtain that credit. It then examines how securitization works, the relative importance of securitization in both small business and household lending, and the terms and early operation of the TALF, as well as securitization's potential strengths and weaknesses, all through the lenses of small business and family lending. (In the report, the term ``family lending'' refers to the type of credit that families are most likely to require: credit card, student, and auto loans.)

B. Small Business Lending

1. THE IMPORTANCE OF SMALL BUSINESSES IN THE U.S. ECONOMY

Congress has defined small businesses as those that are: (1) organized for profit; (2) independently owned and operated; (3) not dominant in their field of operation; and (4) under a

certain size.\6\ The SBA sets specific size standards for various industries based on either revenue streams or number of employees.\7\ As a result of industry-specific standards, the scale of a small business in one industry may look very different from the scale of a business in another. For example, while a retail company must have less than $7 million in annual revenue to be a small business, a construction company must have less than $33.5 million in annual revenue. While a manufacturing company must have fewer than 500 employees to qualify as a small business, a wholesale company must have fewer than 100 employees.\8\

\6\ Small Business Act of 1953, Pub. L. No. 85-536 (codified at 15 U.S.C. 632(a)).

\7\ See U.S. Small Business Administration, Size Standards (online at www.sba.gov/contracting opportunities/officials/size/index.html) (accessed May 5, 2009).

\8\ U.S. Small Business Administration, Size Standards FAQ's (online at www.sba.gov/contractingopportunities/officials/size/SIZE_STANDARDS_FAQS.html) (accessed May 5, 2009).

However, policymakers and businesspeople have long debated the precise definition of a small business. This debate has resulted in various government agencies using means and methods of defining small businesses that differ from those used by the SBA. For example, the Internal Revenue Service has developed a definition that designates partnerships and corporations (including S corporations) with assets of $5 million or less--as well as all sole proprietorships--as small businesses.\9\ Other programs designed to help small businesses use more fluid, conceptual definitions.\10\

\9\ Government Accountability Office, Tax Administration: IRS Faces Several Challenges As It Attempts To Better Serve Small Businesses, at 3 (Aug. 2000) (GAO/GGD-00-166) (online at www.gao.gov/archive/2000/gg00166.pdf).

\10\ National Federation of Independent Business, Small Business Policy Guide (online at www.nfib.com/tabid/56/Default.aspx?cmsid=13787&v=1) (accessed May 5, 2009).

Although the SBA's definition is not universal, it is the most instructive for the purposes of this report, given the SBA's role in expanding credit for small businesses. Moreover, the Small Business Act states that ``unless specifically authorized by statute, no Federal department or agency may prescribe a size standard for categorizing a business concern as a small business concern, unless such proposed size standard'' is approved by the SBA Administrator.\11\

\11\ Small Business Act, supra note 6 (codified at 15 U.S.C. 632(a)(2)(C).

Under any definition, small businesses play a vital role in the U.S. economy, and their health in the months ahead will be a necessary precondition for economic recovery. They are not only the engines of innovation--many of the largest corporations began as small businesses--but they are also America's largest job producers. Today, more than six million small business employers collectively employ more than half of all private-sector workers.\12\ Small businesses have generated more than half of all new jobs over the past ten years; from 2004-2005, they created 78.9 percent of new jobs.\13\ Moreover, small businesses produce about half of the nation's private, nonfarm GDP.\14\

\12\ U.S. Small Business Administration, Small Business Profile (online at www.sba.gov/advo/research/profiles/08us.pdf) (accessed May 5, 2009) (hereinafter ``SBA Small Business Profile''). For state-specific small business employment statistics, see U.S. Small Business Administration, Small Business Profiles for the States and Territories (online at www.sba.gov/advo/research/profiles) (accessed May 5, 2009).

\13\ SBA Small Business Profile, supra note 12; Senate Committee on Small Business and Entrepreneurship, Testimony of Member of the Board of Governors of the Federal Reserve System Frederic S. Mishkin, The Impact of the Credit Crunch on Small Business, 110th Cong. (Apr. 16, 2008) (online at sbc.senate.gov/hearings/testimony/080416-Mishkin-testimony.pdf) (hereinafter ``Mishkin Testimony'').

\14\ SBA Small Business Profile, supra note 12.

To that end, Secretary of the Treasury Timothy Geithner recently met with small business owners to emphasize their importance to the economy and discuss the Administration's efforts to support them under the Financial Stability Plan. At that time, Secretary Geithner stated that:

> Small businesses are the engine of America's dynamism. You create and sustain most of the jobs in this country. You are the anchor of our communities,

and you are ever more linked to the global economy. You take the germ of an idea and transform it into products and services that make America more productive. When you prosper the nation prospers. And when the national economy is hurting, you bear that burden heavily.\15\

\15\ U.S. Department of the Treasury, Remarks of Secretary Geithner: Unlocking Credit for Small Businesses (Mar. 16, 2009) (online at www.treas.gov/press/releases/reports/tg58_tfg_smallbiz_remarks.pdf) (hereinafter ``Geithner Small Business Remarks'').

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2. SOURCES OF SMALL BUSINESS LENDING

Credit offers essential funds to entrepreneurs by injecting capital for setting-up shop, financing inventory and operations during payment cycles, maintaining operations during slow seasons or downturns, and expanding operations when business booms. Generally, small businesses formally obtain credit through: (1) a conventional loan; (2) an SBA-guaranteed loan; or (3) credit cards. Other sources of capital include personal home equity lines of credit; personal savings; or informal, nonbank lending from small-scale ``angel'' investor networks or friends and family.\16\

\16\ See National Small Business Association, 2008 Year-End Economic Report, at 6 (2008) (online at www.nsba.biz/docs/08trend_eoy.pdf) (hereinafter ``NSBA 2008 Report''). The NSBA survey indicated that 16 percent of small businesses used private, individual loans for financing during 2008. Id.

Through a conventional loan, a bank provides capital to a small business in exchange for regular interest payments and collateral. While this form of loan is most desirable for small business owners, it can be difficult to obtain. One recent survey found that only 44 percent of small business owners relied on bank loans to finance their business operations.\17\ Even in times of economic growth, entrepreneurs may fail to acquire a conventional loan because their credit score is too low, their endeavor is too risky, or they lack fixed assets to provide collateral.\18\ Additionally, small businesses are also more likely than larger businesses to be affected by ``credit rationing,'' which occurs when lenders lack sufficient information to differentiate between creditworthy and non-creditworthy borrowers, resulting in the possibility of creditworthy borrowers being denied access to credit along with non-creditworthy borrowers.\19\ In times of downturn, access to credit shrinks even further, and otherwise creditworthy entrepreneurs may fail to acquire traditional loans--or even lose already open lines of credit--as banks tighten lending.

\17\ Id. at 6.

\18\ In determining whether to award a loan to a small business, banks generally consider: (1) a company's balance sheet and income statements; (2) the quality of available collateral; (3) the creditworthiness of the company's principal; and/or (4) proprietary information gained in past dealings. Kenneth Temkin and Roger C. Kormendi, U.S. Small Business Administration, An Exploration of a Secondary Market for Small Business Loans, at 6 (Apr. 2003) (online at www.sba.gov/advo/research/rs227_tot.pdf).

\19\ Government Accountability Office, Small Business Administration: Additional Measures Needed to Assess 7(a) Loan Program's Performance, at 4 (July 2007) (GAO07/769) (online at www.gao.gov/new.items/d07769.pdf) (hereinafter ``2007 GAO 7(a) Report'').

If a small business fails to obtain a conventional loan, it can seek a loan with the assistance of the SBA. The SBA has two major small business loan programs. First, under its 7(a) program, the SBA is authorized to guarantee $17.5 billion worth of loans each year for working capital. Second, under its 504 program, the SBA is authorized to guarantee $7.5 billion of loans for the development of small assets such as land, buildings, and equipment that will benefit local communities.\20\ While SBA programs have helped promote lending to small businesses, SBA-guaranteed loans constitute only a small percentage of total small business lending.\21\ In a recent survey of small business owners, only three percent reported using SBA-guaranteed loans in 2008.\22\ Moreover, the Government Accountability Office (GAO) has calculated that, in recent years, only about four percent of the total value of outstanding small business loans is guaranteed through the 7(a) program.\23\ As a result, any government strategy to promote small business access to credit must address conventional loans and other sources of credit in addition to SBA-guaranteed loans.

\20\ 504 projects are generally made up of a senior lien of up to

50 percent from a private lender combined with a junior lien of up to 40 percent from a certified development company with at least ten percent equity from the small business. The junior lien is backed by a 100 percent SBA-guaranteed debenture.

\21\ The SBA approved $23 billion of loans in FY 2007 and, at around the same time, estimated that total small business loans outstanding at that time were valued at $684.6 billion. U.S. Small Business Administration, Table 2--Gross Approval Amount by Program (online at www.sba.gov/idc/groups/public/documents/sba_homepage/serv_bud_lperf_grossapproval.pdf) (accessed May 5, 2009); U.S. Small Business Administration, Small Business and Micro Business Lending in the United States, for Data Years 2006-2007, at 3 (June 2008) (online at www.sba.gov/advo/research/sbl_07study.pdf) (hereinafter ``Small Business and Micro Business Lending'').

\22\ NSBA 2008 Report, supra note 16, at 6.

\23\ 2007 GAO 7(a) Report, supra note 19, at 7. In an appendix to that report, GAO explains how this calculation was made: ``To compare the number and amount of outstanding small business loans to 7(a) loans, we used the [FDIC call reports] for U.S. banks . . . We considered the call report data on loans under $1 million to be a proxy for general small business loans, even though there is no attempt to directly link the loans to the size of the firm accessing credit in the call report data.'' Id.

Small businesses that fail to acquire traditional or SBA-backed loans often obtain credit through credit cards. However, small business owners generally view credit cards as undesirable because of their high interest rates and frequently changing terms.\24\ Although the total outstanding value of credit card loans to small businesses is unknown, survey information sheds light on trends in this type of lending. While 44 percent of small business owners identified credit cards as a source of their financing in a 2008 survey, only 16 percent did so 15 years earlier.\25\ Additionally, the Federal Reserve Board's 2007 Survey of Consumer Finances found that credit card debt has risen sharply for the self-employed in recent years.\26\ The increasing use of credit cards by small businesses has concerned policymakers for years, but the current crisis has reinforced the importance of a healthy market for conventional and SBA-guaranteed loans.

\24\ Senate Committee on Small Business and Entrepreneurship, Testimony of President of the National Small Business Association Todd McCracken, Perspectives from Main Street on Small Business Lending, 111th Cong., at 5 (Mar. 19, 2009) (online at sbc.senate.gov/hearings/testimony/09_03_19_credit_hearing/NSBATestimony.pdf) (hereinafter ``McCracken Testimony'').

\25\ Id. at 4; Board of Governors of the Federal Reserve System, Changes in U.S. Family Finances from 2004 to 2007: Evidence from the Survey of Consumer Finances, Federal Reserve Bulletin, at 45 (Feb. 2009) (online at www.federalreserve.gov/pubs/bulletin/2009/pdf/scf09.pdf) (hereinafter ``Survey of Consumer Finance'').

\26\ Survey of Consumer Finance, supra note 25, at A38 and A40.

While formal sources of credit are an important asset for small businesses, they are often complemented by informal sources. Of particular relevance to the current crisis is the extent to which small business owners take out loans collateralized by real estate assets, often their own homes. The Survey of Consumer Finances found that 18 percent of households that own and actively manage a small business use personal assets to guarantee or collateralize business loans.\27\ These Federal Reserve Board data also indicate that self-employed persons are more likely to have a home equity line of credit and to have accessed it.\28\ Further, the Federal Reserve Board's 2003 Survey of Small Business Finances--the most recent survey conducted--found that 15 percent of the total value of small business loans in that year was collateralized by personal real estate.\29\ More recently, the National Federation of Independent Business (NFIB) found in its 2008 Small Business Poll that 22 percent of small businesses responding to the survey had taken out at least one mortgage to fund business activities, with 16 percent using real estate to collateralize other business assets and ten percent using their personal homes as collateral.\30\ Although this source of credit creates considerable risk under any economic conditions, small business owners are particularly vulnerable when home equity evaporates with declining property values.

\27\ House Committee on Small Business, Testimony of Member of the Board of Governors of the Federal Reserve System Randall S. Kroszner, Effects of the Financial Crisis on Small Business, 110th Cong. (Nov. 20, 2008) (online at www.federalreserve.gov/newsevents/testimony/kroszner20081120a.htm) (hereinafter ``Kroszner Testimony'').

\28\ Survey of Consumer Finances, supra note 25, at A44.

\29\ Kroszner Testimony, supra note 27.

\30\ National Federation of Independent Business, National Small

Business Poll, at 1 (2008) (online at www.411sbfacts.com/files/Access%20to%20Credit.pdf) (hereinafter ``NFIB Small Business Poll'').

The exact volume of small business financing that comes from each of these sources can be difficult to determine beyond the rough sketches that survey results provide. For example, a home equity line of credit extended to an individual is functionally indistinguishable from one extended to an entrepreneur. Similarly, a loan from an angel investor, friend, or family member will not appear on a bank's call report, nor will drawing down on personal savings in order to finance small business activity. Despite this difficulty, any analysis of the availability of small business financing must account for these various sources.

3. THE CURRENT CREDIT CRUNCH

In contrast to large corporations, small businesses are generally less able to access the capital markets directly and thus are more vulnerable to a credit crunch.\31\ The result of reduced access to credit can be that too few small businesses start and too many stall--a combination that can hinder economic growth and prolong economic downturn.

\31\ Federal Reserve Bank of San Francisco, FRBSF Economic Letter: How Will a Credit Crunch Affect Small Business Finance, at 1 (Mar. 6, 2009) (online at www.frbsf.org/publications/economics/letter/2009/el2009-09.pdf).

Throughout 2008, small business lenders and borrowers reported signs of a credit slowdown. This process of tightening credit for small businesses began in early 2008 and worsened over the course of the year. Whereas only 5-10 percent of bank officers reported tightening standards for small businesses throughout 2007 in the Federal Reserve Board's Senior Officer Opinion Survey, that number jumped to 30 percent in January 2008.\32\ Bank officers continued to report tightening standards throughout 2008, with 50 percent reporting tighter standards in April \33\ and almost 70 percent in July.\34\ In January 2009, 70 percent continued to report tighter standards.\35\ Moreover, a large percentage of banks also reported that they had increased the cost of the credit they did provide.\36\ Following this period of widespread and well reported tightening in small business lending standards, small businesses have continued to face even further tightening. In the April survey, 40 percent of banks reported tightening standards and no banks reported easing them.\37\

\32\ Board of Governors of the Federal Reserve System, The January 2007 Senior Loan Officer Opinion Survey on Bank Lending Practices (Feb. 2007) (online at www.federalreserve.gov/boarddocs/snloansurvey/200701/fullreport.pdf) (7.1 percent); Board of Governors of the Federal Reserve System, The April 2007 Senior Loan Officer Opinion Survey on Bank Lending Practices (May. 2007) (online at www.federalreserve.gov/boarddocs/snloansurvey/200705/fullreport.pdf) (3.8 percent); Board of Governors of the Federal Reserve System, The July 2007 Senior Loan Officer Opinion Survey on Bank Lending Practices (Aug. 2007) (online at www.federalreserve.gov/boarddocs/snloansurvey/200708/fullreport.pdf) (9.6 percent); Board of Governors of the Federal Reserve System, The October 2007 Senior Loan Officer Opinion Survey on Bank Lending Practices (Nov. 2007) (online at www.federalreserve.gov/boarddocs/snloansurvey/200711/fullreport.pdf) (9.6 percent); Board of Governors of the Federal Reserve System, The January 2008 Senior Loan Officer Opinion Survey on Bank Lending Practices (Feb. 2008) (online at http://www.federalreserve.gov/boarddocs/snloansurvey/200801/fullreport.pdf) (30.4 percent).

\33\ Board of Governors of the Federal Reserve System, The April 2008 Senior Loan Officer Opinion Survey on Bank Lending Practices (May 2008) (online at www.federalreserve.gov/boarddocs/snloansurvey/200805/fullreport.pdf).

\34\ Board of Governors of the Federal Reserve System, The July 2008 Senior Loan Officer Opinion Survey on Bank Lending Practices (Aug. 2008) (online at www.federalreserve.gov/boarddocs/snloansurvey/200808/fullreport.pdf).

\35\ Federal Reserve Board, The January 2009 Senior Loan Officer Opinion Survey on Bank Lending Practices (Feb. 2009) (online at www.federalreserve.gov/boarddocs/snloansurvey/200902/fullreport.pdf) (``the net fractions of respondents that reported having tightened their lending policies on all major loan categories over the previous three months stayed very elevated.''). See also Board of Governors of the Federal Reserve System, The October 2008 Senior Loan Officer Opinion Survey on Bank Lending Practices (Nov. 2008) (online at www.federalreserve.gov/boarddocs/snloansurvey/200811/fullreport.pdf).

\36\ Id.

\37\ Board of Governors of the Federal Reserve System, The April 2009 Senior Loan Officer Opinion Survey on Bank Lending Practices (May 2009) (online at www.federalreserve.gov/boarddocs/snloansurvey/200905/fullreport.pdf) (hereinafter ``April Senior Loan Officer Opinion

Survey'').

Not surprisingly, small businesses have reported being at the other end of the tightening. In a November 2008 survey of small business owners, 85 percent of respondents reported feeling the impact of the credit crunch.\38\ In a separate survey at around the same time, nearly half of small businesses that had applied for credit in the prior two months reported being unable to obtain the full amount they requested.\39\ Despite TARP and other government actions, small business owners continued to express concerns in more recent surveys. In an April 2009 survey, for example, only 29 percent of small business owners surveyed by the NFIB reported that all their borrowing needs were met.\40\

\38\ McCracken Testimony, supra note 24, at 1.
\39\ NFIB Small Business Poll, supra note 30, at 1.
\40\ National Federation of Independent Business, Small Business Economic Trends, at 2 (Apr. 2009) (online at www.nfib.com/Portals/0/PDF/sbet200904.pdf) (hereinafter ``NFIB Small Business Economic Trends'').

The National Small Business Association (NSBA) has also reported that it ``has heard anecdotally from small business owners across the country who have had a credit-card limit or line of credit arbitrarily reduced due to no fault of their own.'' \41\ Similarly, the Panel found compelling reports of slowed lending at its recent field hearing in Milwaukee, Wisconsin.\42\ At that hearing, small business owners discussed their lack of access to credit in recent months. One small business owner noted that, even though he has kept current with all obligations, his business's ``situation is urgent and time is of the essence as [his] financial institution has given [him] a very short deadline to pay approximately $2,000,000.00 or they will call [his] loans and [he] will be placed out of business.'' \43\ Another expressed frustration that, since September 2008, he has had to spend all his time ``working on funding the company rather than addressing opportunities to grow.'' \44\

\41\ Id, at 6.
\42\ Congressional Oversight Panel, Hearing on the Credit Crisis and Small Business Lending (Apr. 29, 2009) (online at cop.senate.gov/hearings/library/hearing-042909-milwaukee.cfm) (full audio recording) (hereinafter ``Panel Milwaukee Field Hearing'').
\43\ Congressional Oversight Panel, Testimony of Wayne Perrins, Hearing on the Credit Crisis and Small Business Lending (Apr. 29, 2009) (online at cop.senate.gov/documents/testimony-042909-perrins.pdf) (hereinafter ``Perrins Testimony'').
\44\ Congressional Oversight Panel, Testimony of Thomas Klink, Hearing on the Credit Crisis and Small Business Lending (Apr. 29, 2009) (online at cop.senate.gov/documents/testimony-042909-klink.pdf) (hereinafter ``Klink testimony''). While two witnesses representing community banks emphasized that they have continued to lend throughout the crisis, they acknowledged that they have had no choice but to pursue new opportunities cautiously.

SBA lending has also declined considerably, even though those loans can provide a fallback for business owners who fail to obtain conventional loans. The tightening of credit in the SBA lending markets mirrored the tightening of credit in conventional markets for small business loans, with loan volume decreasing over the course of 2008. By the end of March of 2008 (the halfway point in FY 2008 for the SBA's purposes), the SBA had guaranteed 18 percent fewer 7(a) loans and six percent fewer 504 loans than it had guaranteed at the same point a year earlier.\45\ At the conclusion of FY 2008, volume was down by 30 percent in the 7(a) program and 17 percent in the 504 program when compared to FY 2007.\46\ The decline in SBA lending became even more pronounced in the early months of FY 2009. From October through December of 2008, the SBA guaranteed 57 percent fewer 7(a) loans and 46 percent fewer 504 loans than it did during that period the year before.\47\

\45\ U.S. Small Business Administration, SBA--Business Loan Approval (online at www.sba.gov/loans/business/regionaw.html) (accessed May 5, 2009).
\46\ Id.
\47\ Id. See also McCracken Testimony, supra note 24, at 2.

While surveys, anecdotal information, and SBA data can be instructive, actual data on overall small business lending rates are limited. In particular, a review of available sources of data on small business lending reveals that there is currently no comprehensive, timely source of information on small business lending trends and terms. This lack of data not only makes it difficult to identify problems or assess the depth of problems, but it also makes it difficult to evaluate

attempted policy solutions. The difficulty of tracking less visible sources of credit for small businesses, such as home equity lines of credit, personal credit cards, and loans from friends, family, and angel investors, compounds these difficulties.

Despite the limited availability of data on small business lending, there is general consensus that lending has decreased. Nonetheless, policymakers have debated the extent to which various factors have contributed to the contraction of small business lending. Some small business owners and commentators have emphasized the impact of bank policies and tougher lending standards.\48\ At the Panel's recent field hearing in Milwaukee, Wisconsin, one small business owner emphasized that he had been unable to find a bank to lend even with an SBA guarantee up to 90 percent and despite his past reliability in keeping current on his payments.\49\ On the other hand, some observers have suggested that reduced lending results more from two byproducts of the economic climate: reduced demand as small businesses have retrenched and hesitated to take on additional debt; and the deteriorating creditworthiness of borrowers.\50\ One of the community bankers who testified at the Panel's field hearing suggested that many of his customers are ``looking for opportunities beyond the moment, but proceeding very cautiously.'' \51\ Larger banks have also pointed to reduced demand as an explanation for the slowdown.\52\ Of course, these various explanations are not mutually exclusive and can in fact reinforce each other. For example, poor access to credit for a business, its suppliers, and its customers can weaken that business's finances and ultimately its creditworthiness.

\48\ See, e.g., McCracken Testimony, Supra note 24.

