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

Asset-backed securities (ABS) markets historically have funded a substantial share of consumer and small business credit, including receivables from credit card loans, auto loans and leases, student loans, small business and dealer floorplan loans, business equipment loans, and mortgage servicing advances. The disruption in the supply of credit for these routine purposes has magnified the adverse impact of the downturn in the housing cycle, and a continued dislocation in credit availability could contribute to further weakening of U.S. economic activity.

The Term Asset-Backed Securities Loan Facility (TALF) is a funding facility through which the Federal Reserve Bank of New York extends three-year loans collateralized by certain types of ABS that are, in turn, backed by loans to consumers and small businesses. The facility is designed to help market participants meet the credit needs of households and small businesses by supporting the issuance of those ABS.

Any U.S. company that owns eligible collateral may borrow from the TALF provided the company maintains an account relationship with a primary dealer. A broad base of investor demand should lower the cost of funding for new TALF-eligible ABS issues and bring additional liquidity into the market. This greater demand should increase the flow of credit to and reduce the borrowing rates experienced by consumers and small businesses. In fact, results from the TALF's first subscription showed a substantial decline in funding costs for the auto and credit card issuers that came to market. If sustained, this should translate to lower credit card and auto loan rates for consumers.

The term "collateralized debt obligation" is not precisely defined, but the TALF does not accept ABS collateral that might be regarded as complex CDOs--that is, where the underlying credit exposures are themselves cash ABS or synthetic ABS. These types of cash and synthetic collateralized debt obligations, known as structured-finance CDOs, contributed to the current financial crisis by obscuring the risk of the underlying ABS collateral to the investor and are not eligible.

The *Wall Street Journal* article cited in your letter asserts that market participants' establishment of special purpose vehicles (SPVs) to function as investors and borrowers in the TALF program can be viewed as the creation of collateralized debt obligations. In our view, this analogy is misleading. The creation of SPVs facilitates broad participation in the program, which is essential for its success. It has been our long standing goal to make TALF financing available to a broad range of borrowers that meet standard eligibility criteria. Currently, any U.S. company that owns eligible collateral may borrow from the TALF provided the company maintains an account relationship with a primary dealer. U.S. organized and managed investment funds--such as hedge funds, private equity funds, pension funds, mutual funds and other pooled investment vehicles holding eligible collateral--are considered to be eligible entities. All borrowers are subject to certain legal and compliance standards, outlined in our Master Loan and Security Agreement and our Conflict of Interest and Borrower Eligibility and Due Diligence Policies.

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

The TALF is designed to improve credit conditions for consumer and small business loans by including a wide range of eligible participants, across a broad investor base. Any U.S. company that owns eligible collateral may borrow from the TALF provided the company maintains an account relationship with a primary dealer. Ultimately, the inclusive nature of the program helps improve access to and lowers the cost of credit to consumers and small businesses through the issuance of ABS.

Each investor bears substantial risk in the form of the equity investment needed to finance the “haircuts” that are assessed to the collateral backing the TALF loan. Moreover, investors compensate the government for the risk protection they receive by paying a premium rate charged for TALF loans.

The TALF program includes these and a number of other safeguards that protect taxpayer interests and ensure that investors bear appropriate levels of risk.

- The TALF is a collateralized lending program that uses risk-based haircuts, ranging from 5 to 16 percent, to help protect the taxpayer against losses. Thus, for every $100 in pledged collateral, borrowers commit $5 to $16 of their own capital. These haircuts represent TALF borrowers’ equity interest in the arrangement, and serve as an additional buffer that is forfeited, along with the collateral, in the event the loan is not repaid. The haircuts vary across asset types depending on an assessment of the riskiness of the ABS and the average maturity of the underlying credits. Please see Appendix 1 for the current schedule of haircuts.

- Further protection is provided by the risk premium included in the TALF loan rate. TALF loans will be extended at 100 basis points over one-month Libor for most floating rate ABS or 100 basis points above the three-year swap rate for most fixed rate ABS.[1] The Federal Reserve will claim some of the income as its cost for providing liquidity, but the remainder, which represents a large portion of the interest, will accumulate in the TALF facility in order to absorb any losses. This interest rate spread will provide a substantial buffer for taxpayers, paid for by the private sector, in the event that the ABS is surrendered in lieu of repayment.

