Congressional Oversight Panel Releases Oversight Report on the Continued Risk of Troubled Assets

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For Immediate Release

Financial Stability is at Risk if the Underlying Problem of Troubled Assets Remains Unresolved

WASHINGTON, D.C. - The Congressional Oversight Panel (COP) today released its August oversight report, "The Continued Risk of Troubled Assets," which examines the economic implications of troubled assets and assesses Treasury's strategy for removing these assets from bank balance sheets. The Panel found that the future performance of the economy and the performance of the underlying loans, as well as the method of valuation of the assets, are critical to the continued operation of the banks.

Last fall, as increasing numbers of subprime mortgage-holders defaulted on their loans, the financial markets for these assets effectively ceased to function. In response to the crisis, Treasury proposed a major government program to move hundreds of billions of dollars in troubled assets off the banks' books. But by the time the Troubled Asset Relief Program (TARP) was signed into law in early October, Treasury had decided to use TARP funds to pursue a different strategy: providing banks with a capital buffer to write-down many of their troubled assets and to build reserves for the future. Today, ten months later, substantial troubled assets remain on banks' balance sheets.

Treasury has launched the new Public-Private Investment Program (PPIP) in an effort to restart the mortgage-backed asset market. The Panel's report raises several questions about the program, including whether accounting rules that allow banks to carry assets at higher valuations will diminish their willingness to sell, and whether potential buyers may decline to participate due to concerns about political interference or government restrictions. PPIP could help to jump-start the troubled asset market, but serious questions remain about its effectiveness.

For smaller banks, those not among the 19 stress tested bank holding companies, troubled assets pose special challenges that have not been acknowledged. These banks' troubled assets are generally whole loans, which are not currently being addressed by Treasury's PPIP program. These banks also hold greater concentrations of commercial real estate loans, which pose a threat of high defaults. These banks also have more difficulty accessing the capital markets, which heighten concerns about their stability.

Treasury and relevant government agencies should move toward greater disclosure of the terms and volume of troubled assets on banks' balance sheets. Because banks typically disclose few details about the toxic assets on their books, it is difficult to gauge the magnitude of the risk that these assets pose to the financial system. Greater transparency would allow for better judgments about the scale of the problem and the adequacy of the government's response.

If the economy worsens beyond the levels considered in the recent stress tests, these tests should be repeated. Stress tests have the potential to gauge the impact of troubled assets on bank capitalization and to measure the risk that troubled assets could once again trigger instability. The Panel recommends that stress tests be adapted to consider the challenges facing smaller banks, including the adequacy of these banks' capital.

The full report can be found at cop.senate.gov.

The Congressional Oversight Panel was created to oversee the expenditure of the Troubled Asset Relief Program (TARP) funds authorized by Congress in the Emergency Economic Stabilization Act of 2008 (EESA) and to provide recommendations on regulatory reform. The Panel members are: Congressman Jeb Hensarling (R-TX), Richard H. Neiman, Superintendent of Banks for the State of New York, Damon Silvers, Associate General Counsel of the AFL-CIO, former U.S. Senator John E. Sununu (R-NH) and Elizabeth Warren, Leo Gottlieb Professor of Law at Harvard Law School.