\49\ Congressional Oversight Panel, Testimony of David Griffith, Hearing on the Credit Crisis and Small Business Lending (Apr. 29, 2009) (online at cop.senate.gov/documents/testimony-042909-griffith.pdf) (discussing explanations that banks provided for why they would not lend to his business even if the SBA guaranteed his loan) (hereinafter ``Griffith Testimony'').

\50\ See, e.g., NFIB Small Business Economic Trends, supra note 40, at 2 (``Certainly fewer loans are being made, but a substantial share of the decline is due to lower demand, not unusual problems on the supply side. It is harder to find creditworthy borrowers these days. Record sales declines have a way of weakening balance sheets.''). While demand has likely increased for loans to help businesses maintain operations despite decreased revenues, it has likely decreased for expansion projects.

\51\ Congressional Oversight Panel, Testimony of Robert Atwell, Hearing on the Credit Crisis and Small Business Lending (Apr. 29, 2009) (online at cop.senate.gov/documents/testimony-042909-atwell.pdf) (hereinafter ``Atwell Testimony'').

\52\ Senate Committee on Small Business and Entrepreneurship, Testimony of Wells Fargo Bank's Executive Vice President of SBA Lending David Rader, Hearing on Perspectives from Main Street on Small Business Lending, at 3(Mar. 19, 2009) (online at sbc.senate.gov/hearings/testimony/09_03_19_credit_hearing/Rader.pdf) (``With the future unclear as it is today, customers aren't borrowing money like they use to . . . Our credit-approved customers are halting their projects, cancelling their loan and walking away from their dreams prior to their scheduled loan closing.'').

Moreover, as they have worked to stabilize the economy, policymakers have also spent considerable time debating the optimal level of lending moving forward.\53\ While additional lending can potentially benefit the economy and help restore economic growth, weak underwriting standards and excessive high-risk lending contributed to the current crisis by increasing default rates. When discussing small business lending levels with bankers in March, Secretary Geithner suggested that ``[m]any banks in this country took too much risk, but the risk now to the economy as a whole is that you will take too little risk.'' \54\ Because setting the appropriate lending level is not certain and also politically charged, banks long have expressed concern about receiving mixed signals from regulators calling for more lending on the one hand and reduced risk-taking on the other.\55\ Ultimately, not until banks strike an appropriate balance of risk--providing credit to creditworthy borrowers while guarding against the excesses that lie at the core of the current crisis--will the credit crunch for small businesses be resolved.

\53\ See, e.g. House Financial Services Committee, Hearing on Exploring the Balance Between Increased Credit Availability and Prudent Lending Standards, 111th Cong. (Mar. 25, 2009) (online at www.house.gov/apps/list/hearing/financialsvcs_dem/hr030409.shtml).

\54\ Geithner Small Business Remarks, supra note 15.

\55\ The American Bankers Association has argued that banks have had to reduce lending to satisfy regulators. Senate Committee on Small Business and Entrepreneurship, Testimony of Chief Economist of the

American Bankers Association James Chessen, Hearing on Perspectives from Main Street on Small Business Lending, 111th Cong., at 5 (Mar. 19, 2009) (online at sbc.senate.gov/hearings/testimony/09_03_19_credit_hearing/Chessen.pdf).

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4. TARP AND SMALL BUSINESS LENDING

Treasury's programs to expand access to credit for small businesses can be separated into three basic categories: (1) those designed to stabilize banks through capital injections and consequently to keep credit flowing; (2) those designed to incentivize banks to participate in SBA programs; and (3) those designed to restore secondary markets for securitized loans guaranteed by the SBA. While the last category will be addressed at length in the TALF section of this report, the first two are the focus of this section.

The principal Treasury program to provide banks with capital has been the CPP. Under the CPP, capital injections have been weighted toward large, complex, ``systemically significant'' financial institutions. This was particularly the case during the early days of TARP.\56\ In 2008, 83.5 percent of TARP dollars spent by Treasury through the CPP went to 20 banks.\57\ That has potential implications for small business lending because small, regional, and community banks lend a disproportionately large share of small business loans. Specifically, the SBA has calculated that, in 2007, banks with $10 billion or less in total assets held 24.42 percent of total domestic bank assets yet provided 52.18 percent of the total value of small business loans made by banks.\58\ Larger banks--those with more than $10 billion in total assets--held 75.59 percent of total assets and made 47.81 percent of the total amount of small business loans made by banks.\59\

\56\ See Congressional Oversight Panel, Accountability for the Troubled Asset Relief Program, at 5 (Jan. 9, 2009) (online at cop.senate.gov/documents/cop-010909-report.pdf) (``While a total of 317 financial institutions have received a total of $194 billion under the CPP as of January 23, 2009, eight large early investments represent $124 billion, or 64 percent of the total'').

\57\ See Government Accountability Office, Troubled Asset Relief Program: March 2009 Status of Efforts to Address Transparency and Accountability Issues, at 55 (Mar. 31, 2009) (GAO09/504) (online at www.gao.gov/new.items/d09504.pdf) (hereinafter ``March GAO Report''); U.S. Department of the Treasury, Troubled Asset Relief Program: Transaction Report for the Period Ending December 31, 2008 (Jan. 5, 2009) (online at www.financialstability.gov/docs/CPP/001-05-08CPPChart.pdf). From these documents, it can be determined that the 20 largest recipients of CPP funding had received $156.6 billion of $187.5 billion spent under the CPP through December 31, 2008.

\58\ In these calculations, the SBA defines a small business loan as a commercial and industrial loan under $1 million. SBA Small Business and Micro Business Lending, supra note 21.

\59\ Id. at 6.

Perhaps in recognition of that dynamic, Treasury has sought to put pressure on recipients of funds under the CPP to increase lending to small businesses. Secretary Geithner has urged all banks, regardless of whether or not they have received capital through the TARP, to make an ``extra effort'' to reach out to creditworthy small businesses.\60\ Indirectly, Treasury has expanded reporting requirements for TARP recipients, presumably so it can bring public attention and possibly its own pressures to bear on institutions that do not provide adequate lending. Beginning with their April lending reports, Treasury will require the 21 largest banks receiving money through the TARP to report small business lending activity on a monthly basis. Also, Treasury announced that it will work with bank regulators to require all banks to report small business lending data in their quarterly call reports, as opposed to once a year, in order to allow for more accurate, real-time analysis of the impact of efforts to expand small business access to credit.\61\ The Panel has called on Treasury to expand its efforts to track data on lending by TARP recipients since its first report last December,\62\ and GAO and the Special Inspector General for TARP (SIGTARP) have done the same.\63\

\60\ U.S. Department of the Treasury, Fact Sheet: Unlocking Credit for Small Businesses (Mar. 17, 2009) (online at www.financial stability.gov/road to stability/unlocking Creditfor Small Businesses.html) (hereinafter ``Treasury Small Business Fact Sheet'').

\61\ Id. See also House Financial Services Committee, Testimony of Office of the Comptroller of the Currency Deputy Comptroller of the Northeast District Toney Bland, Hearing on Seeking Solutions: Finding Credit for Small and Mid-Size Businesses in Massachusetts, 111th Cong., at 6 (Mar. 23, 2009) (online at www.occ.gov/ftp/release/2009-30b.pdf) (noting that ``Bank regulators are currently in the process of revising

the quarterly Report of Condition'' to require banks to provide
quarterly data on small business lending.).
    \62\ Congressional Oversight Panel, Questions About the $700
Billion Emergency Economic Stabilization Funds, at 17 (Dec. 10, 2008)
(online at cop.senate.gov/documents/cop-121008-report.pdf) (hereinafter
``COP December Oversight Report'').
    \63\ March GAO Report, supra note 57, at 59; SIGTARP, Initial
Report to Congress, at 25 (Feb. 6, 2009) (online at www.sigtarp.gov/
reports/congress/2009/SIGTARP_Initial_Report_to_ the_Congress.pdf).

Although the Panel welcomes these new requirements, the fact that, to date, Treasury's monthly lending snapshots have not included data on lending to small businesses makes it difficult to assess whether CPP investments have made a marked difference in the level of credit that TARP-recipient banks have extended to small businesses. However, if lending to small businesses mirrors the trend for commercial and industrial loans more generally, it is likely that credit to small businesses has contracted in recent months. Treasury's Monthly Lending and Intermediation Snapshot for February--the most recent available--found that commercial and industrial lending activity decreased among the largest recipients of TARP funds, with both extensions of existing loans and new commitments down 14 percent.\64\ Anecdotally, small business owners who testified at the Panel's Milwaukee field hearing suggested that their banks, which had received TARP injections, had been unable to fulfill their credit needs, which ranged from additional loans to restructuring or even sustaining existing lines of credit.\65\ On the other hand, the community bankers who testified at the field hearing highlighted their efforts to extend credit to their small business customers since receiving TARP funds.\66\ Treasury's enhanced effort to collect data on small business lending will allow for improved tracking of trends in this sector. The data will be especially useful for the public and outside analysts if Treasury provides even-handed, accurate analysis of the information it collects.\67\

    \64\ U.S. Department of the Treasury, Treasury Department February
Monthly Lending and Intermediation Snapshot (Apr. 15, 2009) (online at
www.financialstability.gov/latest/tg_041509.html) (hereinafter
``Treasury February Snapshot'').
    \65\ Griffith Testimony, supra note 49; Klink Testimony, supra note
44; Perrins Testimony, supra note 43.
    \66\ Atwell Testimony, supra note 51; Congressional Oversight
Panel, Testimony of Peter Prickett, Hearing on the Credit Crisis and
Small Business Lending (Apr. 29, 2009) (online at cop.senate.gov/
documents/testimony-042909-prickett.pdf).
    \67\ The Wall Street Journal recently reported that its own
analysis of data collected from TARP recipients ``paints a starker
picture of the lending environment than the monthly snapshots released
by the government and is a reminder of the severity of the credit
contraction.'' David Enrich, Michael Crittenden, and Maurice Tamman,
Bank Lending Keeps Dropping, Wall Street Journal (Apr. 20, 2009)
(online at online.wsj.com/article/SB124019360346233883.html). The
article further stated that ``Treasury crunches the data in a way that
some experts say understates the lending decline.'' Id.

In addition to encouraging lending to small businesses by TARP recipients, the Administration has also sought to encourage institutions to participate in SBA programs as part of its Small Business and Community Lending Initiative.\68\ The American Recovery and Reinvestment Act (ARRA),\69\ for example, reduced the risk to private lenders by temporarily increasing the government guarantee on loans issued through the SBA's 7(a) loan program to as much as 90 percent.\70\ The SBA began implementing the increased guarantee program on March 16 and intends to continue it through the end of 2009.\71\ Moreover, the ARRA included a temporary elimination of up-front fees that the SBA charges on 7(a) loans that increase the cost of credit for small businesses, as well as temporary elimination of Certified Development Company processing fees and third-party participation fees typically charged on 504 loans.\72\ These fee waivers are to be retroactive to the enactment of the ARRA on February 17, 2009, and are intended to be available until the end of the calendar year.\73\ Finally, the ARRA also includes a Business Stabilization Program--not yet implemented--that will allow the SBA to guarantee fully loans to ``viable'' small businesses experiencing short-term financial difficulty (up to $35,000).\74\ While these efforts will encourage banks to lend through the government-guaranteed SBA loan programs, the government and taxpayers will ultimately be liable if SBA-backed loans go bad. Moreover, as noted above, any effort to address SBA-guaranteed loans will have limited reach because of the limited overall role of the SBA in small business financing.

    \68\ Treasury Small Business Fact Sheet, supra note 60.
    \69\ The American Recovery and Reinvestment Act of 2009 (ARRA),

Pub. L. No. 111-5 (Feb. 17, 2009).

\70\ U.S. Small Business Administration, Q&A for Small Business Owners (Mar. 16, 2009) (online at www.treas.gov/press/releases/reports/tg58_smallbiz_qa.pdf) (hereinafter ``SBA Q&A for Small Business Owners'').

\71\ U.S. Small Business Administration, Statement by SBA Acting Administrator on Recovery Efforts Announced by President Obama Today (Mar. 16, 2009) (online at www.sba.gov/idc/groups/public/documents/sba_homepage/news_release_09-17.pdf) (hereinafter ``SBA March 16 Press Release'').

\72\ Typically, a fee of two percent to 3.75 percent of the SBA-guaranteed portion of a 7(a) loan is charged up-front to recipients of 7(a) loans. Certified Development Companies charge a 1.5 percent application fee to small business borrowers and the SBA charges the holder of the first-lien mortgage affiliated with a 504 loan a fee equal to 0.5 percent of that first mortgage. The elimination of these fees is designed to expand small business access to credit by reducing the barriers to both borrowers and lenders. See SBA Q&A for Small Business Owners, supra note 70.

\73\ SBA March 16 Press Release, supra note 71.

\74\ ARRA, supra note 69, at Sec. 506.

C. Family Lending

1. HOUSEHOLD BORROWING AND THE ECONOMY

Families today carry an unprecedented debt load, which has affected consumer demand for goods and additional borrowing. The historic level of debt held by families also affects their creditworthiness for additional borrowing and, when coupled with rising job losses and falling home values, affects the ability of families to stay current on their existing debt. Access to consumer credit is critical because of the role played by consumption in economic growth. Consumer spending is the largest single element of the American economy, making up approximately 70 percent of gross domestic product (GDP) at the end of 2008.\75\ By comparison, consumer spending made up slightly more than 60 percent of GDP in 1980.\76\ As shown below, the money for this increase in consumption comes from falling personal savings and rising consumer debt. Over the long run, this may not be a sustainable economic structure for the United States, a point made by the Panel in its March oversight report.\77\ In the fourth quarter of 2008, consumer spending on goods and services fell 4.3 percent--a decline responsible for nearly half of the reported 6.2 percent annualized contraction in GDP. This is the largest spending decrease in 29 years.\78\ Recent news is more positive, as consumer spending showed a 2.2 percent annualized increase in the first quarter of 2009.\79\ An examination of economic data from the past few decades for households provides context for examining the health of American households as Treasury's efforts to revive consumer lending and demand get off the ground.

\75\ Board of Governors of the Federal Reserve System, Federal Reserve Statistical Release Z.1: Flow of Funds Accounts of the United States, Flows and Outstanding Fourth Quarter 2008, at 12 (Mar. 12, 2009) (F.6 Distribution of Gross Domestic Product) (online at www.federalreserve.gov/releases/z1/Current/z1.pdf) (hereinafter ``Fourth Quarter Flow of Funds'').

\76\ Board of Governors of the Federal Reserve System, Federal Reserve Statistical Release Z.1: Flow of Funds Accounts of the United States, 1975-1984, at 4 (Mar. 12, 2009) (F.6 Distribution of Gross Domestic Product) (online at www.federalreserve.gov/releases/z1/Current/annuals/a1975-1984.pdf).

\77\ Congressional Oversight Panel, Foreclosure Crisis: Working Towards a Solution, at 7 (Mar. 6, 2009) (online at cop.senate.gov/documents/cop-030609-report.pdf) (``This is not a sustainable economic structure, and over time the United States must return to an economy where consumption is wage based and there is adequate consumer savings. But while the economy cannot be revived based on more asset-based consumption, neither can the country afford a continuing asset price collapse. An orderly return to a more wage-driven economy requires that we have functioning credit markets.'').

\78\ Bureau of Economic Analysis, GDP and the Economy: Preliminary Estimates for the Fourth Quarter of 2008, at 3 (Mar. 2009) (online at www.bea.gov/scb/pdf/2009/03%20March/0309_gdpecon.pdf).

\79\ Bureau of Economic Analysis, Gross Domestic Product: First Quarter 2009 (Advance) (Apr. 29, 2009) (online at www.bea.gov/newsreleases/national/gdp/gdpnewsrelease.htm).

Families are currently holding debt at near historic levels. Total household borrowing as a percentage of GDP--the ratio of all household debt to the total economic output of the nation--has grown since the end of the Second World War, and this growth accelerated greatly in the past decade. This debt

figure includes family borrowing both in the form of: (1) credit cards, student and auto loans, and other forms of borrowing; and (2) mortgages. Figure 1 illustrates the ratio of household debt to GDP in the postwar era. A decade ago, the household debt-to-GDP ratio was approximately 2:3; today, that ratio is roughly 1:1, meaning that American households are holding debt equal to domestic output. This is an unprecedented level of debt, and a return to the level of household debt held during the 1990s would require a significant period of deleveraging, which would reduce borrowing demand and contribute to economic contraction.
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The long-term trend has been toward increasing debt, but the run up in recent years has been especially sharp. A period of deleveraging by households may have already begun, as household debt fell by an annualized rate of two percent \81\ in the fourth quarter of 2008.

\80\ Fourth Quarter Flow of Funds, supra note 75, at 12 (F.6 Distribution of Gross Domestic Product); Fourth Quarter Flow of Funds, supra note 75, at 8 (D.3 Debt Outstanding by Sector).
\81\ Fourth Quarter Flow of Funds, supra note 75, at 6.

While the total debt numbers in Figure 1 are significant, the impact of this debt on individual households is illustrated in Figure 2, which compares average debt per household to median income over time. The phenomenon of households owing more than their annual income is a recent one. As recently as 1976, households owed less than their median annual income. Today, the average amount owed far exceeds household income. The chart reveals that the debt held by individual households grew by a significantly faster rate than real income, meaning that real wage increases could not keep up with borrowing.
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This chart highlights the pressure on families. Over the course of the past few decades, even as families increasingly sent two workers into the paid work force, total household income increased only modestly and families went deeply into debt.

\82\ Fourth Quarter Flow of Funds, supra note 75, at 8 (D.3 Debt Outstanding by Sector); U.S. Census Bureau, Historical Income Tables--Households: Table H-6 (online at www.census.gov/hhes/www/income/histinc/h06ar.html) (accessed May 5, 2009).

The experiences of the recent boom show that the challenges facing families have accelerated. During a boom, income typically advances, so the household develops a cushion against the upcoming bust. Income grew during the 1960s, 1980s and 1990s at 33 percent, ten percent, and 11 percent, respectively.\83\ But family income advanced by only 1.6 percent over the course of the economic boom of this decade, measured from 2001 to 2007.\84\ This stagnation of income has left families in a vulnerable position as the recession accelerates.

\83\ Bureau of Economic Analysis, National Income and Product Accounts Table 1.1.1: Percent Change From Preceding Period in Real Gross Domestic Product (Apr. 29, 2009) (online at www.bea.gov/national/nipaweb/TableView.asp? SelectedTable=1&View Series=NO&Java=no&Request3Place=N&3Place=N&FromView=YES&Freq=Qtr&FirstYear=1961&LastYear= 2009&3Place=N&Update=Update&JavaBox=no). This report used the NIPA table to determine the periods of growth as the following: 1961q1-1969q3, 1982q4-1990q3, 1991q2-2000q2, 2001q4-2007q3. For income growth, the Panel used Census Bureau data. Income in 1960 and 1969 was calculated as a weighted average of family and individual household incomes. U.S. Census Bureau, Current Population Reports: P60-37 (tbl.B), P60-75 (tbl.7), P60-142 (tbl.A), P60-174 (tbl.1), P60-180 (tbl.A), P60-213 (tbl.A), P60-218 (tbl.1), P60-235 (tbl.1) (online at www.census.gov/ prod/www/ abs/income.html).
\84\ U.S. Census Bureau, Historical Income Tables--Households: Table H-10 (online at www.census.gov/hhes/www/income/histinc/h10AR.html) (accessed May 5, 2009).

As wages stagnated and household debt grew at an unprecedented rate, savings by families fell to new lows, adding even more risk to the family balance sheet. Figure 3 shows starkly that households in 2007 entered the recession with little put away, unlike households in the 1980s, which entered a recession with substantial savings.
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Another metric of the ability and willingness of households to take on more debt is the decline in household net worth

experienced by families over the past year. Of the past recessions, only one other was accompanied by a decline in net worth over the course of a year: the recession at the beginning of this decade. During this downturn, household net worth fell by nearly four percent. By contrast, in the current downturn, households have seen their net worth fall by approximately 20 percent, for a loss of nearly $13 trillion in wealth.\86\ This loss can damage the creditworthiness of households, affecting their ability to obtain credit--a loss of ability reflected in the decline in household loans over the past few months. And the decline in net wealth may not be over yet, as housing prices continue to fall in some parts of the country while the rolls of the unemployed swell.

\85\ Bureau of Economic Analysis, 2.1 Personal Income and Its Disposition (Oct. 30, 2008) (online at www.bea.gov/national/nipaweb/TableView.asp?SelectedTable=58&ViewSeries=NO&Java=no&Request3Place=N&3Place=N&FromView=YES&Freq=Year&First Year=1970& LastYear=2007& 3Place=N&Update=Update& Java Box=no).

\86\ From peak household net worth in third quarter 2007 to trough in fourth quarter 2008. Fourth Quarter Flow of Funds, supra note 75, at 102 (B.100 Balance Sheet of Households and Nonprofit Organizations).

The data reviewed indicate that consumers may not be ready to drive economic recovery or take on additional borrowing, as American families are holding high levels of debt with minimal savings following a decade of nominal wage growth. While paying down debt and increasing savings is good for family balance sheets, it is procyclical during a downturn and worsens the current recession by reducing aggregate demand. Continued job losses, which have mounted at a rate of over a half-million jobs each month since October 2008, pushed the national unemployment rate to 8.5 percent.\87\ This is the highest rate since 1983.\88\

\87\ Bureau of Labor Statistics, The Employment Situation: March 2009 (Apr. 3, 2009) (online at www.bls.gov/news.release/pdf/empsit.pdf).

\88\ Bureau of Labor Statistics, Labor Force Statistics from the Current Population Survey (online at data.bls.gov/PDQ/servlet/SurveyOutputServlet?data_tool=latest_numbers&series_id = LNS14000000) (accessed May 5, 2009).

[GRAPHIC] [TIFF OMITTED] 49573A.004

Following years of debt build-up and stagnant wages, these job losses only add to the turmoil faced by households today.

\89\ Id.

There is evidence that households, as in previous recessions, are deleveraging, which is contributing to economic contraction. Thirty-five percent of banks report that demand for all consumer loans decreased during the first quarter of 2009. Only 17.6 percent reported an increase.\90\ The most recent Treasury Monthly Snapshot, released in April, catalogs lending activity for the month of February and shows that median consumer loan originations fell by nearly half from January to February of 2009 while credit card loan balances fell by one percent.\91\ In total, Federal Reserve Board data revealed an annualized decrease in household borrowing, which includes mortgages, of 3.5 percent for the month of February.\92\ The total volume of originations of four types of consumer loans--first mortgages, home equity loans, credit cards, and other consumer loans--at the biggest TARP recipient banks was 41 percent lower in February 2009 than it was in October 2008.\93\ Total loan balance outstanding grew one percent over the same period but would have fallen if not for the spike in mortgage refinancings. Current lending data thus provide additional evidence that households are deleveraging, with implications for the pace of economic recovery and demand for consumer lending.