- The current economic situation is extraordinary and the outlook is therefore especially uncertain. We accounted for that uncertainty by making very conservative assumptions when calibrating the haircuts. The haircuts are designed so that, even if the economy evolves in a manner significantly worse than we currently expect, all credit costs will be more than covered by the haircuts and the excess interest rate spread paid by investors, resulting in no credit losses for the Treasury or Federal Reserve.

- The interest rates on TALF loans are set with a view to providing borrowers with an incentive to purchase eligible ABS at yield spreads higher than in more normal market conditions but lower than in the highly illiquid market conditions that have prevailed during the recent credit market turmoil. In doing so, TALF loan rates encourage the flow of credit, but provide the private sector with an incentive to borrow only selectively from taxpayer resources.

- The TALF relies on specific collateral eligibility requirements in order to ensure that taxpayer funds are used to finance targeted asset classes whose probability of loss has been assessed by credit rating agencies. Given the important role that credit ratings play in our eligibility criteria, Federal Reserve economists have conducted due diligence on rating agency methodologies for various ABS sectors. Moreover, each issuer must hire an external auditor that must provide an opinion, using examination standards, that management's assertions concerning key collateral eligibility requirements are fairly stated in all material respects. The auditor's attestation provides a high level of assurance concerning TALF collateral eligibility requirements.

While TALF is designed with robust and conservative measures to protect taxpayer interests, no lending program is without risk. Nonetheless, we remain confident that we have designed a program that will manage these risks, and that the TALF will be a benefit to U.S. consumers and businesses, providing critical access to loans at lower cost.

3. Is the report in the *Wall Street Journal* substantially correct? If so, please explain in detail how the final terms, details, and structure of the financing

[1] The interest rate spread on TALF loans backed by collateral benefitting from a government guarantee--that is, FFELP ABS, SBA 7(a) ABS, and SBA 504 ABS--will be 50 basis points, and different reference benchmarks may apply. Please refer to the schedule of haircuts for details.

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

From the outset of the program, the TALF Terms and Conditions have indicated that "investment funds" that meet certain conditions are included among the broad range of entities that would be eligible to borrow from the TALF. This inclusion reflects a long standing objective to democratize the program by making it available to a wide range of investors. Thus, the *Wall Street Journal's* assertion that the inclusion of such funds was an "eleventh hour" concession to attract participants in the program was inaccurate.

As with other potential borrowers, investment funds are subject to certain legal and compliance standards, outlined in our Master Loan and Security Agreement and our Conflict of Interest and Borrower Eligibility and Due Diligence Policies. The Federal Reserve has not relaxed its borrowing standards with respect to investment funds. To the contrary, our guidance to date has strengthened the requirements associated with investment funds. The Conflict of Interest Policy and Borrower Eligibility & Due Diligence Policy both impose a set of responsibilities with regard to vehicles created by primary dealers.

The Federal Reserve expects to release guidance shortly that will clarify the legal and compliance standards applicable to investment funds, with the aim of ensuring that all borrowers in the program, regardless of investor type, meet a common set of eligibility standards.

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

The Federal Reserve and Treasury are committed to transparency regarding the terms and implementation of the TALF. In an effort to better support the TALF program and its various constituents, the Federal Reserve has provided a significant amount of information through our website, and has periodically updated the Frequently Asked Questions associated with the TALF.

In establishing the TALF program, the Federal Reserve and the Treasury needed to balance the need for public consultation with the need to make the program operational on a sufficiently timely basis for it to be effective in addressing the ongoing financial crisis, which is imposing severe costs on U.S. households and businesses. Despite this tradeoff, the Federal Reserve has consulted actively with the public and with the Congress. Federal Reserve and Treasury staff have frequently briefed Congressional staff on the progress of the design of the facility. And with the goal of fostering better public dialogue concerning the TALF, we hosted a series of interactive conference calls with the primary dealer community, including their bankers, operations personnel, compliance and legal representatives. With support from the American Securitization Forum, we hosted an issuer and a second primary dealer legal and compliance call where we fielded questions. We also hosted an investor call that was publicly announced and open to the general public. The call was oversubscribed beyond the one thousand available lines we had scheduled, and a replay of the presentation was made available for those who were not able to join the original broadcast. In conjunction with all of these efforts, Federal Reserve staff continued to engage with market participants by answering questions posted to TALF email inboxes or voice mail inboxes or inquiries that were personally directed to the staff. Input gathered through all of these channels has been constructive in shaping the direction of the TALF program and has contributed to subsequent revisions in the program's terms and supporting documentation.

