BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

DIVISION OF MONETARY AFFAIRS

October 3, 2012

Christy L. Romero
SIGTARP
1801 L St, NW
Washington, DC 20220

Dear Special Inspector General Romero,

Chairman Bernanke asked me to reply to your letter of August 22, 2012 in which you recommend that the Federal Reserve change the Term Asset-Backed Securities Loan Facility (TALF) to eliminate any reliance on the London Interbank Offered Rate (LIBOR). As your letter notes, recent information regarding the way the LIBOR has been calculated has created some uncertainty about the reliability of the rate.

The TALF program stopped extending new credit in March 2010. Over $70 billion in loans were extended under the program; there is $1.5 billion currently outstanding. The outstanding loan balance has declined both because of scheduled repayments of principal and because of a large amount of pre-payments. All credit outstanding under the TALF is expected to be repaid in full by 2015.

As you know, the TALF was established in the fall of 2008, the height of the financial crisis, by the Federal Reserve and the Treasury Department to increase the availability of credit for U.S. households and small businesses. Under the TALF, the Federal Reserve Bank of New York (FRBNY) extended loans to finance purchases of certain highly rated asset-backed securities (ABS) that were in turn backed by loans to businesses and households.

The choice of which interest rate a TALF borrower would use was not driven by the borrower's preference, but by the nature and terms of the underlying collateral used to secure the loan. Interest payments on the securities collateralizing the TALF loans are paid to the FRBNY, which retains the interest owed on the TALF loan before passing the remainder to the TALF borrower. As you note, TALF loans with both fixed and floating interest rates were extended, and the floating-rate loans were based on several base rates including LIBOR, prime, and the FOMC's target federal funds rate. Each TALF borrower was required to choose a TALF loan rate that corresponds to the interest payments on the securities financed by and collateralizing the TALF loan. If the interest rate on the securities is based on LIBOR, the TALF loan rate is also based on LIBOR. About half of the TALF loans extended had interest rates that were based on LIBOR. Over 98 percent of those loans have already been repaid.

Under the terms of the TALF lending agreements, neither the Federal Reserve nor the Treasury has the authority to unilaterally change the interest rate. The TALF borrower would have to agree to any change in the base rate used to determine the TALF loan rate and would likely agree to such a change only if it benefitted the borrower. Consequently, the most likely outcomes of seeking to renegotiate the small number of remaining TALF loans that rely on LIBOR are that the borrower would either not agree to a rate change or would only agree to a change that would result in a lower payment to the U.S. taxpayer.

Sincerely,

Wm R Nelson

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