\90\ April Senior Loan Officer Opinion Survey, supra note 37.

\91\ Treasury February Snapshot, supra note 64.

\92\ Board of Governors of the Federal Reserve System, Federal Reserve Statistical Release G.19: Consumer Credit (Apr. 7, 2009) (online at www.federalreserve.gov/releases/g19/Current) (hereinafter ``April 7, 2009 G.19'') (this number excludes real estate loans).

\93\ U.S. Department of the Treasury, Treasury Monthly Intermediation Snapshot (Feb. 17, 2009) (online at www.treas.gov/press/releases/reports/tg30-122008.pdf) (hereinafter ``Fourth Quarter 2008 Snapshot''); Treasury February Snapshot, supra note 64. These figures exclude Wells Fargo and PNC Bank because their New Years Eve mergers with Wachovia and National City, respectively, prevent a good comparison between October and February lending activity. The figure for loan origination also excludes first mortgage refinancing because those figures exaggerate the amount of truly new lending that is taking

place. Each refinancing adds new credit to the market while also removing old credit, but the Treasury data does not account for the removal of old credit.

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2. CREDIT AVAILABILITY FOR HOUSEHOLDS

Consumer credit indicators show the tightening of the credit markets and the effect on household borrowing. This reduction in credit availability can be seen through rising interest rates and higher lending standards, as well as through reductions in the rate and overall volume of lending. At the same time, the recession has had an impact on demand for borrowing as well, as households pay down debts built up during the boom years. Overall lending numbers frame the story, as household lending began to slow in the second quarter of 2008, and contracted tightly in the third quarter.\94\ The most recent data, from February 2009, show an annualized decrease of 3.5 percent in outstanding consumer credit.\95\ Revolving loan balances (which are mostly credit cards) decreased at an annualized rate of 9.7 percent in February. This is the largest drop in over 30 years.\96\ Non-revolving loans (such as auto loans and student loans) slowed to a trickle, growing at an annualized rate of 0.2 percent during that time period. The aggregate decline in consumer lending is likely due to a combination of deleveraging by households and reduced access to credit. The sections below examine the available evidence of reduced access to consumer credit.

\94\ April 7, 2009 G.19, supra note 92.
\95\ April 7, 2009 G.19, supra note 92.
\96\ April 7, 2009 G.19, supra note 92.

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a. Credit Cards

Credit cards are among the most familiar forms of borrowing to American households. In recent months, credit card borrowing has come under stress, as interest rates have increased while the number of people who miss payments or default on their debt, measured as charge-offs and delinquencies, is growing rapidly. Interest rates are one of the primary indicators of tightening lending standards, as issuers have increased rates in recent months. According to the Federal Reserve Board's Report on Consumer Credit for February 2009, credit card interest rates have increased from 12.02 to 13.08 percent between November 2008 and February 2009, a period in which the total volume of credit card receivables has stayed approximately level.\97\ A private survey, by IndexCreditCards, confirms the trend.\98\ This upswing in interest rates appears similar to a rise in credit card rates observed before the previous recession at the outset of this decade, as shown in Figure 5. This most recent upswing in rates, however, is steeper than the ones households experienced earlier this decade.

\97\ However, in recent time periods, this rate has swung between a high of 13.38 percent in 2007 to an annualized low of 11.87 percent in the second quarter of 2008. April 7, 2009 G.19, supra note 92; Board of Governors of the Federal Reserve System, Federal Reserve Statistical Release G.19: Consumer Credit (Feb. 6, 2009) (online at www.federalreserve.gov/releases/g19/20090206)

\98\ IndexCreditCards.com, Credit Card Monitor (May 4, 2009) (online at www.indexcreditcards.com/creditcardmonitor). Financial institutions represented in the survey include Advanta, American Express, Bank of America, Capital One, Chase/Washington Mutual, Citi, Discover, PNC/National City, Pulaski Bank, U.S. Bank, and Wells Fargo.

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After a reduction in credit card interest rates following the dot com collapse, rates rose steadily during the boom. Rates are currently on the increase as well, as credit card issuers seek to augment revenue in the face of rising defaults and delinquencies. At the same time, it must be noted that, during the past year, the cost of funds to issuers has declined. The effective Federal Funds rate on April 27, 2009 was 0.17 percent per year, as compared to 2.37 percent exactly one year earlier.\100\ Half of all banks report that spreads between interest rates and cost of funds have widened in the first quarter of 2009.\101\

\99\ Board of Governors of the Federal Reserve System, Federal Reserve Statistical Release G.19: Consumer Credit Historical Data (online at www.federalreserve.gov/Releases/G19/hist) (accessed May 5, 2009) (hereinafter ``G.19 Historical Data''). Figure 4 shows interest rates for two sets of card users: all users, and only those users who were assessed interest. In general, a card user is only assessed

interest if he carries a balance on his credit card. One can infer that users who are assessed interest are a riskier group of borrowers, and thus carry higher interest rates on their credit cards.

\100\ Board of Governors of the Federal Reserve System, Federal Reserve Statistical Release H.15: Federal Funds Historical Data (online at www.federalreserve.gov/releases/h15/data.htm) (accessed May 5, 2009).

\101\ April Senior Loan Officer Opinion Survey, supra note 37, at question 16.b.

With the economy worsening, more households are missing payments on their credit cards and defaulting on their debt. ``Charge-offs''--which are loans removed from the books and charged against loss reserves \102\--have been increasing in recent months. The Federal Reserve Board reported an annualized charge-off rate of 6.25 percent in the fourth quarter of 2008,\103\ compared with a 3.97 percent charge-off rate in the fourth quarter of 2006.\104\ The rate at which charge-offs are increasing will further impair bank balance sheets, raising the question of whether time is on Treasury's side in the planning of financial stabilization programs, a question the Panel previously discussed in its April report.\105\

\102\ They are adjusted by recoveries on these loans, and shown as a percentage of all loans.

\103\ Board of Governors of the Federal Reserve System, Federal Reserve Statistical Release: Charge-Off and Delinquency Rates (online at www.federalreserve.gov/releases/chargeoff/chgallsa.htm) (accessed May 5, 2009) (hereinafter ``Fed Charge-off and Delinquency Rates'').

\104\ Id.

\105\ Congressional Oversight Panel, Assessing Treasury's Strategy: Six Months of TARP, at 81 (Apr. 7, 2009) (online at cop.senate.gov/documents/cop-040709-report.pdf) (hereinafter ``COP April Report'') (``The banking system itself creates a possible timing problem. The existence of weak institutions that are sustained only by taxpayer guarantees and infusions of cash threatens the health of all banks, drawing off depositors and undermining public support. Continued operation of systemically significant but weakened institutions at the heart of a nation's financial system may prevent a robust economic recovery of the sort that would cause time be on our side. In such a case, delay and half steps would seem to be the main enemy.'').

The American Banker reports a ``sudden'' escalation in charge off rates in the first quarter of 2009, ``as unemployment and other economic conditions worsened.'' \106\ Reports from individual card issuers may give us a preview of what the numbers could look like for the first quarter of 2009. Capital One reported an annualized charge-off rate of 9.33 percent in February 2009,\107\ more than a one percent increase over February's annualized rate of 8.06 percent.\108\ The March rate is nearly as high as the October 2005 peak just before the enactment of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005.

\106\ Harry Terris, Card Hits May Prompt Permanent Adjustments, American Banker (Apr. 29, 2009) (online at www.americanbanker.com/article.html?id=20090428WFBO5NUA).

\107\ Capital One Financial Corporation, Form 8-K, Ex. 99.1 (Apr. 14, 2009) (online at www.sec.gov/Archives/edgar/data/927628/000119312509078900/dex991.htm).

\108\ Capital One Financial Corporation, Form 8-K, Ex. 99.1 (Mar. 16, 2009) (online at www.sec.gov/Archives/edgar/data/927628/000119312509054037/dex991.htm).

Federal Reserve Board data also indicate that credit card delinquency rates are climbing. In the fourth quarter of 2008, the delinquency rate on credit cards climbed to 5.56 percent from 4.83 percent in the preceding quarter.\109\ Figure 5 illustrates the rate of both credit card charge-offs and delinquencies since 1991. Prior to the current peak, there are two previous peaks in credit card charge-offs: one in October 2005, and the other in the first quarter of 2002 due to the previous recession.

\109\ Fed Charge-off and Delinquency Rates, supra note 103.

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The increase in charge-offs and delinquencies highlights the impact of the economic downturn on the loan portfolios of card issuers.

\110\ Fed Charge-off and Delinquency Rates, supra note 103.

Declining credit card balances are another prevailing trend in the market today. According to the February Treasury Snapshot, total used and unused commitments on credit card loans held by the 21 participating TARP banks has fallen by

seven percent since October 2008.\111\ Federal Reserve Board data confirm the same trend, revealing an annualized decline of nearly ten percent in revolving debt in February 2009.\112\ This decline can be caused, in part, by households paying down existing balances. As discussed above, deleveraging in this manner is good for family finances but procyclical in a downturn, contributing to economic contraction by helping reduce demand. Some of this decline, however, may be caused by the reduction of credit lines by issuers. A recent study by FICO found that 16 percent of the population experienced a reduction in credit limits from April to October of 2008.\113\ Nearly 70 percent of those experiencing a credit limit reduction, according to the FICO study, had no triggering risk event and otherwise made payments on time or paid down balances every month. The Senior Loan Officer Opinion Survey on Bank Lending Practices, released in May 2009 by the Federal Reserve Board, revealed that 56.5 percent of card issuers reported reductions in consumer credit account limits during the first quarter of 2009.\114\ Reduced credit limits are one way for credit card issuers to reduce potential liabilities to increasingly risky borrowers. For many households, however, a reduction in credit limits imposed by issuers can have a negative impact on the borrower's credit score.\115\

\111\ Fourth Quarter 2008 Snapshot, supra note 93. Treasury February Snapshot, supra note 64.

\112\ April 7, 2009 G.19, supra note 92.

\113\ Fair Isaac Corporation, Study: How Credit Line Decreases Can Affect FICO Scores (Apr. 17, 2009) (online at www.fico.com/en/Company/News/Pages/credit-line-and-fico-score.aspx) (hereinafter ``FICO Study'').

\114\ April Senior Loan Officer Opinion Survey, supra note 37, at question 19.b.

\115\ FICO Study, supra note 113.

Overall, the trend across the sector is one of debt reduction, credit limit decreases, rising delinquencies and tightening lending standards. Credit cards remain a vital source of liquidity for millions of American households, but the economic downturn continues to drive up the risk to credit card issuers while rising fees and rates are further constricting families' borrowing abilities.

b. Auto Lending

Auto sales have dropped precipitously in the past six months. Many prospective buyers have delayed new car purchases or turned to the used car market.\116\ In the first quarter of 2009, light vehicles sold at an annualized pace of just over nine million, a 38 percent drop compared to the same period a year ago.\117\ This is far below the peak of 17 million new cars sold or leased in 2007.\118\ Vehicle production has dropped in response to falling sales.

\116\ CNW Marketing Research projects used car sales in 2009 will rise 9.5 percent over 2008, to 40 million. They project new car sales of ten million, down from 13.2 million in 2008. Greg Gardner, Customers Look for New Cars, but Buy Used, Detroit Free Press (Mar. 23, 2009) (online at www.freep.com/article/20090323/BUSINESS01/903230382).

\117\ Ward's Auto, U.S. Light Vehicle Sales Summary (Mar. 2009) (online at wardsauto.com/keydata/USSalesSummary0903.xls); Ben Klayman, Reuters, April U.S. auto sales plunge near 30-year lows (May 1, 2009) (online at www.reuters.com/article/privateEquity/idUSN0130972820090501).

\118\ Bureau of Transportation Statistics, New and Used Passenger Car Sales and Leases (online at www.bts.gov/publications/national_transportation_statistics/html/table_01_17.html) (accessed May 5, 2009).

It is unclear how much of the reduction in auto sales is due to constrictions in credit availability and how much is due to a reduction in demand caused by macroeconomic conditions. Recent data on loan terms appear more favorable, likely due to the collapse of the subprime auto loan market.\119\ This means that credit is cheaper for people who can get it, but some people who would have received loans during boom years are unable to qualify for any loans today. Auto finance companies offered an average interest rate of 3.17 percent in February, an improvement from the previous low of 4.55 percent in the fourth quarter of 2007.\120\ Commercial banks are offering 48-month new car loans for an average of 6.92 percent interest, which is lower than at any time since 2004 (6.6 percent), except the second quarter of 2008 (6.84 percent). Thus, the decline in subprime auto loans and tightening lending standards for prime lenders may support the view that tightening credit is a factor in reduced auto sales. Nonetheless, increasing job losses and overall household debt is playing a role in limiting consumer demand for autos as well.

\119\ Fitch Ratings, US Auto: Asset Quality Review 4Q08, at 5 (Feb. 18, 2009) (hereinafter ``Fitch Auto Asset Quality Review'').

\120\ These differences are less stark than they appear because average maturity in February 2009 was 59 months, whereas it was 63 months in Q4 2007. April 7, 2009 G.19, supra note 92.

Auto loans have fallen from their peak in the boom years. The Federal Reserve Board's most recent data for non-revolving consumer credit provide a useful proxy for auto loans.\121\ These data indicate that the total amount of non-revolving consumer debt was virtually unchanged from the second quarter of 2008 through February 2009. In contrast, during the boom years for auto sales between 2004 and 2007, non-revolving consumer credit outstanding grew an average of $62 billion per year. The diminished availability of subprime loans and stagnation in auto sales and non-revolving credit indicate that a decreasing number of borrowers have access to financing for auto loans, but that those terms are growing more favorable as auto financing companies offer better rates to a shrinking audience of creditworthy borrowers.

\121\ April 7, 2009 G.19, supra note 92, at 2.

Households are also having more trouble keeping current on their auto loan payments, as delinquency rates on auto loans grew in the fourth quarter of 2008. According to data from a survey by TransUnion, auto delinquency rates have increased by 25 percent since December of 2007.\122\ The national 60-day auto delinquency rate, which is the percentage of auto loan borrowers 60 days or more past due, increased from 0.80 percent in the third quarter of 2007 to 0.86 percent in the fourth quarter of 2008. Rising delinquency rates may be another factor behind tightening lending standards, and also affect the profitability of auto-backed securities, which have proven to be an important source of financing for auto lending by both banks and non-banks.

\122\ TransUnion, TransUnion.com: National Auto Loan Delinquency Rates Increase 7 Percent to Close 2008 (Mar. 17, 2009) (`` `How does the rise in auto delinquency compare to the 2001 recession?' asked Peter Turek, automotive vice president in TransUnion's financial services group. `Although that recession was short by most standards (beginning in March of 2001 and ending in November of the same year), the auto delinquency ratio increased by almost 10 percent. In contrast, in our current recession which began in December of 2007, we see that the auto delinquency rate has already increased by 25 percent--more than double what occurred in the last recession, with an endgame that is still uncertain.' '').

As a result of declining automobile sales and lending, loan portfolios of auto lenders, both bank and nonbank, declined in the fourth quarter of 2008.\123\ This contraction could be coming from the supply-side or the demand-side. As discussed below, financing for auto lenders has also been reduced due to a steep decline in the volume of auto securitization in 2008. This decline may be both a result and a cause of tightened lending terms and reduced credit availability. For Americans who can qualify for automobile loans today, the terms are better than ever. But lending and sales have both dropped off steeply. It is hard to determine from the data whether the decrease in sales is due more to a reduction in credit availability or a drop in demand. Either way, the auto companies and the communities they support are struggling.

\123\ Fitch Auto Asset Quality Review, supra note 119.

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c. Student Lending

Higher education borrowing has also been affected by the credit crisis.\124\ Unique to student loans, however, a recently-passed legislative act may be playing a role. In order to promote direct-to-students federal lending over more costly private lending, the College Cost Reduction and Access Act cut subsidies for federally guaranteed private loans.\125\ The decreased revenue from these subsidies might factor into lenders' decisions to cut back on student lending.\126\ In addition, the Obama Administration has proposed to eliminate the subsidized lending altogether in favor of the government lending directly to students.\127\ This puts government policy in a potential contradiction. Through TALF, the government is effectively lending money to the private lenders to lend to students, at the same time that the government is reducing incentives for private lenders. Some question why TALF is necessary or appropriate in light of the new law and the Administration's proposal.

\124\ Finaid.org, Impact of the Subprime Mortgage Credit Crisis on Student Loan Cost and Availability (online at www.finaid.org/loans/creditcrisis.phtml). See also SLM Corp., Form 8-K, at 3 (Jan. 3, 2008) (online at sec.gov/Archives/edgar/data/1032033/000110465908000386/a08-1101_18k.htm) (hereinafter ``SLM 8-K'').

\125\ College Cost Reduction and Access Act, Pub. L 110-84, 110th Cong. (2007).

\126\ Id.

\127\ The White House, President Obama Meets with Family Struggling with College Costs, Underscores Need to Eliminate Wasteful Spending in Federal Student Loan Program, Reinvest Savings in Making College More Affordable (Apr. 24, 2009) (online at www.whitehouse.gov/the_press_office/President-Obama-Meets-with-Family-Struggling-with-College-Costs). Recent data shows it to be more expensive for the government to administer the Federal Family Education Loan program, in which it subsidizes private lenders, than it is to make direct loans to students. Congressional Budget Office, CBO March 2009 Baseline Projections for the Student Loan and Grant Programs (Mar. 20, 2009) (online at www.cbo.gov/budget/factsheets/2009b/education.pdf); New America Foundation, News Alert: CBO Finds Administrative Costs to be Higher in FFEL (Mar. 25, 2009) (online at www.newamerica.net/blog/higher-ed-watch/2009/news-alert-cbo-finds-administrative-costs-be-higher-ffel-10775). Student loan lenders might be evaluating this information in their decisions to contract lending.

In recent years, the costs of education have grown faster than family income. For the 2008-2009 school year, tuition and fees at four-year public schools grew by 6.4 percent, and grew for private schools by 5.9 percent.\128\ Families pay for nearly 40 percent of undergraduate costs through borrowing, either by the parents or the student.\129\ Of this, 23 percent of loans were taken by students, and 16 percent by parents. This borrowing is divided between federal student loan programs and private student loan programs. Twenty-eight percent of families make use of federal student loan programs.\130\ Because financing through the bond markets grows increasingly expensive and securitization in the private student loan markets has ground to a halt, private lenders are cutting back on their federal student loan programs or exiting the market altogether.\131\ Changes in private lender interest rates, fees, and terms have made private loans more expensive, or even ruled out this option completely for some borrowers.

\128\ College Board, Published Tuition and Fee and Room and Board Charges (online at www.collegeboard.com/html/costs/pricing).

\129\ Sallie Mae, How America Pays for College: Sallie Mae's National Study of College Students and Parents, Conducted by Gallup, at vii (Aug. 2008) (online at www.salliemae.com/content/dreams/pdf/AP-Report.pdf) (hereinafter ``Sallie Mae Report''). The remainder was financed by parental income and savings (32 percent), grants and scholarships (15 percent), student income and savings (10 percent) and friend and relative support (3 percent).

\130\ Id. at viii.

\131\ See, e.g., Fitch Ratings, Private Education Loans: Time for a Re-Education (Jan. 28, 2009) (``Higher funding costs and reduced margins led many lenders, like CIT, College Loan Corporation, KeyBank, and Astrive Student Loans, to exit the business altogether. Those that remain have reduced origination volume and re-evaluated underwriting criteria.'') (hereinafter (``Fitch Time for a Re-Education'').

The group of banks that received TARP funds decreased their loan originations for consumer loans, including student loans, from January 2009 to February 2009.\132\ The National Consumer Law Center reports that private student loan lending decreased as much as 25 percent in early 2009.\133\ Lenders are tightening standards and raising interest rates on private loans. For example, in December 2007, Sallie Mae announced that it would tighten credit standards as well as increase prices for private loans.\134\ Default rates are rising as well. The Department of Education announced that the FY 2007 default rate for federal loans was 6.9 percent, up from 5.2 percent in FY 2006 and 4.6 percent in FY 2005.\135\

\132\ Treasury February Snapshot, supra note 64.

\133\ National Consumer Law Center, Too Small to Help: The Plight of Financially Distressed Private Student Loan Borrowers, at 6 (Apr. 2009) (online at www.student loanborrowerassistance.org/uploads/File/Too Small to Help.pdf).

\134\ SLM 8-K, supra note 124.

\135\ U.S. Department of Education, FY 2007 Draft Student Loan Cohort Default Rates (Mar. 26, 2009) (online at www.ifap.ed.gov/eannouncements/032609DraftStudentLoanCohDfltRatesFY07.html).

Students and parents also use borrowing other than student lending to finance educations. While only three percent of parents use home equity loans to pay tuition costs, those who do borrow an average of $10,853.\136\ Also, increasing numbers of students are financing education costs with credit cards.

Nearly one-third of students charged tuition on their credit cards. Of those, the average tuition charge to the credit card was $2,200, up from $924 in 2004.\137\ When asked why they used credit cards to pay tuition, 58 percent of respondents said that it was because they ``didn't have enough savings and financial aid to cover all the costs.'' Since 82 percent of the students surveyed carried balances, they were paying finance charges on these amounts.

\136\ Sallie Mae Report, supra note 129.
\137\ Sallie Mae, How Undergraduate Students Use Credit Cards, at 3 (Apr. 13, 2009) (online at www.salliemae.com/NR/rdonlyres/0BD600F1-9377-46EA-AB1F-6061FC763246/10744/SLM Credit Card Usage Study 41309 FINAL2.pdf).

D. Securitization and the TALF

1. SECURITIZATION

Most Americans first heard about securitization when they learned that the collapse of the value of securities backed by subprime mortgages was both a signal and a trigger of the financial crisis. It is likely that few people outside of the financial sector knew the extent to which money raised through securitization of loans had become an important part of the process of lending. Until the financial crisis began, increasing amounts of loans were securitized, that is, the loans were combined in pools that in turn backed securities sold to investors. The increase is illustrated in the following table.\138\

\138\ As noted above, securitization is also a basic mechanism for financing residential and commercial mortgages. Annual issuance of asset-backed securities resulting from the securitization of mortgage and real estate-related loans exceeded $2 trillion from 2002-2007, before the credit crunch took effect. This report does not deal with real estate-based securitization, both because the TALF does not at present extend to real estate, and because real estate securitization raises its own set of issues.