The *Wall Street Journal* provided an inaccurate portrayal of our position with respect to the reported proposals of certain dealers as they regard "vehicles [created] to participate in TALF that would allow investors in the program to circumvent many of the restrictions laid out by the Fed." The Federal Reserve expects to release guidance shortly that will clarify the legal and compliance standards applicable to investment funds, with the aim of ensuring that all borrowers in the program, regardless of investor type, meet a common set of eligibility standards. The guidance will be published on our website.

5. **Two conditions of eligibility described in the TALF Documents appear to have been directed against specific abuses of the mortgage-backed securities market. These are the bar against third-party guarantees (such as, presumably, credit default swaps) of ABS to obtain TALF financing and the ban on such financing for ABS composed of loans originated or securitized by the borrower or an affiliate of the borrower. According to the *Wall Street Journal*, those conditions have recently been weakened or abandoned. Please explain if this is accurate and, if it is, why Treasury would take such steps.**

The *Wall Street Journal* report that the conditions noted in your question have been weakened or abandoned is inaccurate. Neither of these provisions has been altered in any way since the outset of the program.

Under the Terms and Conditions of the TALF, eligible collateral may not be backed by loans originated or securitized by the borrower or an affiliate of the borrower. Primary dealers are required to agree under the Master Loan and Securities Agreement that neither the primary dealer nor its affiliates will enter into any agreement with the intended effect of reducing or eliminating any loss that a TALF borrower would realize on the sale of TALF collateral in a fair market value transaction. The Terms and Conditions also assert that eligible collateral will not include ABS that obtain credit ratings based on the benefit of a third-party guarantee.

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

Market participants often look to the spread between ABS yields and an underlying reference benchmark rate as a broad indicator of market conditions and risk appetite.[2] As an example, AAA-rated consumer ABS historically traded at a spread of only several basis points above relevant benchmark rates. Spreads began to widen gradually in the summer of 2007, when dislocations in funding markets became apparent. This trend accelerated in March 2008 following the demise of Bear Stearns, and spreads spiked to historically wide levels of between 500 and 600 basis points in the fourth quarter as the severity of the economic downturn became increasingly apparent.

Since the TALF program was announced in November 2008, ABS spreads in the secondary market for TALF-eligible asset classes have narrowed significantly, although they still remain well above their historic norms. Five-year spreads on AAA-rated credit card ABS 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.

With the onset of the severe dislocation in the credit markets, new issuance of consumer ABS declined precipitously in the third quarter of 2008 before coming to a virtual halt in October. From October 2008 to the TALF's launch in March 2009, a total of $5.7 billion in consumer ABS was issued. Only $550 million of this was student loan ABS, and the rest was auto ABS; no credit card ABS had been issued. This cumulative issuance volume over the past five months compares to average consumer ABS issuance volumes of $20 billion, $18 billion and $6 billion per month during 2007, the first half of 2008 and the third quarter of 2008, respectively. For detailed data on ABS issuance, and some charts showing recent trends ABS prices and issuance, please see Appendixes 2 and 3, respectively.

[2] Reference rates are generally measured against Libor for floating rate collateral and the Libor swap rate for fixed-rate collateral.

It is encouraging that $8.3 billion of credit card and auto ABS was issued coincident with the initial TALF subscription in March, more than doubling the amount of credit card and auto ABS that had been issued since last October. Moreover, as discussed in Question 1, ABS associated with the initial TALF subscription priced at spreads between 100 and 200 basis points lower than previously issued ABS, marking a substantial decline in interest rates for these instruments. The narrowing of spreads has reportedly generated a renewed enthusiasm for ABS following the program's initial success, with more issuance being developed.