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According to the Federal Reserve Board and Treasury, ``over the past few years around a quarter of all non-mortgage consumer credit'' has been financed through securitization.\140\

\139\ Securities Industry and Financial Markets Association, U.S. ABS Issuance (online at www.sifma.org/uploadedFiles/Research/Statistics/SIFMA_USABSIssuance.pdf) (based on data from the U.S. Department of the Treasury, other Federal agencies, and news agencies) (hereinafter ``U.S. ABS Issuance''). U.S. issuance includes only securitizations involving loans secured by United States assets or receivables owed by United States companies. 2009 shows Q1 issuance only. ``Other'' includes account receivables, tax liens, aircraft leases, auto floorplan receivables, consumer loans, catastrophe bonds, boat loans, motorcycle receivables, utilities-related assets, timeshare assets and assets otherwise not categorized.
\140\ U.S. Department of the Treasury, White Paper: Term Asset-Backed Securities Loan Facility (Mar. 3, 2009) (online at www.treas.gov/press/releases/reports/talf_white_paper.pdf) (hereinafter ``TALF White Paper'').

Securitization first developed in the 1970s as a way for the federal government to tap the capital markets for residential mortgage financing. When the Federal Reserve Board drastically raised interest rates in 1979 to curtail inflation, depository institutions found themselves caught between having to pay higher rates for short-term funding (e.g., by depositors) relative to the lower rates they were earning on their (longer term) investments.\141\ Securitization of mortgages provided a way out of this squeeze, because it allowed institutions to turn the mortgages they held into cash immediately (that is, before the mortgages paid off over the long term) by transferring those mortgages to investors in the capital markets.

\141\ Lewis S. Ranieri, The Origins of Securitization, Sources of Its Growth, and Its Future Potential, in A Primer on Securitization, at 33 (ed. Leon T. Kendall and Michael J. Fishman, 1996).

Asset securitization grew for many types of loans across numerous industries after 1986. As a result, what was initially a multi-million dollar alternative financing market became a multi-trillion dollar part of the mainstream American and global economies. The White Paper issued by Treasury to announce the TALF provides a convenient summary of the types of

loans normally subject to securitization.

FIGURE 8: ASSET CLASSES THAT HAVE HISTORICALLY BEEN FUNDED IN SECURITIZATION MARKETS

Categories	Lending Examples	Assets Funded Through Securitization
Auto Lending	Consumer loans and leases, dealership funding programs.	Automobiles, light trucks, motorcycles and recreational vehicles (RVs).
Student Loans	Federally guaranteed student loans (including consolidation loans) and private student loans.	Students and education providers.
SBA Loans	Loans, debentures, or pools originated under the SBA's 7(a) and 504 programs.	Small businesses.
Credit Cards	Consumer and corporate credit cards.	
Vehicle Leases	Rental, commercial and government fleet leases.	Automobiles and other fleets including forklifts, taxis, and long-haul trucks.
Equipment Loans and Leases	Small ticket equipment loans and leases.	Phone systems, computers and copiers to small businesses.
	Heavy equipment loans and leases.	Cranes, excavators, and a range of other construction equipment.
	Agricultural equipment loans and leases.	Harvesters, specialty grape harvesters, and a variety of other agricultural equipment.
Other Floorplan Securitizations	Floorplan loans and dealer inventory programs.	Small equipment showrooms, heavy equipment showrooms, certain lots of used car dealers.
Residential Property (RMBS)	Non-agency residential mortgages and loans.	Residential property.
Commercial Property (CMBS)	Commercial mortgages, commercial loans.	Industrial, office, retail and multi-family residential property.

Securitization involves a simple economic transformation. When a financial institution makes loans--to small businesses, credit card borrowers, students, or auto buyers, for example--it transfers the full amount of the loan to the borrower but it receives that amount back over time, as the loan is repaid. The amount it lends is cash, the most highly liquid of assets, but what it receives in return is a stream of payments over time, an asset that is valuable (if the institution has judged its credit risk correctly) but that ties up the institution's money until repayment. That is, the asset the banks receives in return is illiquid. Securitization, at its best, provides a way out of that mismatch; it converts the institution's loans into a pool that converts the loans back to cash--makes them liquid again--by transforming them into bonds that are themselves sold to investors, who can wait for payments over time. Investors are attracted to these bonds because the pooled loans, and hence the bonds, often pay higher interest rates than corporate or municipal bonds.

Many aspects of securitization are highly technical, but the basic steps in the process are not.

1. A financial institution--which may or not be a bank--makes loans. This step is commonly called ``origination,'' and the institution making the loan is called the ``originator.''

2. The originator creates a separate entity (often a trust, called a ``special purpose vehicle,'' or ``SPV''). The vehicle is legally separate (and, the investors hope, bankruptcy-remote) from the originator company,\142\ and its purpose is to issue debt securities that are backed by the loans transferred to it. Hence the debt securities are called ``asset-backed securities.'' \143\ In some cases, the SPV issues different classes--called ``tranches''--of debt securities, to reflect different risk and interest components of the underlying loan pool, and to entitle the holders to different priorities of payment. Tranched securitizations are more complex and can create more difficult risk and pricing terms for investors in lower level tranches (who are paid only after investors in higher level tranches receive their payments), than single level ``plain vanilla'' securitizations.

\142\ Bankruptcy remoteness means that the bankruptcy or the regulatory takeover of the originator will not affect the value and independence of the special purpose vehicle.

\143\ Sometimes the SPV is created not by the originator of the loans but instead by the underwriter who will sell the securities to investors and who wants to create a securitization vehicle to start an investment transaction.

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3. Because the risk of non-repayment is a critical component in the pricing of the debt, rating agencies are hired by the originator to determine the default risk of the pool of loans the vehicle is to hold.

4. The originator sells the pool of loans to the SPV.

5. The debt securities are sold to underwriters, who, in turn, sell them to investors. The price the investors pay is based on their assessment of the risk that interest rates will rise (making the debt securities less valuable) and that default rate on the loans backing the debt securities will not prove higher than they have estimated.

6. The investors buy the interests for cash that--after subtraction of fees--is paid to the SPV, which in turn pays the amount to the originator in return for the pool of loans. (As in the case of any investment, the investors may ``leverage'' their investments--that is, they may borrow money to pay for the asset-backed securities they buy. If the interest rate or credit assumptions on which the price of those securities, and the amount the investors borrowed, was based prove wrong, the investors cannot look to the value of the securities to pay back their debts. Eliminating that risk is a key feature of the TALF, as discussed below.)

7. The investors now own interests in the SPV and they receive the payments of interest and principal due under the debt securities as interest and principal payments are made to the SPV on the underlying loans.\144\

\144\ Investors who have doubts about the strength of the asset pool that backs the securities they have purchased might seek external credit enhancement such as a surety bond or letter of credit.

Although Steps 2-6 are described separately here, they are planned and negotiated together and usually happen simultaneously at the closing of the transaction.\145\

\145\ This may not be the end of the originator's relationship with the securitized assets. Originators sometimes also serve as ``servicers,'' charging the SPV a fee to collect payments from those who owe on the underlying accounts and then forwarding the cash to the SPV so it can be used for debt repayment. An originator might alternatively contract with a third party to perform those services or sell the right to act as servicer outright.

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Securitization allows originators to generate cash and obtain a lower cost of funds by selling long-term assets (loans) for the highest price they can obtain that still provides investors with the returns necessary to compensate them for the credit and interest rate risk they assume. The ability to convert illiquid assets into cash increases the amount of money originators have available for lending. This is especially true as competition for the funds of both corporate and individual investors, large and small, has grown over the last three decades. Two other benefits often cited for securitization are that the risks of default are spread from a single originator to a group of investors and that the substitution of illiquid assets for cash on the balance sheets of originators strengthens the lenders. In the aftermath of the current financial crisis, however, the scope of those benefits will require thoughtful reevaluation.

The ways in which small businesses and families benefit from securitization are not well documented. There is little doubt that the growth of securitization has been associated with dramatic growth in the size of credit markets and that securitization can increase credit availability. But it is also difficult to separate the underlying increases in credit availability generated by the classic model of securitized vehicles from those increases generated by risky and economically unsustainable practices within the securitization markets. Such practices include:

Underwriting Standards. Because the underlying loans are reflected on the originator's balance sheet for only a short time--until they are sold away--the originator may drop underwriting standards, and make less creditworthy loans, in order to generate loans that will be immediately sold off for cash.\146\

\146\ Fees and other compensation to originators and participants in the securitization process rewarded short-term issuance of large volumes of such securities without imposing consequences for poor long-term performance. Likewise, these participants had no ownership stake in the security they helped to create, leading to a misalignment of incentives. Community bankers who testified at the Panel's Milwaukee hearing on April 29, 2009, discussed this point, noting that, in their view, securitization can undermine prudent loan underwriting standards by creating a barrier between borrowers and the person or entity that ends up owning the loans involved. See Panel Milwaukee Field Hearing, supra note 42.

Risk, Credit Ratings, and Pricing. The lender should receive a lower price for riskier loans, which would produce a counter pressure to increase loan underwriting standards and the quality of the loans. But counter pressure is less likely to arise: (1) when the ratings of creditworthiness of the underlying assets are opaque or inaccurate; (2) if asset prices are rapidly rising (for example, for real estate during the real estate bubble); or (3) if the lender wants the cash badly enough in order to generate quick profits, to prop up a failing balance sheet, or for other potential uses.

Originator's SPV Risk. The securitization process may mask an originator's exposure to the effect of the riskiness of the loans in the SPV pool, and the originator may be forced in certain circumstances to bail out the SPV at a cost to its own balance sheet.

Concentration Rather Than Dispersion of Risk of Loss. Lax underwriting standards in loan pools are not reflected in credit ratings, and this has the effect of concentrating--not dispersing--risk.

Impact on Workout of Individual Loans or Groups of Loans. The aggregation of loans into large pools to generate composite investment payments may make workouts of individual loans or groups of loans extremely difficult, which means that the impact of a rise in defaults is magnified in a securitized loan pool. This problem is further magnified when careful recordkeeping becomes one of the first casualties of an over-accelerated securitization process. (Several other factors also produce difficulties in work-out situations that affect the ability to reformulate or grant forbearance to individual debtors. These include the terms of pooling and servicing agreements, potential litigation risk, and objections by investors who hold junior tranches of debt securities and who worry that the impact of forbearance will be borne solely by their ``lower tier'' investments.) \147\

\147\ The January Regulatory Reform Report adopted by a majority of the Panel suggested several possible ways to reform the securitization process. These include requiring issuers to retain a portion of their offerings to give issuers an economic stake in the validity of their underwriting process and phased compensation based on loan or pool performance. See Congressional Oversight Panel, Special Report on Regulatory Reform, at 49 (Jan. 2009) (online at cop.senate.gov/documents/cop-012909-report-regulatoryreform.pdf) (hereinafter ``Panel's January Regulatory Reform Report''). The Panel noted, however, that further study would be required before any of these reforms could be recommended affirmatively. Id.

The financial crisis illustrated the difficulties facing investors in judging the quality of the loans backing their debt securities. To perform this function they turned to credit rating agencies. For a combination of reasons--including the use of flawed models and analytic assumptions--the performance of credit rating agencies in dealing with securitized vehicles during the last several years has been subject to increasing questions and, at least with respect to mortgage-backed securities, has proved to be little short of disastrous.

Thus, securitization has both strong proponents and some equally strong critics. Securitization can enhance credit availability as the economy grows, even if traditional deposits

grow at a slower rate. There is, however, general agreement that identifiable breakdowns in the system, such as the deterioration in underwriting standards, must be addressed.

2. THE TALF

The securitization market has now contracted dramatically, with the annual rate of activity in the first quarter of 2009 running at a level that was 80 percent below the level in 2007.\148\ Annual issuance of asset-backed securities resulting from non-real estate securitization approached $300 billion before the credit crunch.\149\ In terms of total debt issuances (including Treasury borrowing) in the U.S. credit markets, all forms of securitizations accounted for 54 percent of the market in 2005.\150\ Securities backed by credit card debt, student loans, and auto loans fell from $230 billion in 2007 to only $121 billion in issuances in 2008, and most of the $121 billion in 2008 occurred in the first half of the year.\151\ Global asset-backed securities issuances fell from $4.1 trillion for 2006 to only $2.8 trillion for 2008.\152\

\148\ See U.S. ABS Issuance, supra note 139.
\149\ See Figure 7.
\150\ See U.S. ABS Issuance, supra note 139.
\151\ See U.S. ABS Issuance, supra note 139.
\152\ International Financial Services London, Securitisation 2009, at 2 (Apr. 2009) (online at www.ifsl.org.uk/upload/CBS_Securitisation_2009.pdf).

Many investors have fled the market. Where they remain, they have demanded increased yields on even the highest-rated asset-backed securities (AAA); the interest rate spreads on these securities in the first quarter of 2009 stood at record highs. Uncertainty in the market about the broader economy and the ability of securities to produce their promised payment streams only heightens the problem. If the recession worsens, even the most creditworthy of small businesses and consumers may fall behind or default on their loans. If delinquency and default rates increase on these loans, then the value of even the highest-rated securities can drop precipitously.

The Federal Reserve Board and Treasury summarized their concerns and solution in March of this year:

> The asset-backed securities market has been under strain for some months. This strain accelerated in the third quarter of 2008 and the market came to a near-complete halt in October. At the same time, interest rate spreads on AAA-rated tranches of such securities rose to levels well outside the range of historical experience, reflecting unusually high-risk premiums. The securitization markets historically have funded a substantial share of consumer credit and [SBA]-guaranteed small business loans. Continued disruption of these markets could significantly limit the availability of credit to households and small businesses and thereby contribute to further weakening of U.S. economic activity. The TALF is designed to increase credit availability and support economic activity by facilitating renewed issuance of securities backed by small business and family loans at more normal interest rate spreads.\153\

\153\ Federal Reserve Bank of New York, Term Asset-Backed Securities Loan Facility (TALF) Frequently Asked Questions (online at www.newyorkfed.org/markets/talf_faq.html) (accessed May 5, 2009) (hereinafter ``TALF FAQs'').

As noted above, the Financial Stability Plan intends to revive small business and family credit by restarting the securitization process through the TALF. The TALF, in turn, attempts to address the reasons investors are fleeing the securitization markets in order to bring them back into those markets until economic conditions improve to the point that the markets can again become self-sustaining.\154\ Eligible investors must be organized in the United States to be eligible for TALF financing but may otherwise be any sort of vehicle, including hedge funds, private equity funds, mutual funds, or investment vehicles created exclusively for the purpose. Treasury and the Federal Reserve Board hope that including all sorts of investment vehicles within the range of eligible investors will itself add to investor demand for securitized products.

\154\ U.S. Department of the Treasury, U.S. Treasury and Federal Reserve Board Announce Launch of Term Asset-Backed Securities Loan Facility (TALF) (Mar. 2, 2009) (online at www.financialstability.gov/latest/tg45.html).

The TALF works through monthly facilities. Each month, until the end of 2009, the FRBNY will make loans to investors to buy securities backed by one or more of four classes of securities: credit card receivables, student loans, loans guaranteed by the SBA, and personal auto loans and leases. The asset-backed securities become the collateral--i.e., are pledged to the FRBNY as security--for the loans. Significantly, the loans are non-recourse; if the investors default, the government is left simply with the pledged asset-backed securities, which may be worth less than the outstanding loan balance.\155\ The total amount devoted to these facilities will initially be $200 billion. Treasury agrees to put up as much as $20 billion to defray losses realized by the FRBNY if loan defaults occur.

\155\ The intended appeal of the program, for investors, lies in the fact that there is a fixed, and fairly limited, downside and no reflection of the government's subsidy on the upside, as discussed below.

The loan pools, except for pools of loans guaranteed by the SBA, must all be rated as AAA by two ratings agencies and continue to satisfy the requirements for an AAA rating.\156\ No third party guarantee may be taken into account in arriving at the AAA rating.\157\ The FRBNY will try to control for the risk it assumes by discounting the value of the collateral; that is, it will fund less than the full value of the asset-backed securities being purchased with its loan. This discount is called a ``haircut'' and is based on: (1) the asset class of the underlying asset; and (2) the duration of the underlying loan. For example, current haircuts range from five to 16 percent (that is, loans will cover between 95 and 84 percent of the asset-backed securities being purchased).\158\ The haircut effectively represents the amount the investor places at risk in return for the loan.

\156\ Only three accredited credit rating agencies are recognized by TALF for purposes of determining TALF-eligible asset-backed securities: Moody's Investor Service, Standard and Poor's, and Fitch Ratings. The FRBNY will ``periodically review its use of NRSROs for the purpose of determining TALF-eligible ABS.'' TALF FAQs, supra note 153. On May 1, the FRBNY announced that it would reevaluate the rating agencies that may be used in evaluating, for TALF purposes, pools of loans backed by commercial mortgages. Federal Reserve Bank of New York, Term Asset-Backed Securities Loan Facility (CMBS): Frequently Asked Questions (May 1, 2009) (online at www.newyorkfed.org/markets/talf_cmbs_faq.html).

\157\ This condition appears to rule out the use of letters of credit, guarantees, or credit default swaps or other derivatives to boost the creditworthiness of a pool of assets sought to be securitized.

\158\ For the May TALF operation, automobile sector haircuts range from six percent to 16 percent; fixed interest rates are based on the LIBOR swap rate for the comparable period of the loan plus 100 bps and floating rates are based on the 1-month LIBOR plus 100 bps. Credit card sector haircuts range from five percent to ten percent, with interest rates following the same profile as automobile sector. Student loan haircuts range from five percent to 14 percent for private loans, with only floating rates available at 1-month LIBOR + 50 bps and 1-month LIBOR + 100 bps for government and private loans respectively. Small business loan haircuts range from five percent to six percent, with rates dependent on the whether the loans are 7(a) or 504 loans. For a complete list of haircuts and rates, see Federal Reserve Bank of New York, Term Asset-Backed Securities Loan Facility: Terms and Conditions (Apr. 21, 2009) (online at www.newyorkfed.org/markets/talf_terms.html) (hereinafter ``TALF Terms and Conditions'').

The program is administered by the ``primary dealers'' through whom the FRBNY normally conducts monetary policy; in this case, the primary dealers enter into the actual loan agreements, receive payments of interest and principal on behalf of the FRBNY, and are responsible for assuring that prospective investors meet the requirements for TALF participation. Securitized pools still may be issued in tranches--usually based on differing times for repayment in the case of auto loans and in some cases for student loans.

These terms represent an improvement over prior securitization structures. First, because the Federal Reserve Board and Treasury have taken on the ``leveraging'' risk, there is only a limited possibility that a precipitous drop in the value of asset pools can generate the chain-reaction defaults that characterized the financial crisis. Second, the value of pools cannot be inflated by cloaking their credit risks through the use of third-party instruments such as credit default swaps. Third, originators cannot buy the asset pools that they originated, a limitation that should prevent originators from pumping up market values and stimulating demand for over-lending. (This feature poses a problem for SBA loans that needs

to be addressed.) Finally, funds will not be loaned for the purchase of synthetic obligations, that is, second-level obligations backed by asset-backed securities that are themselves backed by assets. The prohibition against synthetic securities removes from TALF securitization one of the most serious flaws in the securitization system before the crisis began.

Some features of the securitization model that were problematic in some contexts before the onset of the financial crisis may not be dealt with fully by the TALF. Among these issues are the problem of insufficient risk retention by the originators of the credit and the reliance on credit rating agencies, absent reforms to the credit rating agency model to determine credit quality for the purposes of eligibility for the TALF program.\159\

\159\ The January Regulatory Reform Report adopted by three of the five members of the Panel recommended that a regulatory body, such as the Securities Exchange Commission or a newly-created independent agency, oversee credit rating agencies in order to defuse the potential conflicts of interest that exist in the current system. Panel's January Regulatory Reform Report, supra note 147, at 43-44. An alternative approach discussed by the Panel was the transfer of credit rating functions themselves to a government agency. Id.

But the core of the TALF, as noted above, and the most fundamental policy question it raises, is the transfer of the risk of loss from the investor to the taxpayer. In a normal securitization, the investor bears the risk. Ordinarily the investor loses money if the asset-backed security declines in value; if the investor has taken out loans to pay for the investment, funds to pay back the loan must come from other sources if the investor is to avoid default. Under the TALF, when the loan matures, the investor may elect to pay the loan or remit the collateral to the FRBNY. If the securities decline in value, the investor can walk away and leave the FRBNY with the asset-backed securities that the investors posted as collateral when the loans were made. If the collateral's credit rating falls over the course of the loan, moreover, there is no requirement that the investor post any additional collateral. The investor's loss would be limited to the equity paid to make up the shortfall between the asset's purchase price and the TALF loan (i.e., the amount of the haircut) plus fees and, in certain cases, any interest that has been paid on the loan. If the securities increase in value, however, the investor reaps any profit. In establishing the loans in the facility as non-recourse, Treasury and the FRBNY (and ultimately the Federal Reserve System) appear to have taken on the lion's share of the risk in their effort to entice investors back into these markets in what they believe is the necessary volume. It should be noted, however, that the risk to the FRBNY and Treasury will be offset to some degree not only by the haircut charges but also by the interest charged by the FRBNY on the TALF loans.

(One method of valuing the potential cost of the subsidy inherent in the TALF loan terms is not easy. One method may be to refer to the cost in the market for credit default swaps for private loans with non-recourse financing and interest rate, haircut, and other terms similar to TALF terms. A greater volume of transactions is required in order to conduct a sound valuation using this or other methods.)

Despite the substantial inducements the TALF is designed to provide, the demand for TALF financing to date has been mixed. Neither the March nor April facilities generated substantial interest, especially in light of the $200 billion set aside for the TALF until the end of the year (approximately $20 billion a month). Subscription activity increased to $10.6 billion in early May.

FIGURE 10: AMOUNT OF TALF LOANS REQUESTED AT MARCH 17-19, 2009 SUBSCRIPTION

Sector	Amount
Auto	$1,902,404,052
Credit Card	$2,804,490,000
Student Loan	-
Small Business	-
Total	$4,706,894,052

FIGURE 11: AMOUNT OF TALF LOANS REQUESTED AT APRIL 7, 2009 SUBSCRIPTION

Sector	Amount
Auto	$811,023,487.61
Credit Card	$896,780,798.84
Student Loan	-

Small Business	-
Equipment	-
Floorplan	-
Servicing Advances	-
Total	$1,707,804,286.45

FIGURE 12: AMOUNT OF TALF LOANS REQUESTED AT MAY 5, 2009 SUBSCRIPTION

Sector	Amount
Auto	$2,184,661,172
Credit Card	$5,524,840,000
Student Loan	$2,347,482,720
Small Business	$86,564,702
Equipment	$456,075,698
Floorplan	-
Servicing Advances	-
Total	$10,599,624,291

The first two rounds of TALF lending produced only loans made to the credit card and the auto sectors. During the March 17-19 round, a total of $4.7 billion in TALF lending was issued with $1.9 billion, or 40 percent, attributable to the auto sector and $2.8 billion, or 60 percent, attributable to the credit card sector. There were no loans in the student loan or small business sectors. During the April 7 round, a total of $1.7 billion in TALF loans issued were again divided between the auto and credit card sectors: $811 million in auto loans and just under $900 million to the credit card sector.