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

When they are issued, most ABS, regardless of rating, are priced at or near face value, or "par." Some do not issue at par; for example, ABS issued under the Small Business Association 7(a) program are issued at prices well above par. Over time, the market values of the ABS, including AAA ABS, will move above or below par with variations in other market interest rates and variations in the perceived credit risk of the securities.

The non-recourse nature of the TALF loans allows the borrower to elect to surrender the collateral in lieu of repaying the loan. That option limits the downside risk to the borrower to the loss of the funds invested to finance the haircut. Even though, as explained in the answer to Question 2, the haircuts have been chosen to exceed the losses in value likely in nearly all future outcomes, providing investors a limit on potential losses is an important means by which the program stimulates investor demand, even for AAA-rated securities. The provision of non-recourse loans through the TALF program was therefore intended to attract broad investor interest, thus allowing issuers to bring new securities to market at lower spreads. While the nature of this arrangement has a clear value to the investor and issuer, competitive primary markets also ensure that U.S. consumers and small businesses, the ultimate beneficiaries of the program, are able to obtain credit at lower costs.

The success seen from the TALF's first subscription in stimulating new demand and issuance for these types of ABS, of which there had been little to no activity since September, seems to reinforce the program's value. If these results are sustained, this should translate to lower credit rates for households and businesses.

8. **Consistent failures of the credit rating agencies were a significant factor in the sales of risky mortgage-backed securities that helped produce the current**

financial crisis. In light of these failures, please explain why reliance on credit ratings for the TALF is a reasonable basis on which to protect the taxpayers, regardless of the number of credit-ratings agencies whose opinions are required.

Credit rating agencies (CRAs) continue to play a critical role in ABS markets, and are essential to their effective functioning and recovery. Regulators and industry participants, including the CRAs themselves, are working hard to address the CRA-related failures that contributed to the current financial crisis. These efforts have contributed to tighter underwriting standards and stricter ratings criteria. It is also worth noting that the CRAs' performance has shown a more stable track record with regard to consumer ABS credit ratings.

The TALF program employs a number of safeguards to protect taxpayers, including CRA ratings of eligible collateral. Given this important function, Federal Reserve economists have conducted due diligence on rating agency methodologies for eligible ABS sectors. Moreover, each issuer must hire an external auditor that must provide an opinion, using examination standards, that management's assertions concerning key collateral eligibility requirements are fairly stated in all material respects. The auditor's attestation provides a high level of assurance concerning TALF collateral eligibility requirements.

TALF investors also serve an important ongoing role in price discovery and assessing risk through their ability to demand greater credit enhancements or price concessions. In particular, the sale of securities through TALF in an arms-length transaction is an independent check not only on the underwriting practices of the issuer, but also of the efficacy of rating agency methodologies.

In addition to agency ratings, the TALF program employs other safeguards to protect taxpayer interests, including interest rate premiums and risk-based collateral haircuts. In recognition that the current economic situation is extraordinary and the outlook is especially uncertain, our economists made very conservative assumptions in calibrating the program's haircuts, which together with the interest premiums described in Question 2, provide critical first-loss buffers that shield taxpayers from credit risk should the current outlook prove inaccurate.

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

The Federal Reserve is deeply committed to consumer protection and the Board of Governors has promulgated Regulation Z, designed to promote the informed use of consumer credit as well as significant other protections to consumers associated with installment credit. We believe that consumer interests are best served under the protections provided by a regulatory regime rather than through the terms of a lending program.

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

The TALF program supports the provision of loans to consumers and small businesses. Although these loans traditionally have been financed through securitization, funding for such activities has dissipated in the current crisis. The TALF fills this liquidity gap.

The TALF is just one of many programs undertaken by the Federal Reserve, Treasury, and other agencies to strengthen financial institutions and encourage lending, including efforts to recapitalize financial institutions and to provide an abundant supply of liquidity. For example, the Federal Reserve's decisions to lower rates on and lengthen the maturity of primary credit loans, and to create the Term Auction Facility, have helped to relieve short-term liquidity strains for individual institutions and the banking system as a whole. Nevertheless, ongoing stress on financial institutions arising from their residential and commercial real estate exposures continues to constrain their ability to intermediate credit across the broader markets.

The TALF complements other policy initiatives by re-opening channels of funding for assets that had traditionally been securitized.

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

The U.S. subsidiaries of non-U.S. companies supply credit to U.S. consumers and businesses and employ U.S. workers. Moreover, at least 95 percent of the loans backing the ABS accepted as collateral for the TALF program must be loans to U.S domiciled borrowers, i.e., U.S. domiciled students, car purchasers, small businesses and credit card customers. Consequently, financing the sale of these entities' securitized debt, provided the debt meets all other eligibility criteria outlined in the program's documentation, further advances the core policy objective of re-opening the flow of credit to U.S. households and businesses.

Note: A list of URLs for official program documentation referenced throughout this response can be found in Appendix 4.

APPENDIX 1

Schedule of Haircuts
Effective March 19, 2009

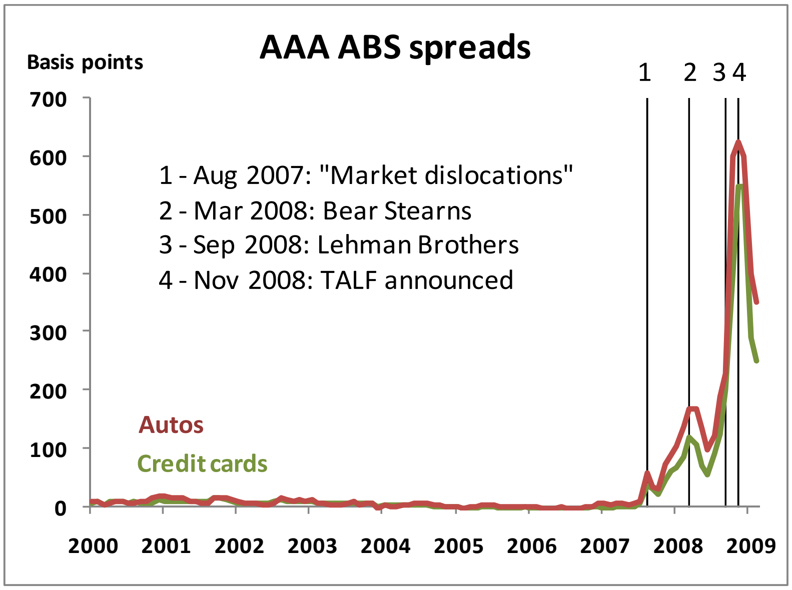
		ABS Expected Life (years)						
Sector	Subsector	0-1	>1-2	>2-3	>3-4	>4-5	>5-6	>6-7
Auto	Prime retail lease	10%	11%	12%	13%	14%		
Auto	Prime retail loan	6%	7%	8%	9%	10%		
Auto	Subprime retail loan	9%	10%	11%	12%	13%		
Auto	Motorcycle/other recreational vehicles	7%	8%	9%	10%	11%		
Auto	Commercial and government fleets	9%	10%	11%	12%	13%		
Auto	Rental fleets	12%	13%	14%	15%	16%		
Credit Card	Prime	5%	5%	6%	7%	8%		
Credit Card	Subprime	6%	7%	8%	9%	10%		
Equipment	Loans and leases	5%	6%	7%	8%	9%		
Floorplan	Auto	12%	13%	14%	15%	16%		
Floorplan	Non-auto	11%	12%	13%	14%	15%		
Small Business	SBA loans	5%	5%	5%	5%	5%	6%	6%
Student Loan	Private	8%	9%	10%	11%	12%	13%	14%
Student Loan	Gov't guaranteed	5%	5%	5%	5%	5%	6%	6%
Servicing Advances	Residential mortgages	12%	13%	14%	15%	16%		