The May 5 round showed a significant increase in participation, both in terms of total lending and sectors represented. Credit card securitizations financed by TALF, totaling $5.5 billion, were well above the combined total for the previous two facilities. For the first time, TALF was used to securitize lending in student loans, small businesses, and equipment, although the amounts in the latter two categories were modest.

By way of comparison, total non-real estate backed securities' originations for 2008 were $135 billion; they were $14.6 billion for the first quarter of 2009. The apparent drop in monthly originations may be a result of the economic climate, tightening terms, or deleveraging.

If the quantitative results of the TALF have been below expectations to date, there are indications that its qualitative effects on the securitization markets have begun to take hold. In discussions with staff of the Panel, officials of the FRBNY have reported that interest rate spreads on new securities backed by credit card and auto-loan receivables have narrowed since the TALF began operation. As indicated above, the level of interest payments investors require to buy asset-backed securities indicates their relative confidence, or lack of confidence, in the health of the loans backing their securities. Once the credit crunch began, investors were demanding higher levels of interest on asset-backed securities than were normally seen, and bringing those interest rate levels back into line--and hence raising the price that originators could receive for their loans--was a major objective of the TALF. It is not surprising that the TALF is having this effect, given that the non-recourse nature of the TALF loans reduces substantially the risk to investors regardless of the health of the asset pool. Investors have been willing to buy new securities backed by credit card and auto-loan receivables that bear lower interest rates, indicating a lower assessment of risk.
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TALF investors are willing to accept lower interest rates on the securities that they have purchased through the TALF because, in large part, of the favorable financing they have received from the FRBNY. This appears to have been a key cause of the narrowing of interest rate spreads (see Figure 13). But the TALF apparently does not eliminate all concern about heightened investment risk. Although spreads have fallen to about half of their peak levels, most remain well above 100 basis points from similar spreads before the crisis and some reach upwards of 300 basis points.\161\

\160\ Chart created using subscription-only data (with permission) from Morgan Markets, the research and market data portal for J.P. Morgan Chase & Co.

\161\ See Board of Governors of the Federal Reserve System and Federal Reserve Bank of New York, Responses to March 20 Inquiry of the Congressional Oversight Panel, at 6 (Apr. 10, 2009) (online at www.newyorkfed.org/markets/response_040109.pdf) (``Five-year spreads on

AAA-rated credit card asset-backed securities tightened to 300 basis points above Libor in early February 2009, down from 550 to 600 basis points in December; 3-year AAA-rated auto ABS spreads tightened to 350 basis points above swaps in March, down from 600 basis points in early January; and FFELP student loans of similar tenors and ratings fell to 175 basis points in February, down from 350 basis points in early January. Market participants noted that spreads on each of these asset classes benefitted from inclusion in the original TALF design, even before the first subscription date.'').

FRBNY officials also attribute the sale of several ``non-TALF'' packages of auto-loan receivables to the impact of the TALF on spreads. This is an important reminder that the success of TALF in generating additional small business and family credit should not be judged solely by the volume of TALF transactions. And, in conversations with Panel staff, they noted that ``traditional investors,'' such as asset management firms and pension funds, have begun to return to the market as asset-backed securities investors, although banks and insurance companies have not done so due to balance sheet constraints. But the evidence to support this statement is not available.\162\ Officials also argue that many participants have stayed away from TALF financing because their regulatory regimes do not currently permit them to borrow to buy asset-backed securities.

\162\ In its April Report, SIGTARP requested more transparency regarding the details of TALF transactions. The report states that ``SIGTARP continues to recommend that Treasury require all TARP recipients to report on the actual use of TARP funds in the manner previously suggested. This recommendation applies not only to capital investment and lending programs involving banks and other financial institutions, but also to programs in which TARP funds are used to purchase troubled assets, including details of each transaction in the Public-Private Investment Program (`PPIP') as well as all transactions concerning the surrender of collateral (including the identity of the surrendering borrowers) in the Term Asset-Backed Securities Loan Facility (`TALF').'' SIGTARP, Quarterly Report to Congress, at 138 (Apr. 21, 2009) (online at www.sigtarp.gov/reports/congress/2009/April2009_Quarterly_Report_to_Congress.pdf) (hereinafter ``SIGTARP Quarterly Report'').

It is difficult to draw a line in evaluating the level of demand for TALF-funded securitizations between systemic problems and issues created by the design of the TALF itself. The regulatory limitations on the purchase of securitized loans existed before the financial crisis began. In addition, traditional participants in the asset-backed securities markets are now weak; pension funds, for example, are likely to be leaving stable fixed income products to rebalance their portfolios as a result of equity and alternative asset losses, and the TALF cannot change that dynamic. Moreover, if banks are weak, they cannot participate in the markets even on the terms of the TALF.

However, FRBNY officials and the Securitization Forum of the Securities Industry and Financial Markets Association point to what investors may view as problems with the TALF itself. These problems affect all potential transactions.

One problem is the lack of transferability of the asset-backed securities after the end of 2009. The prohibition means that investors are locked into their investments; they can neither realize a profit if interest rates drop nor limit a drop in value of their securities if interest rates rise. They also cannot protect themselves against a loss in the amount of the haircut they bore if credit experience proves worse than was assumed when the price for the securities was set. Second, there was a mismatch between the three-year maximum loan term and the five-year maximum range of the underlying assets backing the loans, until the Federal Reserve Board acted on May 1 to extend the loan term to five years.\163\ The mismatch meant that the non-recourse financing would expire before the debt securities were paid back, leaving the investors to assume the full risk for the last two years of the investment. Third, some representatives of institutions and investors who normally participate in securitizations have indicated that the average cost of funds for participating in the program is greater than that offered by other federal loan assistance and guarantee programs. The FRBNY has not provided any information regarding its methodology for setting either the haircuts or the interest rates for the loans, and investors may well hesitate to make their own funds the test case to determine if the FRBNY has estimated the rates correctly.\164\

\163\ See TALF FAQs, supra note 153.

\164\ Some investors have indicated that the limitation to AAA credit ratings on the underlying assets is restricting the growth of loan demand. The transfer of liability from investors to taxpayers is premised on the fact that only the most secure loans should be subject

to securitization under those terms. Any revision of this limitation would raise the risk for the taxpayer and move the program into the financial universe that prevailed before the crisis began.

FRBNY officials have observed that investors have questions as to whether or not TALF investors will be subject to conditions that have been placed on participants in the TARP generally. An example is how the limits on executive compensation imposed on recipients of TARP funds would apply to TALF. The FRBNY's and Treasury's current position is that private parties participating in TALF generally will not be subject to either statute-based or policy-based executive compensation restrictions.\165\ Before issuing this recent guidance, however, the FRBNY and Treasury had made an initial policy decision to require TALF sponsors, but not investors, to adopt certain executive compensation practices as a requirement of participation.\166\ However, financial market participants continue to express concern about the potential application of executive compensation and other TARP limitations to participants.\167\

\165\ SIGTARP Quarterly Report, supra note 162, at 103, 225-28 (including a Treasury legal memorandum, produced in response to SIGTARP questioning on the issue, concluding that private TALF participants were not subject to the executive compensation provisions found in section 111 of EESA, as amended by ARRA, because of its determination that ``the relationship between TALF participants and the TARP program was not sufficiently direct to conclude that the TALF participants were receiving `financial assistance' from TARP.''); TALF FAQs, supra note 153 (``Given the goals of the TALF and the desire to encourage market participants to stimulate credit formation and utilize the facility, the restrictions will not be applied to TALF sponsors, underwriters, and borrowers as a result of their participation in the TALF.'') Treasury left open the possibility that fund managers in the PPIF's Legacy Security Program could be subject to executive compensations restrictions if they are deemed active investors when these securities receive financing an expanded TALF and that the FRBNY itself may be subject to the restrictions. SIGTARP Quarterly Report, supra note 162, at 110, 226-27.

\166\ SIGTARP Quarterly Report, supra note 162, at 103, 226-27.

\167\ See Federal Reserve Bank of New York, Remarks as Prepared for Delivery by President and Chief Executive Officer of the New York Federal Reserve Bank William C. Dudley at Vanderbilt University: The Federal Reserve's Liquidity Facilities (Apr. 18 2009) (online at www.newyorkfed.org/newsevents/speeches/2009/dud090418.html) (characterizing fears expressed by some investors that participation in TALF may lead to increased regulation of investor practices as ``misplaced'' but ``understand[able] . . . given the political discourse'' and the ``intense scrutiny of bank compensation practices'' that arose from TARP investments in financial institutions).

The uncertainty of the application of a provision to TALF participants who hire foreign workers also may limit participation in the program. TALF investors face restrictions on their ability to hire new foreign workers on temporary H-1B visas.\168\

\168\ Section 1611 of ARRA, supra note 69, prohibits any recipient of funding under Title I of EESA or section 13 of the Federal Reserve Act from hiring new H-1B workers unless they had offered positions to equally- or better-qualified U.S. workers, and prevents recipients from hiring H-1B workers in occupations in which they have laid off U.S. workers. U.S. Citizen and Immigration Services, USCIS Announces New Requirements for Hiring H-1B Foreign Workers (Mar. 20, 2009) (online at www.uscis.gov/files/article/H-1B_TARP_20mar2009.pdf). See also TALF FAQs, supra note 153 (``The EAWA applies to all borrowers under the TALF. In addition, if the eligible borrower is an investment fund, the EAWA also applies to any entity that owns or controls 25% or more of the total equity of the investment fund.'').

FRBNY officials have also asserted that a reason for investor reluctance is uncertainty surrounding the TALF's terms and conditions. Since the TALF was first announced, there have been numerous changes to the program. These include potential expansion of the TALF to include new classes of assets and standardization of master agreements and procedures.

If the TALF has not been as successful as originally projected because potential investors want to loosen its terms to resemble those of the old securitization markets, Treasury is faced with a Hobson's choice between limiting a critical financial mechanism and facilitating market recovery in a way that increases the same risks associated with dangerous underwriting. These risks can be mitigated through appropriate reforms in asset-backed securities markets.

A different set of issues is presented if the lack of demand for the TALF reflects investor demands rather than the availability of reasonably creditworthy assets to back the proffered asset-backed securities. In that case, the government

may be facing the unintended effects of its creation of a number of different facilities to lower the cost of funds to financial institutions. Problems with the terms of proffered credit and the economic condition of small businesses and families greatly complicate the ability of securitization to revive small business and family lending at this point in the recovery cycle.\169\

\169\ When details of the program were first rolled out in early March, eligible securities were limited to those backed by four categories of loans: federally guaranteed student loans; SBA guaranteed small business loans; certain auto loans (retail loans and leases relating to cars, light trucks, motorcycles and RVs, as well as auto dealer floorplan loans); and credit cards. Even at that time, however, the Federal Reserve Board had plans to extend the program to include securities backed by additional categories of loans. As of the writing of this report, TALF-eligible securities include those backed by the original four categories, plus those backed by: commercial and government fleet auto leases; rental fleet loans; non-auto floorplan loans; residential mortgage servicing advances; and certain equipment loans and leases. Each of these categories was included in the April round of TALF lending. Although these new TALF assets do not reduce the $200 billion allocated for small business and family securitization transactions under TALF, they may reduce the relative proportion of such loans securitized under this part of the TALF. Expansion of the TALF to include another $800 billion for securitization of commercial assets and purchase of mortgage-backed securities issues before the financial crisis began are not within the scope of this report, except to note that the allocation of such funds for other purposes reduces the potential for increase in the $200 billion ceiling.

The most significant issue this raises for the Federal Reserve Board and Treasury is whether the TALF, and a restarting of the securitization markets, is the best way to revive small business and family lending.

E. Small Business Credit, the TALF, and Other Efforts to Expand Small Business Access to Credit by Jumpstarting Secondary Markets

Small business loans have generally provided a less attractive target for securitization than mortgage and credit card loans because they lack standardized loan performance data, documentation, and underwriting procedures.\170\ In particular, non-SBA guaranteed portions of 7(a) loans, as well as loans made outside the SBA framework, are usually more profitable to hold to term than to sell in the secondary market.\171\ In addition to the lack of standardization of those loans, a recent study has suggested that information gaps provide a significant barrier to securitization:

\170\ Devon Pohlman, Federal Reserve Bank of Minneapolis, With Support, Securitization Could Boost Community Development Industry (Nov. 2004) (online at www.minneapolisfed.org/publications_papers/pub_display.cfm?id=2416). See also, Ron J. Feldman, Federal Reserve Bank of Minneapolis, An Update on the Securitization of Small Business Loans (Sept. 1997) (online at www.minneapolisfed.org/publications_papers/pub_display.cfm?id=3632) (``the heterogeneity of small business loans has made it difficult for a firm to act as a conduit to the securitization market for small business lenders.''); Temkin and Kormendi, supra note 18.

\171\ Id.

> In contrast to the residential and commercial mortgage market, there are much less data available on the performance of conventional small business loans. Lack of data was an issue raised by nearly all of the industry participants we spoke with, including representatives of rating agencies, lenders and investment banks regarding the feasibility of a secondary market for these loans. According to one key informant, the biggest problem in increasing the secondary market volume for conventional small business loans is that historical loan performance and loss rate data are not available.\172\

\172\ Id. at 25.

While securitization consequently plays a limited role in small business financing--especially in comparison to the role it plays in the consumer and mortgage credit markets--the securitization of SBA-guaranteed portions of 7(a) loans has nonetheless accelerated over the past few decades.\173\ In recent years, 7(a) loans have often been spliced, with the guaranteed portion (up to 75 percent) sold in the secondary market and the non-guaranteed portion held on the bank's balance sheet.\174\ From 2006 through 2008, between 40 and 45 percent of the SBA guaranteed portion of 7(a) loans were sold into the secondary market.\175\ The SBA estimates that about

$15 billion of securities backed by 7(a) loans are currently outstanding.\176\ As discussed supra, however, SBA-guaranteed loans constitute only a small percentage of total lending to small businesses. As a result, the overall impact of the secondary market on small business financing is limited.

\173\ Id. at 14; Temkin and Kormendi, supra note 18, at 14.

\174\ Panel staff discussions with GAO and trade groups have confirmed that the non-guaranteed portions of the SBA loans are generally kept in the lender's portfolio and are not securitized.

\175\ Government Accountability Office, Small Business Administration's Implementation of Administrative Provisions in the American Recovery and Reinvestment Act of 2009, at 6 (GAO_09_507R)(Apr. 16, 2009) (online at www.gao.gov/new.items/d09507r.pdf) (hereinafter ``April GAO Report on SBA Implementation'').

\176\ U.S. Small Business Administration, SBA Welcomes Federal Reserve and Treasury Actions to Improve TALF Program to Help Unclog Secondary Market for Small Business Loans (Mar. 5, 2009) (online at www.sba.gov/idc/groups/public/documents/sba_homepage/news_release_09_15.pdf) (hereinafter ``SBA TALF Press Release'').

Even though secondary markets play only a minor overall role in small business financing, the SBA has attributed the lending slowdown in part to the stalled securitization market for 7(a) loans.\177\ The way small business loans are securitized is somewhat different from the mechanisms described above, however, and the reasons for investment in pools of 7(a) loans are unique. In contrast to other types of loans, SBA loans are not securitized by their originators. The most important reason for this is that few lenders originate a sufficiently large number of 7(a) loans to form a marketable pool. But it is also important that the loans generally do not have uniform terms or interest rates and are difficult to put into a pool that can accurately be priced. A small group of specialized broker-dealers has developed the expertise to understand what is essentially a niche market and develop risk and interest rate assumptions to bridge some of these difficulties.

\177\ The secondary market for first lien mortgages associated with the SBA's 504 loan program also seized up last year in part because broker-dealers who assemble pools of 504 loans found themselves unable to secure ``credit enhancements,'' which made the pooled loans more attractive to investors. The secondary market for the SBA-guaranteed debenture portion of 504 loans remains largely intact.

Generally, these broker-dealers (who function as ``pool assemblers'' in this context) buy small business loans from the many banks that originate them and assemble the loans into pools. The mechanics of the process require that the broker-dealers hold the loans themselves (in their securities inventory) until they can assemble a sufficient number of loans to form a pool capable of securitization; the assemblers must themselves borrow funds to finance their inventory of loans pending their pooling and sale.

The portion of small business loans that is SBA-guaranteed generally carries low interest rates, consistent with its guaranteed nature. Investors can generally borrow funds at about 50 basis points below the SBA interest rate, so that they can earn 50 basis points, or about .05 percent, on their safe investment. This return is possible, of course, only if the spread between what investors have to pay and the interest rate the SBA-backed loans pay remains constant.

Last fall, the secondary market for 7(a) loans stalled largely as a result of: (1) the tightening of the Prime versus LIBOR spread, which reduced the attractiveness of investment in securitized 7(a) loans (indeed, the return for investors had disappeared); \178\ (2) the strained capacity of broker-dealers, who were unable to sell their current inventory and thereby free up capital to buy and pool additional loans; (3) the reduced access to and increased cost of credit for broker-dealers, who could not sell off inventory to pay off existing loans; and (4) general uncertainty and fear in the marketplace. While individual investors regularly enter and exit the secondary market for SBA loans, it is unusual for all actors to stop buying simultaneously, as they did last fall. While about $4 billion in securities backed by 7(a) loans are normally traded in securitization markets each year, the SBA estimates that only about a quarter of that volume is currently being traded.\179\ According to the SBA, the illiquidity that resulted has hampered the ability of institutions to make new SBA-backed loans.\180\

\178\ See Coastal Securities, Inc., State of the SBA Market (Dec. 3, 2008) (online at www.coastalsecurities.com/sbamarketinfo/State%20of%20the%20SBA%20 Markets_20081203. pdf). While the three-month LIBOR rate generally has been about 300 basis points below the Prime rate, in October of last year, the spread tightened, with LIBOR

exceeding the Prime rate for a time.

\179\ SBA TALF Press Release, supra note 176. See generally, April GAO Report on SBA Implementation, supra note 175.

\180\ Id.

Treasury and the Federal Reserve Board, through TALF, have acted on the similar premise that the restoration of the securitization markets is essential and perhaps the fastest way to restore lending. Specifically, Treasury and the Federal Reserve Board have sought to provide loans for the purchase of poolable SBA loans to increase demand in the SBA secondary market. By doing so, policymakers have stated that their intention is to increase the capital available for small business loans, reduce costs for lenders, and increase overall lending rates.\181\ The SBA has supported this initiative and argued that it will help ``unfreeze the secondary market for SBA loans, thus making it easier for [lenders] to make new loans to America's small businesses.'' \182\

\181\ See 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.ustreas.gov/press/releases/reports/talf_white_paper.pdf) (hereinafter ``The Consumer and Business Lending Initiative''); U.S. Department of the Treasury and Board of Governors of the Federal Reserve System, Joint Press Release (Mar. 3, 2009) (online at www.federalreserve.gov/newsevents/press/monetary/20090303a.htm).

\182\ SBA TALF Press Release, supra note 176.

Ultimately, the SBA itself has a critical role to play in TALF's success by working with the FRBNY to fit the TALF to SBA loan profiles. This is especially important because the size of existing pools of SBA-guaranteed loans is different from that originally anticipated for TALF products. In addition, the flexible characteristics of SBA loans, which are one of their most important features, and the manner in which the loans have traditionally been securitized, add to the need for a sophisticated approach to securitize them effectively. It is quite possible that SBA loan pools, as a niche market, require a greater lead time to be tested for inclusion in the TALF.

One broker-dealer of SBA loans has also noted problems in the current implementation of the TALF, including that: (1) borrowers must access the TALF by way of a primary dealer--many of whom are unfamiliar with the smaller, idiosyncratic market for pools of SBA loans; and (2) that TALF prohibits borrowers from pledging their own securities as collateral, thereby complicating the process.\183\ There would be demand from the pool assemblers themselves to borrow through the TALF to buy small business loans from their originators, but the TALF's terms and conditions bar them from doing so.\184\ However, an SBA program to provide low-interest loans to systemically significant broker-dealers (discussed below) could ultimately prove to be more attractive to broker-dealers than the TALF. Broker-dealers have also argued that the haircuts on SBA securities outlined by the Federal Reserve Board are not particularly attractive compared with terms they could receive in the open market. Although modest, the inclusion of SBA loans in the May subscription may suggest positive movement.

\183\ Chris LaPorte, Coastal Securities, Inc., Commentary on Recent Fed Initiatives Related to the SBA 7(a) Secondary Market (Mar. 30, 2009) (online at www.naggl.org/AM/Template.cfm?Section=Advocacy&Template=/CM/ContentDisplay.cfm&ContentID=10345) (hereinafter ``LaPorte Commentary'').

\184\ Id.

Beyond TALF, Treasury has also sought to intervene directly in the securitization market for small business loans by purchasing securities backed by SBA loans. Through this program, Treasury plans to dedicate $15 billion of TARP funds authorized under the Emergency Economic Stabilization Act of 2008 (EESA) to the purchase of securities backed by the government-guaranteed portion of SBA 7(a) loans and the non-government-guaranteed first-lien loans affiliated with the SBA's 504 loan program. These securities are to be purchased directly by the government from broker-dealers who purchase and securitize SBA loans to sell into the secondary market, as well as from banks and credit unions themselves. The goal of the program is to complement the TALF in working to improve the liquidity of the secondary market for SBA loans.\185\ Of course, increasing liquidity will be effective only if illiquidity has contributed to the problem, which some observers have questioned.

\185\ U.S. Department of the Treasury, Unlocking Credit for Small Businesses: FAQ on Implementation (Mar. 17, 2009) (online at www.financialstability.gov/docs/FAQ-Small-Business.pdf) (hereinafter ``Treasury FAQ on Implementation of the Small Business Lending

Initiative''). See also SBA Q&A for Small Business Owners, supra note 70.