APPENDIX 2

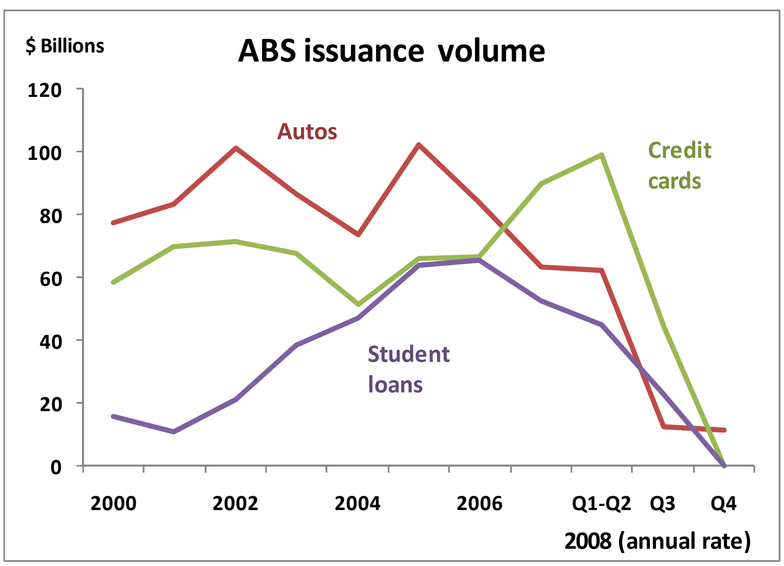
Monthly Consumer ABS Issuance (in millions): January 2007 to March 2009						
		Credit Cards	Auto	Student Loan	SBA 7(a)	SBA 504
Year	Month	Total	Total	Total	Total	Total
2007	Jan	5,025	3,469	4,704	387	361
	Feb	10,549	7,996	6,571	349	310
	Mar	8,747	2,305	12,182	195	387
	Apr	6,474	5,277		312	378
	May	8,790	9,307	4,336	188	449
	Jun	7,255	8,878	4,871	194	386
	Jul	8,483	2,915	5,591	353	381
	Aug	6,250	4,915	1,500	408	466
	Sept	7,868	6,414	3,548	318	452
	Oct	15,633	7,580	3,918	527	414
	Nov	3,225	4,437	5,343	191	421
	Dec	1,700	2,380		740	395
2007 Total		89,998	65,873	52,564	4,162	4,801
2008	Jan	13,388	6,647	3,814	421	429
	Feb	3,660	1,876	982	231	311
	Mar	10,079	1,915	3,311	161	418
	Apr	8,594	3,446	6,531	321	492
	May	8,758	10,791	1,310	384	443
	Jun	5,909	5,814	6,516	312	412
	Jul	4,484	2,104	1,570	408	491
	Aug	3,978		4,086	214	367
	Sept	6,129	1,094		225	454
	Oct		376		136	312
	Nov		500		142	389
	Dec		1,897		102	397
2008 Total		64,980	36,460	28,120	3,060	4,916
2009	Jan	3,500	1,300		130	283
	Feb		1,073	547	280	235
	Mar	3,425	5,115	1,498	150	319
2009 Total		6,925	7,488	2,045	560	837
2007-2009 Total		**161,903**	**109,820**	**82,729**	**7,782**	**10,554**

Source: JPMC, Colson Services

APPENDIX 3



AAA ABS spreads
Basis points
1 2 3 4
1 - Aug 2007: "Market dislocations"
2 - Mar 2008: Bear Stearns
3 - Sep 2008: Lehman Brothers
4 - Nov 2008: TALF announced
Autos
Credit cards
700
600
500
400
300
200
100
0
2000 2001 2002 2003 2004 2005 2006 2007 2008 2009



ABS issuance volume
$ Billions
Autos
Credit cards
Student loans
120
100
80
60
40
20
0
2000 2002 2004 2006 Q1-Q2 Q3 Q4
2008 (annual rate)

Appendix 4

TALF program documentation referenced throughout this response can be found on the Federal Reserve Bank of New York's website at the following URLs:

Terms and Conditions
http://www.newyorkfed.org/markets/talf_terms.html

Frequently Asked Questions (FAQs)
http://www.newyorkfed.org/markets/talf_faq.html

Master Loan and Security Agreement
Auditor Attestation Form
Conflict of Interest Policy
Borrower Eligibility and Due Diligence Policy
http://www.newyorkfed.org/markets/talf_docs.html