It is also of note that, unlike the TALF, Treasury's program to purchase these securities would not utilize private-sector pricing. Rather, Treasury would purchase securities directly from ``pool assemblers'' and banks. According to Treasury documents, ``Treasury and its investment manager will analyze the current and historical prices for these securities'' in order to ``identify opportunities to purchase the securities at reasonable prices.'' \186\ Treasury defines such prices as those that fulfill the dual objective of ``[providing] sufficient liquidity to encourage banks to increase their small business lending and [protecting] taxpayers' interest.'' \187\ Treasury has hired Earnest Partners, an independent investment manager with experience with loans guaranteed by the SBA, to guide its efforts to buy the securities.\188\ Additionally, the Bank of New York Mellon has been chosen to be Treasury's custodian for the securities. While sellers of securities will issue warrants for the purchase of stock to the government and will have to abide by executive compensation requirements, the details of these aspects of the program have not been finalized.\189\ To date, Treasury has not made any purchases under this program \190\ or disbursed any funds to Earnest Partners.\191\

\186\ Treasury FAQ on Implementation of the Small Business Lending Initiative, supra note 185.

\187\ Id.

\188\ SIGTARP Quarterly Report , supra note 162, at 131.

\189\ Treasury FAQ on Implementation of the Small Business Lending Initiative, supra note 185.

\190\ According to Treasury's FAQ on Implementation document, purchases of securities backed by SBA 7(a) loans were to begin by the end of March 2009, while purchases of securities backed by first-lien 504 loans were to begin by May due to ``Treasury's need to conduct a thorough risk analysis, given that these securities are not government guaranteed.'' The direct purchase program is also to be utilized to purchase securities guaranteed through a new SBA 504 loan first-lien guarantee program, which was established by the ARRA when that program becomes operational. However, according to the most recent TARP Transactions report, no money has been disbursed as of yet under this program. See U.S. Department of the Treasury, Troubled Asset Relief Program: Transaction Report for the Period Ending April 13, 2009 (Apr. 15, 2009) (online at www.financialstability.gov/docs/transaction-reports/4-15TransactionReport.pdf).

\191\ SIGTARP Quarterly Report, supra note 162, at 131.

In addition to the TALF and the direct purchase program, ARRA includes a provision that authorizes the SBA to make low-interest loans to systemically important secondary broker-dealers who pool SBA loans to sell into the secondary market.\192\ The goal of this program would likewise be to inject liquidity into the secondary market for SBA loans in order to free up capital for new loans at banks. While the SBA has stated that it plans to implement this program ``as rapidly and effectively as possible,'' significant questions still exist. Specifically, GAO has noted that issuing regulations for these programs is challenging because it requires ``establishing new programs and related infrastructure, such as establishing policies and procedures, hiring and training staff, developing information systems, and establishing risk mitigation strategies as well as resolving critical policy issues.'' \193\

\192\ ARRA, supra note 69.

\193\ SBA Q&A for Small Business Owners, supra note 70; see also April GAO Report on SBA Implementation, supra note 175.

The ultimate success of these programs should be measured primarily by the increase in non-SBA bank lending that constitutes the overwhelming majority of small business credit, and secondarily by the extent to which: (1) the demand for securities and, ultimately, the size of the pool of SBA-guaranteed loans increases; and (2) securitization of non-SBA forms of credit, such as credit cards and home equity lines of credit, also contributes to the availability of small business credit. Treasury should track these metrics and regularly report them as a way to gauge the program's success and ensure accountability. The use of these metrics will also help Treasury and the Federal Reserve Board determine when changes in borrowing terms or tactics are necessary. While it will be difficult to separate out which program is causing which results in the marketplace, Treasury should be clear in stating what it intends to accomplish moving forward and what metrics should be used to judge its success.

In pursuing metrics, Treasury will need to overcome several specific challenges. First, the general lack of data on small

business lending, crisis or no crisis, increases the difficulty of tracking progress. For years, academics who have studied small business lending have cited the lack of concrete data as a major limiting factor in conducting rigorous, scholarly research on lending to small businesses.\194\ Moreover, as discussed earlier in this report, while agencies including the SBA and the Federal Reserve Board do compile some information on lending to small businesses on a yearly basis, these data are outdated, incomplete, and represents only a rough approximation of lending to small businesses over time.\195\ Although Treasury has begun requiring additional reporting in this area from certain TARP recipients, to date, Treasury's monthly lending snapshots have not included a category for small business lending.\196\ The Federal Reserve Board's Beige Book, published eight times per year, includes anecdotal evidence on economic conditions, but it also does not include a specific category for small business or small business lending.\197\

\194\ See Charles Ou, Statistical Databases for Economic Research on the Financing of Small Firms in the United States, SBA Office of Advocacy, at 2 (Feb. 2004) (online at www.sba.gov/advo/research/wkp04Ou.pdf) (``Research on small business financing has been much hampered by the lack of statistics. Small businesses are reluctant to provide information about their finances, and lenders/investors have been unwilling or unable to provide lending data classified by the size of the borrowing business.'').

\195\ Even the Federal Reserve Board, in discussing small business lending in testimony before the Senate Committee on Small Business and Entrepreneurship in 2008, was unable to cite specific metrics for small business lending, instead using loans made by smaller U.S. banks and loans of $100,000 or less as a proxy for small business lending. See Mishkin Testimony, supra note 13, at 3. Also, when banks report data on small business lending once a year in their June call reports, they classify all commercial loans of less than $1 million as ``small business loans''--again merely an approximation of small business lending. See SBA Small Business and Micro Business Lending, supra note 21. Similarly, in the Federal Reserve's quarterly Survey of Terms of Business Lending, there is not a category for small business loans; rather, information must be inferred from loans of smaller dollar amounts and made by smaller banks. See Board of Governors of the Federal Reserve System, Survey of Terms of Business Lending, February 2-6, 2009 (Mar. 17, 2009) (online at www.federalreserve.gov/releases/E2/current/default.htm).

\196\ Treasury noted in its Monthly Lending and Intermediation Snapshot for January that ``several banks include small business loans in their `other consumer loans' ``category.'' See U.S. Department of the Treasury, January Monthly Lending and Intermediation Snapshot (Mar. 16, 2009) (online at www.ustreas.gov/press/releases/tg59.htm#_ftnref1).

\197\ Board of Governors of the Federal Reserve System, The Beige Book: Current Economic Conditions by Federal Reserve District (Apr. 15, 2009) (online at www.federalreserve.gov/fomc/beigebook/2009/20090415/fullreport20090415.pdf).

For these and other reasons, the Panel has called for more to be done to compile relevant data since its first report.\198\ Specifically, Treasury, the Federal Reserve Board, the SBA, or some other agency must strive to compile comprehensive, timely information on small business lending across the country. Both static and flow data should be collected, and these data should include the number and amount of small business loans (SBA and otherwise) on banks' balance sheets, the terms on which credit is being extended to small businesses, and statistics on the current default rates on small business loans. The data should also be compiled in a way that facilitates comparisons across region, types of banks, types of small businesses, and sizes of loans being made. Federal agencies also must be clear in their definition of a small business and small business lending for the purposes of this analysis.

\198\ COP December Oversight Report, supra note 62, at 17.

Second, in addition to data challenges, success is also difficult to measure because so little time has passed since the Administration's launch of the Small Business and Community Lending Initiative. While the Administration began implementing its programs in March to incentivize SBA lending described in the preceding section, initiatives to jump-start the secondary markets for pooled SBA loans and to allow banks to make fully guaranteed ``business stabilization'' loans have not yet begun.

Further, to date, Treasury has not yet begun purchasing SBA loan-backed securities from banks and broker-dealers even though, according to Treasury documents, these purchases were to begin by the end of March. The most frequently cited reason for this delay is that the banks and broker-dealers that hold these securities are reluctant to sell to the government because of fears that they would have to submit to executive

compensation and other requirements that accepting TARP money entails.\199\ One of the largest broker-dealers for SBA 7(a) loans commented that ``the utilization of this program will be hindered significantly by the requirement that participants selling securities also grant warrants that would enable Treasury to purchase common stock, preferred stock, or senior debt obligations.'' \200\ The broker-dealer added that ``other potential limiting factors include pricing of the securities to be purchased and the potential necessity to comply with executive compensation restrictions pursuant to the EESA.'' \201\

\199\ See David Cho, Federal Plan to Aid Small Businesses is Flawed, Lenders Say, Washington Post (Apr. 1, 2009) (``The conditions attached to the program, which require these financial firms to surrender ownership stakes to the government and limit executive pay, are so off-putting that these companies say they will not participate''); Fix for SBA Snagged by TARP's Exec Comp Limits, American Banker (Apr. 14, 2009) (``Since the Treasury Department is funding the plan with $15 billion of Troubled Asset Relief Program funds, broker-dealers and other participants would have to comply with executive compensation limits and issue warrants to the government. As a result, most of the large broker-dealers have said they do not want to participate, according to sources. Without their participation, the plan would almost certainly fail, observers said, leading the Treasury scrambling to come up with alternatives'').

\200\ LaPorte Commentary, supra note 183.

\201\ Id.

While it remains uncertain whether Treasury's strategy will succeed in jumpstarting secondary markets for securitized SBA-backed loans, the fact that SBA-backed loans fulfill a small fraction of the overall capital needs of America's small businesses and that small business loans not guaranteed by the SBA are unlikely to be securitized, suggests that Treasury's strategy may not have any meaningful impact on small business lending. Indeed, small businesses rely in large part on: (1) types of credit that are not readily securitizable, such as loans from friends, family, and angel networks; or (2) credit which originators often choose not to sell into secondary credit markets, such as non-SBA guaranteed loans or portions of loans.

For these reasons, although Treasury has presented its strategy as seeking to expand access to credit, it is unclear to what extent and in what direction its actions have affected or will affect small businesses.\202\ Moreover, policymakers are likely to debate whether any increase in small business lending moving forward is a result of government action. Ultimately, if current efforts to revive securitization fail to expand small business access to credit, the Administration should consider: (1) reviving SBA direct loans without going through bank intermediaries; and/or (2) devoting more funds directly to business lending rather than securitization, given that secondary markets may have limited impact on the financing of small and medium sized firms.

\202\ Treasury has, however, acknowledged a decrease in commercial and industrial lending among TARP recipients in January and February. It has attributed the decrease in large part to lower demand. Treasury February Snapshot, supra note 64.

F. Household Lending and the TALF

The overall household debt burden--which includes consumer loans and mortgages--has ballooned greatly over the past decade, with implications for the TALF. This growing debt burden will have an impact on the ability of families to both shoulder additional debt and service the debt already held on a timely basis, which will affect the risk perceived by potential investors targeted by TALF.

The structural concerns raised in the preceding sections, even if addressed by Treasury and the Federal Reserve Board, may not be enough to equip TALF to revive securitization markets for consumer loans. Treasury and the Federal Reserve Board designed TALF, according to a recent White Paper on the program, ``to stimulate investor demand for these [asset-backed securities], and thereby to reduce the funding costs of the issuers of the loans in the eligible classes. Ultimately, the program should bring down the cost and increase the availability of new credit to consumers and businesses.'' \203\ While success of the TALF should not be measured solely by the volume of TALF-funded securitizations, the monthly rate of TALF subscriptions serves as a useful barometer of investor demand, which itself reflects evaluations made by investors of the risks in buying securities backed by consumer loans.

\203\ The Consumer and Business Lending Initiative, supra note 181.

As indicated above, to date, the FRBNY has operated three TALF facilities that resulted in $17 billion in loans supporting credit card, automobile, student loan, small business and equipment securitizations.\204\ (Whether the use of TALF funding for auto loan-backed securitizations presages a substantial increase in auto lending cannot yet be evaluated.) No TALF loans supporting student loan-backed securities took place in March and April, continuing a drought in student loan securitizations that dates to the fall of 2008. However, in the most recent round of TALF lending, on May 5, 2009, $2.3 billion was requested for securities secured by student loans, signaling a possible uptick in this sector.

\204\ Federal Reserve Bank of New York, Term Asset-Backed Securities Loan Facility Operations (online at www.newyorkfed.org/markets/talf_operations.html).

TALF may lead to improved access to lending by consumers, a central goal of the program, but macroeconomic conditions may limit the impact of this additional financing on household borrowing as families may continue to deleverage over the course of the coming months. Concerns about the economy may also temper investor demand for asset-backed securities. While TALF could increase credit availability and reduce borrowing costs, the burden of existing debt, reduced net worth due to declining home values and stock market portfolios, and the specter of continued job losses could limit the short-term impact of TALF financing on the volume of consumer lending. Continued job losses over the course of the year will act as a drag on aggregate demand and contribute to the risk of default in securities backed by family loans. Thus, there are considerable macroeconomic headwinds, as discussed in Section C, that could limit TALF's success at reinvigorating investor demand for securities backed by loans to families in the early months of its existence.

The increase of TALF offerings may affect Treasury's efforts to loosen consumer credit markets, for securitization has played an increasingly significant role in consumer lending. Federal Reserve Board data show that in the past two years, approximately 25 percent of all non-mortgage consumer credit was funded through securitization.\205\ Since last year's disruption of the credit markets, new securitizations have effectively ceased, a change that has coincided with a decline in net household borrowing and increased interest rates. Auto loans, student loans, credit cards, and home equity loans made up the majority of asset-backed securities in recent years. Home equity loans were the largest proportion--64 percent in 2006. Auto loans, credit cards, and student loans made up 10.87, 8.87 and 8.9 percent, respectively, of asset-backed securities in 2006.\206\ One of the primary factors in determining the structure of the asset-backed securities is whether the underlying debt is revolving, such as credit cards, or non-revolving, such as car loans and student loans. Because installment loans are non-revolving, they must be paid off over a preset period of time and furnish more predictability.

\205\ The Consumer and Business Lending Initiative, supra note 181; TALF White Paper, supra note 140, at 1-2.

\206\ U.S. ABS Issuance, supra note 139.

Revolving debt holds more uncertainty for investors, as default and delinquency rates are more sensitive to economic conditions. As pre-tax profits for credit card issuers more than tripled between 1998 and 2006,\207\ the volume of securitization of revolving consumer credit as measured by the Federal Reserve Board nearly doubled.\208\ Rising profits and securitization helped expand access to credit cards to an unprecedented number of households, which improved the short-term liquidity of households (and made rapid growth of online commerce possible) but also generated fundamental pressure for the overleveraging of many American families.

\207\ Bank Credit Card Annual Pre-Tax Profits, CardTrak.com, (Apr. 29, 2009) (hereinafter ``Bank Credit Card Annual Pre-Tax Profits).

\208\ G.19 Historical Data, supra note 99.

The power of credit card issuers to re-price revolving credit card balances is a critical element in this growth. Nearly all credit card contracts feature a broad power to change the interest rates on existing balances, even if the customer makes all payments according to the terms of the contract. Estimates vary, but it appears that, as recently as 2007, re-pricing accounted for at least $12 billion in income for credit card issuers,\209\ and it accounted for an estimated 30 percent of the industry's pre-tax income in 2008, according to data from CardTrak.\210\ Re-pricing is also an important factor in both the price and the attractiveness of securities

backed by credit card receivables because it promises protection from both interest rate and credit risk. Re-pricing as a means for managing risk is an important question for consideration given the heightened risk of default and delinquency due to the current economic downturn examined in section C. Whether the entire amount of re-pricing is justified by increased risk or is instead an action either to offset other losses or to boost the issuers' net profits is a matter about which analysts disagree.

\209\ See Letter from Oliver Ireland, Partner, Morrison & Foerster, LLP to Jennifer Johnson, Secretary, Board of Governors of the Federal Reserve System, at 3 (Aug. 7, 2008) (online at files.ots.treas.gov/comments/bdc5cc5c-1e0b-8562-eb23-ff7159e49505.pdf).

\210\ Bank Credit Card Annual Pre-Tax Profits, supra note 207.

Re-pricing also illustrates an underlying tension between families who owe credit card debt on the one hand, and the institutions and investors that benefit from securitization of their loans on the other. Re-pricing can be burdensome to some families and have a potentially crippling economic impact on others. According to a recent working paper by the Pew Center, re-pricing a credit card balance of $3,500 can cost the average family one-fourth of its discretionary income over the course of a year.\211\ The lack of transparency in the fee structure behind re-pricing has had a negative impact on many households experiencing the price shock from the imposition of penalty rates and fees. In the current downturn, this price shock can prove especially harmful to families on the brink.

\211\ Letter from R. Dwayne Krumme, General Manager, Pew Credit Card Standards Project to Leonard Chanin, Assistant Director, Division of Consumer and Community Affairs, Board of Governors of the Federal Reserve System, at Exhibit One (Oct. 3, 2008) (online at www.pewtrusts.org/uploadedFiles/wwwpewtrustsorg/Summaries_-_reports_and_pubs/Fed%20Submission%20for%20Web.pdf).

The impact on families of increasing interest rates and fees raises a policy question under the EESA because the six major financial institutions holding 90 percent of the U.S. credit card business--Citigroup, Bank of America, J.P Morgan Chase, Capital One, Discover Card, and American Express--are TARP recipients that have received $123.17 billion in TARP aid.\212\

\212\ U.S. Department of the Treasury, Transactions Report (Apr. 22, 2009) (online at financialstability.gov/docs/transaction_reports/transaction_report_04-22-2009.pdf).

As credit card issuers raise rates and charge a growing range of fees while receiving taxpayer support, policymakers are considering whether financial institutions accepting government money should be subject to new limitations on their lending terms. An array of opinions exists on this question, both among Panel members and key stakeholders.

Changes in credit card lending requirements are currently on the legislative agenda. On December 18, 2008, the Federal Reserve Board announced final rules that will protect credit cardholders from unfair practices such as unexpected rate increases, double cycle billing, universal default and high-fee subprime credit cards.\213\ These rules, which will also amend the Truth in Lending regulation by requiring disclosure of, among other things, how long it would take to pay off the balance using minimum monthly payments and running totals of how much customers have paid in fees and interest, are not scheduled to go into effect until July 1, 2010. The House has passed a bill that would codify the Federal Reserve Board regulations and put them into effect three months after the bill becomes law.\214\ The Senate is considering an alternative version of the bill, while President Obama has indicated his support for an accelerated adoption of the Federal Reserve Board rules, among other changes. These efforts at reform highlight the potential for an emerging consensus among leading policymakers on the need for new regulations on re-pricing and transparency.

\213\ Board of Governors of the Federal Reserve System, Press Release (Dec. 18, 2008) (online at www.federalreserve.gov/newsevents/press/bcreg/20081218a.htm).

\214\ Credit Cardholders' Bill of Rights Act of 2009, H.R. 627, 111th Cong. (2009).

New regulations and reforms under review aside, there are several arguments for requiring TARP recipients to adhere to expanded consumer protection standards as a condition of public funding. The depth of the recession and its impact on families may argue for the government's utilizing every resource, including the authority granted to it under EESA, to provide

enhanced protections to households during this time of crisis. Additionally, by accepting taxpayer funds through TARP while imposing higher fees and rates on the households funding the program, banks could be seen as shifting costs to taxpayers both directly through re-pricing and indirectly through the acceptance of billions in public funds. Credit card issuers may also be undermining their argument that re-pricing is risk-based by shifting much of the risk of default and delinquency back to the public despite the acceptance of taxpayer funds.

On the other hand, leveraging TARP funds to impose new conditions on aid would not effect change industry-wide and could undermine the purpose of both TARP and TALF. First, the imposition of additional conditions on the use of federal funds may deter participation in the CPP and other Treasury programs, while encouraging healthier TARP recipient banks to repay Treasury more quickly, creating the risk of further stigmatizing those banks that cannot. Second, imposing terms through the TALF may also undermine the program's goal of stimulating investor demand for asset-backed securities. Finally, imposing new conditions after the TALF has already been established creates additional uncertainty for prospective TALF investors over both the potential for the imposition of future conditions and the value of securities backed by credit card receivables. Thus, using TARP or TALF as an instrument for new regulations could have the effect of undermining the purpose of these programs, and thereby harming Treasury's ongoing efforts to ensure access to affordable credit for American families in the long term.

Through its efforts to support consumer lending, Treasury is creating value. To what extent should the favorable terms of public assistance to financial institutions be reflected in the terms of loans to consumers and small businesses? The Panel reached no consensus on the resolution of the policy question at stake here, but it hopes that its discussion of the issue advances this important debate.

G. Conclusion

Since the beginning of the credit crunch and the financial crisis, the government has spoken of the paramount need to increase lending by the nation's financial institutions. The availability of credit is necessary for any broad-based economic recovery. But reviving credit is not simple, and different strategies have costs as well as benefits. This report has focused on those issues by examining the credit needs of America's small businesses and families.

A snapshot of small business credit at the beginning of 2009 shows credit terms tightening and loan volume dropping, based on the limited information available. Small businesses also find themselves in a contradictory position: they need credit to operate, but the drop in demand for their products or services as a result of the country's economic difficulties may make lenders unwilling to give them that credit except on terms that the businesses cannot accept.

Families are facing an even more difficult situation. They have entered this serious recession with few economic reserves and high levels of debt. When credit is available--especially through credit cards--interest rates are increasing both on new purchases and outstanding balances. Whether this increase reflects lenders' reasonable protection against increased rates of defaults and charge-offs resulting from the condition of the economy, efforts by banks to generate profits to replace income streams lost because of the financial crisis, or both, available credit terms may make families unwilling to borrow or unable to borrow under terms that free up money for purchases, rather than forcing them to allocate more income to servicing their debt and less to consumption.

The Federal Reserve Board and Treasury have emphasized the securitization markets as an avenue to restore small business and family credit and have created the TALF to regenerate investor interest in those markets by making loans for the purchase of asset-backed securities available on favorable terms that shift most of the risk to the taxpayer. Despite favorable loan terms, the TALF is only beginning to generate significant demand. Some of the slow growth of demand is attributable to lack of demand for securitization, some to claimed flaws in the program's design, and some to fear of political risk. Under those conditions, it is difficult to predict at what rate the demand for TALF loans will increase. And it is important that any changes in the terms of the TALF to increase investor demand not open the door for the abuses in the securitization markets that helped cause the financial crisis in the first place.

The TALF also illustrates the difficulties of any one approach to reviving credit for small businesses and families. The percentage of loans to small business that are securitized has historically been small. The securitization of credit card loans may provide more funds for lending, but it need not do

so. More important, credit card lending depends on a number of variables--terms such as interest rates and re-pricing, the economic condition of families, including default rates, and the state of the economy--so that securitization is only one factor affecting the degree to which family borrowing needs can be met.

TALF and the revival of the securitization markets can be a part of any effective strategy for restarting the credit markets. The securitization markets are an important part of the nation's financial sector, and ensuring their health through strong regulation is important in and of itself, and a necessary focus of Treasury policy. But bank lending without regard to the possibility of securitization is also critical, especially as banks restore their capital condition. Sound policy must assure that banks assess their credit risks without regard to whether loans can be securitized.

Ultimately, then, keeping the credit markets open in a fair--and economically healthy--manner to small business and family borrowers demands a mix of policies that reflect the realities that borrowers face. The problem is circular: Until the economy improves borrowers will have a limit on the debt they can absorb and loan terms may tighten appropriately. The securitization markets can play a part in breaking that circle. But the TALF cannot be the primary means to stimulate credit for small business and family borrowing. Moreover, its shift of liability to the taxpayer remains an important policy issue and requires that the TALF operate in a carefully monitored and fully transparent way.

SECTION TWO: ADDITIONAL VIEWS

Rep. Jeb Hensarling

The subject of the May report by the Congressional Oversight Panel for TARP was reviving lending to small businesses and families. Although this topic poses great interest for Panel members and the public at large, I remain concerned that this subject matter extends beyond the scope of TARP and the proper role of this Panel. This concern over potential Panel mission creep is one that I, and other Panel members, have discussed before and agreed that we must exercise proper diligence in our work to ensure that we remain faithful to our charge. Unfortunately, in this instance, I believe that the Panel did not. At a time when the SIGTARP has reported that it has launched almost 20 preliminary and full criminal investigations regarding TARP,\215\ and when there remains a continuing lack of transparency from the Treasury Department on certain TARP efforts like assistance to the domestic automobile manufacturers, it is more important than ever that the Panel focus its attention on the administration and mechanics of this massive program without deviation to ancillary topics.

\215\ SIGTARP Quarterly Report, supra note 162, at 4.

Instead, in the May report, the Panel strayed too far from its rightful TARP oversight role and waded into a public policy advocacy role on the question of placing new restrictions on credit providers. As Panel colleagues Richard H. Neiman and Senator John E. Sununu pointed out in their ``Additional View'' to the Panel's April report: ``First and foremost, the Panel is charged with evaluating the effectiveness of Treasury's use of the new authority granted it under the Emergency Economic Stabilization Act. It is not our role to design or approve Treasury's strategy, nor should the Panel's mission be expanded to encroach on that authority.'' \216\ Moreover, this controversial language was added at the eleventh hour after the lion's share of the work on the report had been completed, and sadly it overshadowed some otherwise laudable portions of the May COP report, notably the observation on page 15 that: ``While additional lending can potentially benefit the economy and help restore economic growth, weak underwriting standards and excessive high-risk lending contributed to the current crisis by increasing default rates.''

\216\ COP April Report, supra note 105, at 88 (additional view of Richard H. Neiman and John Sununu).

The heart of the conflict regarding this controversial language in this month's report was whether or not the government should impose operating restrictions and requirements on the providers of credit (especially credit card issuers) who have, in some form, accepted TARP assistance and dictate the terms on which they can make that credit available to consumers. One could argue that the imposition of such restrictions is certainly an issue for the Treasury Department to consider. Likewise, it is certainly an issue for Congress to consider. It is not, however, an issue this Panel should consider because every moment we dedicate to issues unrelated

to our charge is a moment that is spent neglecting our charge. By pursuing these extraneous issues, I fear now, more than ever, that the Panel is morphing into something more akin to a congressional advisory panel rather than a true oversight panel.

In this month's report, the language adopted by the majority at the end of Section F. Household Lending and the TALF was purported to be neutral on the subject of whether or not such requirements should be added. In fact, the report even states that the Panel has reached no consensus on the resolution of the policy question regarding to what extent should the favorable terms of public assistance to financial institutions be reflected in the terms of loans to consumers and small businesses.

However, such a conclusion belies the fallacious assumption concealed within that statement, namely that the only consideration is to what extent such conditionality should be applied, and not whether or not such conditionality is appropriate. In an attempt to accommodate the differing views of Panel members on that subject, earlier draft versions of the language made reference to the belief of some Panel members that TARP was not the place to initiate changes in lending policy. That language was omitted from the final version of the report.

Additionally, beyond the question of whether or not policymakers ought to consider such restrictions, there remains the question that if such restrictions were added, would that be a good thing? Clearly, the majority of the Panel held that such restrictions were an inherent benefit to consumers, as reflected by the term ``consumer protection standards.'' However, such a declaration ignores the most essential question in that debate--would such requirements help or harm the consumers that TARP and TALF were ultimately designed to benefit? As I have suggested elsewhere, I believe the answer to that question is that it does not.

From the perspective of borrowers, the evidence that I have seen leads me to believe that leveraging TARP funds to impose new conditions on lenders is likely to end up harming, not benefitting, consumers. Imposing price controls on the providers of credit is undesirable in the best of times, and could be particularly injurious in our weakened economy. A study by the Congressional Research Service has found that efforts to eliminate unpopular credit re-pricing practices, no matter how well intended, may result in making credit more expensive for both good and delinquent borrowers alike.\217\ Comparable attempts elsewhere to force lenders to adopt government-mandated rate limits have shown that to have occurred. For example, in 2006, the United Kingdom ordered credit card issuers to cut their default fees or face legal action. As a result, card issuers complied by imposing higher interest rates on all borrowers including those in good standing, instituting annual fees on accounts, and denying credit to scores of new applicants.

\217\ Darryl E. Getter, The Credit Card Market: Recent Trends, Funding Cost Issues, and Repricing Practices, Congressional Research Service (Feb. 27, 2008).

Further, in its consideration of why credit providers might be re-pricing their loans, the report also ignores the current impact that recent changes by the government to the rules dictating the provision of secured or open-ended credit to consumers might be having on the availability of credit. For example, on December 18, 2008, the Federal Reserve Board announced a set of sweeping rule changes for the credit card industry designed, it stated, to prohibit certain credit card practices. However, at the press conference announcing those new rules, Federal Reserve Board Governor Randall Kroszner admitted that while ``consumers might see some costs decline as new business models emerge, consumer[s] might see other costs increase.'' \218\ Similarly, as Vice Chairman of the Federal Reserve Board Dr. Donald Kohn stated in an interview on the Fed's new credit card rules: ``I do think there will be some reduction in available credit to some people.'' \219\

\218\ Board of Governors of the Federal Reserve System, Statement by Governor Randall S. Kroszner (Dec. 18, 2008) (online at www.federalreserve.gov/newsevents/press/bcreg/kroszner20081218a.htm).

\219\ Emily Flitter, Card Rules Done, Now for the Makeover, American Banker (Dec. 19, 2008).

As I have stated in the past, the Panel has a unique role to play in the accountability of EESA. Time will tell whether or not the Panel will prove effective in that role. When I agreed to serve on the Panel, my top three goals were to ensure that the TARP program works, to ensure that decisions made are based on merit and not political considerations, and most importantly, to ensure that taxpayers are protected. Those

goals have not changed. Thus, with those goals in mind and for the reasons stated above, and others, I regretfully had no choice but to dissent from the majority's report.

SECTION THREE: CORRESPONDENCE WITH TREASURY UPDATE

On April 21, 2009, Secretary Geithner publically promised that he would establish weekly briefings given by Treasury staff to Panel staff on TARP activities. Since then, Treasury staff has provided Panel staff with an increased number of briefings on TARP activities. Panel staff has been in daily communication with Treasury staff on a number of issues. Treasury has also designated a liaison for Panel staff to direct any formal inquiries.

On April 20, 2009,\220\ Secretary Geithner responded by letter to a request made by Chair Elizabeth Warren on behalf of the Panel \221\ regarding the American International Group, Inc. (AIG). The letter represented Treasury's initial response to the Panel's request. In its response, Treasury produced approximately 10,000 pages of documents to the Panel, which Panel staff is currently reviewing. Treasury said that its full and complete response to the Panel's request would be forthcoming. Conversations between Treasury staff and Panel staff regarding the request are ongoing.

\220\ See Appendix II, infra.

\221\ See Appendix IV, infra.

SECTION FOUR: TARP UPDATES SINCE LAST REPORT

A. Public-Private Investment Program

On April 6, 2009, Treasury released an update to the Legacy Securities portion of the Public-Private Investment Program (PPIP) originally announced on March 23, 2009. The update announces only two relatively minor changes to the plan as described in the March 23 documents issued by Treasury, but clarifies some of the original provisions, describes some ways in which Treasury contemplates expanding the program in the near future, and invites suggestions for ways to improve specific aspects of the program.

On April 29, 2009, Treasury announced the receipt of more than 100 applications from potential fund managers interested in participating in the Legacy Securities portion of PPIP. Treasury said it expects to inform applicants of their preliminary qualification around May 15, 2009.

B. Capital Purchase Program (CPP) for Mutual Holding Companies

On April 7, 2009, Treasury announced that it would expand the TARP to include mutual holding companies in the CPP program. This follows an announcement in November 2008 that life insurers could participate in the TARP if they had a federally regulated affiliate. The program is open to bank holding companies and savings and loan holding companies that are publicly traded and directly owned and controlled by a bank holding company or a savings and loan holding company that is organized in mutual form. They also must ``engage solely or predominantly in activities permissible for financial holding companies.''

C. Stress Test

On Friday, April 24, 2009, the Federal Reserve Board released information regarding the design and implementation of the stress tests. This testing, called the Supervisory Capital Assessment Program (SCAP), is intended to evaluate the capital levels over the next two years of the 19 largest bank holding companies (BHC). Results of the testing will be released in early May.

D. Term Asset-Backed Securities Loan Facility (TALF)

The FRBNY held the first three rounds of TALF subscriptions as discussed in the Panel's May report. The three rounds occurred on March 17-19, April 7, and May 5. Since the April subscription, the Federal Reserve has made a handful of announcements clarifying and providing updates on various aspects of the program. On April 21, the Federal Reserve provided additional information with respect to the interest rate spreads offered on TALF loans. On April 29, the FRBNY clarified parts of the program and published a ten-step how-to guide on being a TALF investor. Finally, on May 1, the Federal Reserve announced that ``commercial mortgage-backed securities (CMBS) and securities backed by insurance premium finance loans'' would become eligible collateral under TALF starting in June.

E. Metrics

The Panel's April oversight report highlighted a number of metrics that the Panel and others, including Treasury and the Financial Stability Oversight Board, consider useful in assessing the effectiveness of the Administration's efforts to restore financial stability and accomplish the goals of EESA. Data updates since the Panel's last report, published on April 7, 2009, indicate that some significant movement has occurred in a few of the indicators in recent months.

Credit Default Swaps. Credit default swap spreads for several large banking firms widened during the first quarter of 2009, suggesting market unease concerning the soundness of these institutions.\222\

\222\ Financial Stability Oversight Board, Quarterly Report to Congress Pursuant to Section 104(g) of the Emergency Economic Stabilization Act of 2008, at 12 (Apr. 24, 2009) (hereinafter ``FinSOB April Report'').

Mortgage Foreclosures/Defaults/Delinquencies. Foreclosure filings increased 17 percent in March, likely the result of the expiration of industry moratoria.\223\

\223\ RealtyTrac, Foreclosure Activity Increases 9 Percent in First Quarter (Apr. 16, 2009) (online at www.realtytrac.com// ContentManagement/PressRelease.aspx?channelid=9&ItemID=6180).

Overall Loan Originations. Data for February showed a significant increase in first mortgage originations, reflecting refinancing activity.\224\ Loan originations for other consumer lending decreased by a median percentage of 47 percent from January to February.\225\

\224\ Treasury February Snapshot, supra note 64.
\225\ Id.

Commercial Paper Outstanding. This rough measure of short-term business debt continued to decline in April, with total commercial paper outstanding declining again by more than ten percent on a seasonally adjusted basis.\226\

\226\ Board of Governors of the Federal Reserve System, Federal Reserve Statistical Release: Commercial Paper Outstanding (online at www.federalreserve.gov/releases/cp/outstandings.htm) (accessed May 5, 2009).

Spreads on Overnight Commercial Paper. Reflecting the availability of the Federal Reserve Board's Commercial Paper Funding Facility, spreads on commercial paper fell to pre-crisis levels through the first quarter of 2009.\227\

\227\ FinSOB April Report, supra note 222, at 12.

F. Financial Update

In its April oversight report, the Panel assembled a summary of the resources the federal government has committed to economic stabilization. The following provides (1) an updated accounting of TARP, including a tally of dividend income and repayments the program has received as of May 4, 2009, and (2) an update of the full federal resource commitment as of May 4, 2009.

1. TARP

a. Costs: Expenditures and Commitments

Through an array of programs used to purchase preferred shares in financial institutions, offer loans to small businesses and auto companies, and leverage Federal Reserve loans for facilities designed to restart secondary securitization markets, Treasury has spent or committed $593.1 billion, leaving $106.9 billion available for new programs or other needs.\228\ This figure is down from the $670.1 billion sum of the upper bounds of all Treasury commitments announced to date.\229\ The discrepancy results from Treasury revising its estimates of anticipated commitments down from the maximum announced program funding levels; for example, Treasury initially announced that it would commit $250 billion to CPP purchases but now only anticipates spending $218 billion.\230\

\228\ March GAO Report, supra note 57, at 9. This figure accords with the Panel's independent accounting.
\229\ March GAO Report, supra note 57, at 9. This figure accords with the Panel's independent accounting.
\230\ March GAO Report, supra note 57, at 9. Treasury also anticipates spending only $55 billion in TALF funding as opposed to the

$100 billion initially reported. Michael R. Crittenden, Treasury Seeks to Free Up Funds by Shuffling Spending in TARP, Wall Street Journal (Apr. 2, 2009) (online at online.wsj.com/article/SB123870719693083971.html) (reporting a Treasury commitment to TALF at $55 billion, which would represent a reduction from the $100 billion Treasury initially discussed committing to an expanded TALF).

Of the $593.1 that Treasury has announced it will spend, $376 billion has already been counted against the statutory $700 billion limit.\231\ This includes purchases of preferred stock and warrants under the CPP, TIP, SSFI Program, and AIFP initiatives, a $20 billion loan to TALF LLC, the special purpose vehicle used to guarantee Federal Reserve TALF loans, and the $5 billion Citigroup asset guarantee already exchanged for a guarantee fee composed of additional preferred stock and warrants.\232\ On April 24, Treasury released its sixth tranche report pursuant to 105(b) of EESA.\233\ According to Treasury, it will release its next tranche report when transactions under TARP reach $400 billion.

\231\ EESA limits Treasury to $700 billion in purchasing authority outstanding at any one time as calculated by the sum of the purchases prices of all troubled assets held by Treasury. EESA, supra note 3, at 115(a)-(b).

\232\ U.S. Department of the Treasury, Troubled Asset Relief Program Transactions Report For Period Ending April 29, 2009 (May 1, 2009) (online at www.financialstability.gov/docs/transaction-reports/transactionReport_050109.pdf) (hereinafter ``May 1 Transaction Report'').

\233\ EESA, supra note 3, at Sec. 105(b); U.S. Department of the Treasury, Sixth Tranche Report to Congress (Apr. 24, 2009) (online at www.financialstability.gov/docs/TrancheReports/04242009-6thTrancheReport-appendix.pdf).

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i. Income: Dividends and Repayments

Treasury estimates that it has $134.5 billion in TARP funds remaining for allocation.\234\ The discrepancy between this figure and the numbers independently determined by GAO, SIGTARP, and the Panel results from $25 billion in CPP investments that Treasury expects recipients to repay or liquidate.\235\ Although describing this estimate as ``conservative,'' neither Secretary Geithner nor Treasury has identified the institutions who will supply these anticipated repayments, when they will supply these repayments, or any methodological basis underpinning this figure.

\234\ Congressional Oversight Panel Hearing, Testimony of Secretary of the Treasury Timothy Geithner, (April 21, 2009) (online at cop.senate.gov/documents/testimony-042109-geithner.pdf).

\235\ Id.

Many institutions, including recipients of some of Treasury's largest investments, have indicated their desire to repay the funds and liquidate Treasury's stake in their institutions. Bank of America indicated in March that it could liquidate Treasury's investment immediately but for the need to retain higher capital ratios,\236\ and it continues to be optimistic about plans to repay the money next year.\237\ Similarly, Goldman Sachs reportedly plans an imminent stock sale in order to cover its own TARP repayment.\238\ The total amount repaid currently stands at $1.037 billion.\239\

\236\ Bank of America CEO Says Could Repay TARP in '09: Report, Reuters (Mar. 18, 2009) (online at www.reuters.com/article/ousiv/idUSTRE52H3OD20090318).

\237\ David Mildenberg and Linda Shen, Bank of America Says TARP Repayment Tied to Economy, Bloomberg (Apr. 2, 2009) (online at www.bloomberg.com/apps/news?pid=20601087&sid=aXqYLI4UqNbY).

\238\ Goldman Sachs Mulls Stock Sale to Repay TARP Money: Report, Reuters (Apr. 10, 2009) (online at www.reuters.com/article/topNews/idUSTRE5390ZD20090410).

\239\ May 1 Transaction Report, supra note 232.

In addition, Treasury's investment in preferred stock entitles it to dividend payments from the institutions in which it invests, usually five percent per annum for the first five years and nine percent per annum thereafter.\240\ Treasury has not yet begun officially reporting dividend payments systematically on its transaction reports; in its most recent report, GAO criticized Treasury for this lack of transparency.\241\ According to SIGTARP's April Quarterly Report, Treasury has received $3.1 billion in dividend income.\242\

\240\ See, e.g., U.S. Department of the Treasury, Bank of New York Mellon, Securities Purchase Agreement: Standard Terms, at A-1 (Oct. 28,

2008) (Annex A).

\241\ March GAO Report, supra note 57, at 27-28.

\242\ SIGTARP Quarterly Report, supra note 162.

AIG also owes Treasury an additional $733 million in dividends, but because AIG's board of directors had not declared a dividend as of the payment date, the institution did not pay.\243\ If AIG fails to pay a dividend for an additional three quarters, Treasury will have the right to elect at least two directors of the AIG board; these quarters need not be consecutive.\244\

\243\ March GAO Report, supra note 57, at 27-28.

\244\ U.S. Department of the Treasury, Term Sheet (Mar. 2, 2009) (online at www.treas.gov/press/releases/reports/030209_aig_term_sheet.pdf) (hereinafter ``AIG Term Sheet''). The terms of Treasury's November investment in AIG gave it the right to cumulative dividends. U.S. Department of the Treasury, American International Group, Inc. (AIG): Fixed Rate Cumulative Perpetual Preferred Stock Offering (Nov. 25, 2008). AIG may exchange the cumulative dividend preferred stock from the November transaction for noncumulative dividend preferred stock upon payment of all outstanding dividends. AIG Term Sheet, supra note 244. It is not immediately clear what share of the cumulative dividend preferred stock has been exchanged for noncumulative dividend preferred stock in this manner.

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ii. TARP Accounting as of May 4, 2009

Figure 14: TARP ACCOUNTING (AS OF MAY 4, 2009)

TARP Initiative (Dollars in billions)	Maximum Funding	Announced Funding	Purchase Price	Repayments	Dividend Income
Total	670.1	593.1	375.71	1.037	\245\ 3.124
CPP	250	218	199.01	1.037	$2.5179
TIP	40	40	40	0	0.3289
SSFI Program	70	70	69.8	0	\246\ 0
AIFP	27.6	27.6	27.6	0	.2506
AGP	12.5	12.5	5	0	0.0269
CAP	TBD	TBD	0	0	0
TALF	100	55	20	0	0
PPIP	100	100	0	0	0
Supplier Support Program	5	5	0	0	0
Unlocking Credit for Small Business	15	15	0	0	0
Homeowner Affordability and Stability Plan	50	50	14.3	0	0

\245\ SIGTARP Quarterly Report, supra note 162.

\246\ Although AIG owes Treasury $733 million in dividends, they have not been paid and are not included in this tally.

2. OTHER FINANCIAL STABILITY EFFORTS

a. Federal Reserve, FDIC, and Other Programs

In addition to the more direct expenditures Treasury has undertaken through TARP, the federal government has also engaged in a much broader program directed at stabilizing the economy. Many of these programs explicitly augment Treasury funds, like FDIC guarantees of securitization of PPIF Legacy Loans or asset guarantees for Citigroup and Bank of America, or operate in tandem with Treasury programs, such as the interaction between PPIP and TALF. Other programs, like the Federal Reserve's extension of credit through its Sec. 13(3) facilities and special purpose vehicles or the FDIC's Temporary Liquidity Guarantee Program, stand independent of TARP and seek to accomplish different goals.

b. Total Financial Stability Resources as of May 4, 2009

In it April report, the Panel broadly classified the resources that the federal government has devoted to stabilizing the economy in a myriad of new programs and initiatives such as outlays, loans, and guarantees. Although the Panel calculated the total value of these resources at over $4 trillion, this would translate into the ultimate ``cost'' of the stabilization effort only if: (1) assets do not appreciate, (2) no dividends are received, no warrants are exercised, and no TARP funds are repaid, (3) all loans default and are written off, and (4) all guarantees are exercised and subsequently written off.

This table accounts for changes announced between the release of the April report and May 4, 2009.

FIGURE 15: FEDERAL GOVERNMENT FINANCIAL STABILITY EFFORT (AS OF MAY 4, 2009)

Program (Dollars in billions)	Treasury (TARP)	Federal Reserve	FDIC	Total

Total	700	2,248.3	1,411.5	\249\ 4,359.8
Outlays \247\	495.6	0	29.5	525.1
Loans	30	1,931.3	0	1,961.3
Guarantees \248\	67.5	317	1,382	1,766.5
Uncommitted TARP Funds	106.9	0	0	106.9
AIG	70	91.3	0	161.3
Outlays	\250\ 70	0	0	70
Loans	0	\251\ 91.3	0	91.3
Guarantees	0	0	0	0
Bank of America	52.5	87.2	2.5	142.2
Outlays	\252\ 45	0	0	45
Loans	0	0	0	0
Guarantees	\253\ 7.5	\254\ 87.2	\255\ 2.5	97.2
Citigroup	50	229.8	10	289.8
Outlays	\256\ 45	0	0	45
Loans	0	0	0	0
Guarantees	\257\ 5	\258\ 229.8	\259\ 10	244.8
Capital Purchase Program (Other)	168	0	0	168
Outlays	\260\ 168	0	0	168
Loans	0	0	0	0
Guarantees	0	0	0	0
Capital Assistance Program	TBD	TBD	TBD	\261\ TBD
TALF	55	495	0	550
Outlays	0	0	0	0
Loans	0	\263\ 495	0	495
Guarantees	\262\ 55	0	0	55
PPIF (Loans) \264\	50	0	600	650
Outlays	50	0	0	50
Loans	0	0	0	0
Guarantees	0	0	\265\ 600	600
PPIF (Securities)	50	0	0	50
Outlays	\266\ 20	0	0	20
Loans	30	0	0	30
Guarantees	0	0	0	0
Homeowner Affordability and Stability Plan	50	0	0	\268\ 50
Outlays	\267\ 50	0	0	50
Loans	0	0	0	0
Guarantees	0	0	0	0
Automotive Industry Financing Plan	27.6	0	0	27.6
Outlays	\269\ 27.6	0	0	27.6
Loans	0	0	0	0
Guarantees	0	0	0	0
Auto Supplier Support Program	5	0	0	5
Outlays	\270\ 5	0	0	5
Loans	0	0	0	0
Guarantees	0	0	0	0
Unlocking Credit for Small Business	15	0	0	15
Outlays	\271\ 15	0	0	15
Loans	0	0	0	0
Guarantees	0	0	0	0
Temporary Liquidity Guarantee Program	0	0	769.5	769.5
Outlays	0	0	0	0
Loans	0	0	0	0
Guarantees	0	0	\272\ 769.5	769.5
Deposit Insurance Fund	0	0	29.5	29.5
Outlays	0	0	\273\ 29.5	29.5
Loans	0	0	0	0
Guarantees	0	0	0	0
Other Federal Reserve Credit Expansion Since September 1, 2008	0	1,345	0	1,345
Outlays	0	0	0	0
Loans	0	\274\ 1,345	0	1,345
Guarantees	0	0	0	0
Uncommitted TARP Funds	\275\ 106.9	0	0	106.9
Outlays	TBA	0	0	TBA
Loans	TBA	0	0	TBA
Guarantees	TBA	0	0	TBA

\247\ Treasury outlays are based on: (1) Treasury's actual reported expenditures; and (2) Treasury's anticipated funding levels as estimated by a variety of sources, including Treasury pronouncements, GAO estimates, and news reports. Anticipated funding levels are set at Treasury's discretion, have changed from initial announcements, and are subject to further change. The outlays concept used here is not the same as budget outlays, which under Section 123 of EESA are recorded on a ``credit reform'' basis.

\248\ While many of the guarantees may never be exercised or exercised only partially, the guarantee figures included here represent the federal government's greatest possible financial exposure.

\249\ This figure differs substantially from the $2,476-2,976 billion range of ``Total Funds Subject to SIGTARP Oversight'' reported during testimony before the Senate Finance Committee on March 31, 2009. Senate Committee on Finance, Testimony of SIGTARP Neil Barofsky, TARP Oversight: A Six Month Update, 111th Cong. (Mar. 31, 2009) (hereinafter ``Barofsky Testimony''). It includes neither Federal Reserve credit extensions outside of TALF nor FDIC guarantees under the Temporary Liquidity Guarantee Program, but does go up to the full $1 trillion maximum announced for TALF loans. SIGTARP's accounting, designed to capture only those funds potentially under its oversight authority, is both less and more inclusive and thus not directly comparable to the Panel's. Among the many differences, SIGTARP does not account for Federal Reserve Board credit extensions outside of TALF or FDIC guarantees under the Temporary Liquidity Guarantee Program and sets the maximum Federal Reserve guarantees under TALF at $1 trillion.

\250\ March GAO Report, supra note 57, at 9. This number includes a $40 billion investment made on November 25,

2008 under the SSFI Program and a $30 billion equity capital facility announced on March 2, 2009 that AIG may draw down when in need of additional capital in exchange for additional preferred stock and warrants to be held by Treasury. U.S. Department of the Treasury, Troubled Asset Relief Program Transactions Report For Period Ending March 31, 2009 (Apr. 2, 2009) (online at www.financialstability.gov/docs/transaction-reports/transaction_report_04-02-2009.pdf); AIG Term Sheet, supra note 244.

\251\ Board of Governors of the Federal Reserve System, Federal Reserve Statistical Release H.4.1: Factors Affecting Reserve Balances (Apr. 30, 2009) (online at http://www.federalreserve.gov/releases/h41/Current/) (hereinafter ``Fed Balance Sheet April 30''). This figure, current as of April 29, 2009, includes the AIG credit line as well as the Maiden Lane II LLC and Maiden Lane III LLC special purpose vehicles.

\252\ May 1 Transaction Report, supra note 232. This figure includes: (1) a $15 billion investment made by Treasury on October 28, 2008 under the CPP; (2) a $10 billion investment made by Treasury on January 9, 2009 also under the CPP; and (3) a $20 billion investment made by Treasury under the TIP on January 16, 2009.

\253\ U.S. Department of the Treasury, Summary of Terms: Eligible Asset Guarantee (Jan. 15, 2009) (online at www.treas.gov/press/releases/reports/011508bofatermsheet.pdf) (granting a $118 billion pool of Bank of America assets a 90 percent federal guarantee of all losses over $10 billion, the first $10 billion in federal liability to be split 75/25 between Treasury and the FDIC and the remaining federal liability to be borne by the Federal Reserve).

\254\ Id.

\255\ Id.

\256\ May 1 Transaction Report, supra note 232. This figure includes: (1) a $25 billion investment made by Treasury under the CPP on October 28, 2008; and (2) a $20 billion investment made by Treasury under the TIP on December 31, 2008.

\257\ U.S. Department of the Treasury, Summary of Terms: Eligible Asset Guarantee (Nov. 23, 2008) (online at www.treasury.gov/press/releases/reports/cititermsheet_112308.pdf) (hereinafter ``Citigroup Asset Guarantee'') (granting a 90 percent federal guarantee on all losses over $29 billion of a $306 billion pool of Citigroup assets, with the first $5 billion of the cost of the guarantee borne by Treasury, the next $10 billion by FDIC, and the remainder by the Federal Reserve). See also U.S. Department of the Treasury, U.S. Government Finalizes Terms of Citi Guarantee Announced in November (Jan. 16, 2009) (online at www.treas.gov/press/releases/hp1358.htm) (reducing the size of the asset pool from $306 billion to $301 billion).

\258\ Id.

\259\ Id.

\260\ March GAO Report, supra note 57. This figure represents the $218 billion Treasury reported anticipating spending under the CPP to GAO, minus the $50 billion CPP investments in Citigroup ($25 billion) and Bank of America ($25 billion) identified above. This figure does not account for anticipated repayments or redemptions of CPP investments, nor does it account for dividend payments from CPP investments. Treasury originally set CPP funding at $250 billion and has not officially revised that estimate.

\261\ Funding levels for the CAP have not yet been announced but will likely constitute a significant portion of the remaining $109.6 billion of TARP funds.

\262\ March GAO Report, supra note 57; Crittenden, supra note 230. Treasury's initial commitment to TALF was $20 billion; the increase in funding has coincided with an increase in asset classes eligible for the facility, including allowing legacy securities access to the facility, not just new securitizations.

\263\ This number derives from the unofficial 1:10 ratio of the value of Treasury loan guarantees to of the value of Federal Reserve loans under TALF. See Treasury Fact Sheet, supra note 1 (describing the initial $20 billion Treasury contribution tied to $200 billion in Federal Reserve loans and announcing potential expansion to a $100 billion Treasury contribution tied to $1 trillion in Federal Reserve loans). Because Treasury is responsible for reimbursing the Federal Reserve Board for $55 billion of losses on its $550 billion in loans, the Federal Reserve Board's maximum potential exposure under TALF is $495 billion.

\264\ Because the PPIP funding arrangements for loans and securities differ substantially, the Panel accounts for them separately. Treasury has not formally announced either total program funding level or the allocation of funding between PPIP Legacy Loans Program and Legacy Securities Program. Treasury initially provided a $75-100 billion range for PPIP outlays. U.S. Department of the Treasury, Fact Sheet: Public-Private Investment Program, at 2 (Mar. 23, 2009) (online at www.treas.gov/press/releases/reports/ppip_fact_sheet.pdf) (hereinafter ``Treasury PPIP Fact Sheet''). While SIGTARP has estimated a $75 billion Treasury commitment, we adopt GAO's higher estimate of $100 billion. See Barofsky Testimony, supra note 249, at 12; March GAO Report, supra note 57, at 9, and assume that Treasury will fund the programs equally at $50 billion.

\265\ Treasury PPIP Fact Sheet, supra note 264, at 2-3 (explaining that, for every $1 Treasury contributes in equity matching $1 of private contributions to public-private asset pools created under the Legacy Loans Program, FDIC will guarantee up to $12 of financing for the transaction to create a 6:1 debt to equity ratio). If Treasury ultimately allocates a lower proportion of funds to the Legacy Loans Program (i.e. less than $50 billion), the amount of FDIC loan guarantees will be reduced proportionally.

\266\ Treasury PPIP Fact Sheet, supra note 264, at 4-5 (outlining that, for each $1 of private investment into a fund created under the Legacy Securities Program, Treasury will provide a matching $1 in equity to the investment fund; a $1 loan to the fund; and, at Treasury's discretion, an additional loan up to $1). In the absence of further Treasury guidance, this analysis assumes that Treasury will allocate funds for equity co-investments and loans at a 1:1.5 ratio, a formula that estimates that Treasury will frequently exercise its discretion to provide additional financing.

\267\ March GAO Report, supra note 57, at 9.

\268\ Fannie Mae and Freddie Mac, government-sponsored entities (GSEs) that were placed in conservatorship of the Federal Housing Finance Housing Agency on September 7, 2009, will also contribute up to $25 billion to the Homeowner Affordability and Stability Plan. See U.S. Department of the Treasury, Making Home Affordable: Updated Detailed Program Description (Mar. 4, 2009) (online at www.treas.gov/press/releases/reports/housing_fact_sheet.pdf).

\269\ May 1 Transaction Report, supra note 232.

\270\ March GAO Report, supra note 57, at 9.

\271\ March GAO Report, supra note 57, at 9.

\272\ Federal Deposit Insurance Corporation, Monthly Reports on Debt Issuance under the Temporary Liquidity Guarantee Program: Debt Issuance under Guarantee Program (Apr. 13, 2009) (online at www.fdic.gov/regulations/resources/TLGP/total_ issuance3-09.html). This figure represents the current maximum aggregate debt guarantees that could be made under the program, which, in turn, is a function of the number and size of individual financial institutions participating. $336.2 billion of debt subject to the guarantee has been issued to date, which represents about 44 percent of the current cap. Id.

\273\ This figure represents the FDIC's provision for losses to its deposit insurance fund attributable to bank failures in the third and fourth quarters of 2008. See Federal Deposit Insurance Corporation, Chief Financial Officer's (CFO) Report to the Board: DIF Income Statement (Fourth Quarter 2008) (online at www.fdic.gov/about/strategic/corporate/cfo_report_4qtr_08/income.html); Federal Deposit Insurance Corporation, Chief Financial Officer's (CFO) Report to the Board: DIF Income Statement (Third Quarter 2008) (online at www.fdic.gov/about/strategic/corporate/cfo_report_3rdqtr_08/income.html). As of May 5, 2009, the FDIC had not yet released first quarter 2009 data.

\274\ This figure is derived from adding the total credit the Federal Reserve Board has extended as of April 29, 2009 through the Term Auction Facility (Term Auction Credit), Discount Window (Primary Credit), Primary Dealer Credit Facility (Primary Dealer and Other Broker-Dealer Credit), Central Bank Liquidity Swaps, Bear Stearns Assets (Maiden Lane I LLC), GSE Debt (Federal Agency Debt Securities), Mortgage Backed Securities Issued by GSEs, Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility, and Commercial Paper Funding Facility LLC. See Fed Balance Sheet April 30, supra note 251. The level of Federal Reserve lending under these facilities will fluctuate in response to market conditions and independent of any federal policy decisions.

\275\ Committed TARP funds listed above total $590.4 billion. $109.6 billion remains uncommitted for the $700 billion authorization under EESA and is included in this accounting because it will almost certainly be allocated in the future.

G. Chrysler-Fiat Partnership Plan

President Obama has brokered a plan for Chrysler L.L.C. to combine with the Italian-based Fiat S.p.A. to ensure Chrysler's continued viability. As part of the plan Chrysler has entered a controlled bankruptcy proceeding; to stabilize it during the course of that proceeding Chrysler will receive approximately $4.7 billion in TARP funds, with the potential for additional lending up to a total of $6 billion. On May 6, 2009, the proposed deal cleared its first hurdle as a bankruptcy judge in New York issued a ruling permitting Chrysler to start the process of selling its assets to Fiat. The plan has created a certain amount of controversy as it requires a re-ordering of preferences for Chrysler's creditors, sending secured lenders to wait in line behind more junior debt, which is contrary to standard bankruptcy practice.

H. May TALF Subscription

On May 5, 2009, the FRBNY offered its third TALF subscription. In the two hours the facility was open, $10.6 billion in loans were requested. More than half of the funds were secured by assets backed by credit card debt. Just over $4 billion was secured by assets backed by auto loans and student loans, with about half (or just over $2 billion) going to each sector. Nearly half a billion dollars went to the equipment sector, and the remaining $86.6 million was secured by small business loan backed securities.

I. Repayment of TARP Funds

Treasury is expected to publish this week the conditions under which TARP fund recipients may repay the money. The conditions are expected to include a requirement that the institution repaying the funds demonstrate its continued ability to issue debt to private investors without a guarantee from the Federal Deposit Insurance Corporation.

SECTION FIVE: OVERSIGHT ACTIVITIES

The Congressional Oversight Panel was established as part of EESA and formed on November 26, 2008. Since then, the Panel has issued five oversight reports, as well as its special report on regulatory reform, which was issued on January 29, 2009.

Since the release of the Panel's April oversight report, the following developments pertaining to the Panel's oversight of the TARP took place:

The Panel held a hearing in Washington, DC on April 21, with Secretary Geithner. This was Secretary Geithner's first appearance before the Panel and the first opportunity for panelists to publicly question the Secretary on the various components of Treasury's Financial Stability Plan. The Secretary promised Panel Members that he would establish weekly briefings given by Treasury staff to Panel staff on TARP activities. The Secretary also promised that he would appear again before the Panel in an open public hearing format.

The Panel held a field hearing in Milwaukee, WI on April 29, entitled, ``The Credit Crisis and Small Business Lending.'' At the hearing, the Panel heard testimony from small business owners and representatives from local community banks on the state of credit access for small business in the state of Wisconsin. The testimony revealed the troubling impact of the financial collapse and the ongoing recession on a local economy far from the crisis' epicenter on Wall Street. Both April hearings played an important role in the Panel's evaluation of TARP effectiveness on small business and household lending, as reflected in the May report.

Secretary Geithner sent a letter on April 20, 2009 to the Panel in response to a letter that Chair Elizabeth Warren sent to the Secretary on March 24, 2009 regarding AIG.\276\ Treasury's letter provided an update as to the Panel's request for information in relation to AIG. Treasury also provided the Panel with initial documents and information regarding the Panel's request. The Panel is reviewing the information contained in the initial set documents that were received.

\276\ See Appendix II, infra (Geithner Letter); Appendix IV, infra (Warren Letter).

On behalf of the Panel, Chair Elizabeth Warren sent follow-up letters on April 16, 2009,\277\ to Federal Reserve Chairman Ben Bernanke and FRBNY President William Dudley with respect to AIG. The Panel awaits their response.

\277\ See Appendix III, infra.

On April 23, 2009,\278\ New York Attorney General Andrew Cuomo sent a letter to Chair Elizabeth Warren and others about the merger of Bank of America and Merrill Lynch. The letter asserts that Bank of America wanted to rescind the pending merger because Merrill's deteriorating financial condition was a ``material adverse change in condition.'' The letter states that Bank of America was strongly pressured not to do so by then-Treasury Secretary Paulson, and Federal Reserve Chairman Bernanke, and did not disclose to its shareholders either its concerns about Merrill or the reasons for continuing with the merger. The Panel is reviewing the information provided in the letter.

\278\ See Appendix I, infra.

Upcoming Reports and Hearings

The Panel will release its next oversight report in June. The report will provide an updated review of TARP activities and continue to assess the program's overall effectiveness. The report will also examine the recent stress tests and determine what the results indicate for TARP's stated objective of restoring credit to the markets.

The Panel also plans to hold a field hearing in New York on May 28, 2009. The hearing will examine the state of our financial markets and assess the effectiveness of TARP.

SECTION SIX: ABOUT THE CONGRESSIONAL OVERSIGHT PANEL

In response to the escalating crisis, on October 3, 2008, Congress provided Treasury with the authority to spend $700 billion to stabilize the U.S. economy, preserve home ownership, and promote economic growth. Congress created the Office of Financial Stabilization (OFS) within Treasury to implement a Troubled Asset Relief Program. At the same time, Congress created the Congressional Oversight Panel to ``review the current state of financial markets and the regulatory system.'' The Panel is empowered to hold hearings, review official data, and write reports on actions taken by Treasury and financial institutions and their effect on the economy. Through regular reports, the Panel must oversee Treasury's actions, assess the impact of spending to stabilize the economy, evaluate market transparency, ensure effective foreclosure mitigation efforts, and guarantee that Treasury's actions are in the best interests of the American people. In addition, Congress instructed the Panel to produce a special report on regulatory reform that analyzes ``the current state of the regulatory system and its effectiveness at overseeing the participants in the financial system and protecting consumers.'' The Panel issued this report in January 2009.

On November 14, 2008, Senate Majority Leader Harry Reid and the Speaker of the House Nancy Pelosi appointed Richard H. Neiman, Superintendent of Banks for the State of New York, Damon Silvers, Associate General Counsel of the American Federation of Labor and Congress of Industrial Organizations (AFL-CIO), and Elizabeth Warren, Leo Gottlieb Professor of Law at Harvard Law School to the Panel. With the appointment on November 19 of Congressman Jeb Hensarling to the Panel by House Minority Leader John Boehner, the Panel had a quorum and met for the first time on November 26, 2008, electing Professor Warren as its chair. On December 16, 2008, Senate Minority Leader Mitch McConnell named Senator John E. Sununu to the Panel, completing the Panel's membership.

APPENDIX I: LETTER FROM NEW YORK ATTORNEY GENERAL ANDREW CUOMO TO CHAIR ELIZABETH WARREN, AND OTHERS, REGARDING BANK OF AMERICA AND MERRILL LYNCH, DATED APRIL 23, 2009

[GRAPHIC] [TIFF OMITTED] 49573A.010

[GRAPHIC] [TIFF OMITTED] 49573A.011

[GRAPHIC] [TIFF OMITTED] 49573A.012

[GRAPHIC] [TIFF OMITTED] 49573A.013

[GRAPHIC] [TIFF OMITTED] 49573A.014

[GRAPHIC] [TIFF OMITTED] 49573A.015

[GRAPHIC] [TIFF OMITTED] 49573A.016

[GRAPHIC] [TIFF OMITTED] 49573A.017

[GRAPHIC] [TIFF OMITTED] 49573A.018

[GRAPHIC] [TIFF OMITTED] 49573A.019

[GRAPHIC] [TIFF OMITTED] 49573A.020

[GRAPHIC] [TIFF OMITTED] 49573A.021

[GRAPHIC] [TIFF OMITTED] 49573A.022

[GRAPHIC] [TIFF OMITTED] 49573A.023

[GRAPHIC] [TIFF OMITTED] 49573A.024

[GRAPHIC] [TIFF OMITTED] 49573A.025

[GRAPHIC] [TIFF OMITTED] 49573A.026

[GRAPHIC] [TIFF OMITTED] 49573A.027

[GRAPHIC] [TIFF OMITTED] 49573A.028

[GRAPHIC] [TIFF OMITTED] 49573A.029

[GRAPHIC] [TIFF OMITTED] 49573A.030

[GRAPHIC] [TIFF OMITTED] 49573A.031

[GRAPHIC] [TIFF OMITTED] 49573A.032

[GRAPHIC] [TIFF OMITTED] 49573A.033

[GRAPHIC] [TIFF OMITTED] 49573A.034

[GRAPHIC] [TIFF OMITTED] 49573A.035

[GRAPHIC] [TIFF OMITTED] 49573A.036

[GRAPHIC] [TIFF OMITTED] 49573A.037

[GRAPHIC] [TIFF OMITTED] 49573A.038

[GRAPHIC] [TIFF OMITTED] 49573A.039

[GRAPHIC] [TIFF OMITTED] 49573A.040

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[GRAPHIC] [TIFF OMITTED] 49573A.049

[GRAPHIC] [TIFF OMITTED] 49573A.050

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[GRAPHIC] [TIFF OMITTED] 49573A.066

[GRAPHIC] [TIFF OMITTED] 49573A.067

[GRAPHIC] [TIFF OMITTED] 49573A.068

[GRAPHIC] [TIFF OMITTED] 49573A.069

APPENDIX II: INITIAL RESPONSE LETTER FROM SECRETARY TIMOTHY GEITHNER REGARDING AIG, DATED APRIL 20, 2009

[GRAPHIC] [TIFF OMITTED] 49573A.070

[GRAPHIC] [TIFF OMITTED] 49573A.071

[GRAPHIC] [TIFF OMITTED] 49573A.072

[GRAPHIC] [TIFF OMITTED] 49573A.073

[GRAPHIC] [TIFF OMITTED] 49573A.074

[GRAPHIC] [TIFF OMITTED] 49573A.075

[GRAPHIC] [TIFF OMITTED] 49573A.076

[GRAPHIC] [TIFF OMITTED] 49573A.077

APPENDIX III: LETTER FROM CHAIR ELIZABETH WARREN TO FEDERAL RESERVE CHAIRMAN BEN BERNANKE AND FEDERAL RESERVE BANK OF NEW YORK PRESIDENT WILLIAM DUDLEY REGARDING AIG, DATED APRIL 16, 2009

[GRAPHIC] [TIFF OMITTED] 49573A.078

[GRAPHIC] [TIFF OMITTED] 49573A.079

[GRAPHIC] [TIFF OMITTED] 49573A.080

[GRAPHIC] [TIFF OMITTED] 49573A.081

[GRAPHIC] [TIFF OMITTED] 49573A.082

[GRAPHIC] [TIFF OMITTED] 49573A.083

[GRAPHIC] [TIFF OMITTED] 49573A.084

[GRAPHIC] [TIFF OMITTED] 49573A.085

[GRAPHIC] [TIFF OMITTED] 49573A.086

[GRAPHIC] [TIFF OMITTED] 49573A.087

[GRAPHIC] [TIFF OMITTED] 49573A.088

[GRAPHIC] [TIFF OMITTED] 49573A.089

[GRAPHIC] [TIFF OMITTED] 49573A.090

[GRAPHIC] [TIFF OMITTED] 49573A.091

[GRAPHIC] [TIFF OMITTED] 49573A.092

[GRAPHIC] [TIFF OMITTED] 49573A.093

APPENDIX IV: LETTER FROM CHAIR ELIZABETH WARREN TO SECRETARY TIMOTHY GEITHNER REGARDING AIG, DATED MARCH 24, 2009

[GRAPHIC] [TIFF OMITTED] 49573A.094

[GRAPHIC] [TIFF OMITTED] 49573A.095

[GRAPHIC] [TIFF OMITTED] 49573A.096