



Highlights of [GAO-12-122T](#), a testimony before the Subcommittee on Domestic Monetary Policy and Technology, Committee on Financial Services, House of Representatives

Why GAO Did This Study

The Dodd-Frank Wall Street Reform and Consumer Protection Act directed GAO to conduct a one-time audit of the emergency loan programs and other assistance authorized by the Board of Governors of the Federal Reserve System (Federal Reserve Board) during the recent financial crisis. This testimony summarizes the results of GAO's July 2011 report (GAO-11-696) examining the emergency actions taken by the Federal Reserve Board from December 1, 2007, through July 21, 2010. For these actions, where relevant, this statement addresses (1) accounting and financial reporting internal controls; (2) the use, selection, and payment of vendors; (3) management of conflicts of interest; (4) policies in place to secure loan repayment; and (5) the treatment of program participants. To meet these objectives, GAO reviewed program documentation, analyzed program data, and interviewed officials from the Federal Reserve Board and Reserve Banks (Federal Reserve System).

What GAO Recommends

GAO made seven recommendations to the Federal Reserve Board to strengthen policies for managing noncompetitive vendor selections, conflicts of interest, risks related to emergency lending, and documentation of emergency program decisions. The Federal Reserve Board agreed that GAO's recommendations would benefit its response to future crises and agreed to strongly consider how best to respond to them.

View [GAO-12-122T](#) or key components. For more information, contact Orice Williams Brown, 202-512-8678 or williamso@gao.gov

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FEDERAL RESERVE SYSTEM

Opportunities Exist to Strengthen Policies and Processes for Managing Emergency Assistance

What GAO Found

On numerous occasions in 2008 and 2009, the Federal Reserve Board invoked emergency authority under the Federal Reserve Act of 1913 to authorize new broad-based programs and financial assistance to individual institutions to stabilize financial markets. Loans outstanding for the emergency programs peaked at more than \$1 trillion in late 2008. The Federal Reserve Board directed the Federal Reserve Bank of New York (FRBNY) to implement most of these emergency actions. In a few cases, the Federal Reserve Board authorized a Reserve Bank to lend to a limited liability corporation (LLC) to finance the purchase of assets from a single institution. In 2009 and 2010, FRBNY also executed large-scale purchases of agency mortgage-backed securities to support the housing market. The Reserve Banks' and LLCs' financial statements, which include the emergency programs' accounts and activities, and their related financial reporting internal controls, are audited annually by an independent auditing firm. These independent financial statement audits, as well as other audits and reviews conducted by the Federal Reserve Board, its Inspector General, and the Reserve Banks' internal audit function, did not report any significant accounting or financial reporting internal control issues concerning the emergency programs.

The Reserve Banks, primarily FRBNY, awarded 103 contracts worth \$659.4 million from 2008 through 2010 to help carry out their emergency activities. A few contracts accounted for most of the spending on vendor services. For a significant portion of the fees, program recipients reimbursed the Reserve Banks or the fees were paid from program income. The Reserve Banks relied more extensively on vendors for programs that assisted a single institution than for broad-based programs. Most of the contracts, including 8 of the 10 highest-value contracts, were awarded noncompetitively, primarily due to exigent circumstances. These contract awards were consistent with FRBNY's acquisition policies, but the policies could be improved by providing additional guidance on the use of competition exceptions, such as seeking as much competition as practicable and limiting the duration of noncompetitive contracts to the exigency period. To better ensure that Reserve Banks do not miss opportunities to obtain competition and receive the most favorable terms for services acquired, GAO recommended that they revise their acquisition policies to provide such guidance.

FRBNY took steps to manage conflicts of interest for its employees, directors, and program vendors, but opportunities exist to strengthen its conflict policies. In particular, FRBNY expanded its guidance and monitoring for employee conflicts, but new roles assumed by FRBNY and its employees during the crisis gave rise to potential conflicts that were not specifically addressed in the Code of Conduct or other FRBNY policies. For example, FRBNY's existing restrictions on its employees' financial interests did not specifically prohibit investments in certain nonbank institutions that received emergency assistance. To manage potential conflicts related to employees' holdings of such investments, FRBNY relied on provisions in its code that incorporate requirements of a federal criminal conflict of interest statute and its regulations. Given the magnitude of the assistance

and the public's heightened attention to the appearance of conflicts related to Reserve Banks' emergency actions, existing policies and procedures for managing employee conflicts may not be sufficient to avoid the appearance of a conflict in all situations. As the Federal Reserve System considers revising its conflict policies given its new authority to regulate certain nonbank institutions, GAO recommended it consider how potential conflicts from emergency lending could inform any changes. FRBNY managed vendor conflict issues through contract protections and actions to help ensure compliance with relevant contract provisions, but these efforts had limitations. For example, while FRBNY negotiated important contract protections, it lacked written guidance on protections that should be included to help ensure vendors fully identify and remediate conflicts. Further, FRBNY's on-site reviews of vendor compliance in some instances occurred as far as 12 months into a contract. FRBNY implemented a new vendor management policy but has not yet finalized another new policy with comprehensive guidance on vendor conflict issues. GAO recommended FRBNY finalize this new policy to reduce the risk that vendors may not be required to take steps to fully identify and mitigate all conflicts.

While the Federal Reserve System took steps to mitigate risk of losses on its emergency loans, opportunities exist to strengthen risk management practices for future crisis lending. The Federal Reserve Board approved program terms and conditions designed to mitigate risk of losses and one or more Reserve Banks were responsible for managing such risk for each program. Reserve Banks required borrowers under several programs to post collateral in excess of the loan amount. For programs that did not have this requirement, Reserve Banks required borrowers to pledge assets with high credit ratings as collateral. For loans to specific institutions, Reserve Banks negotiated loss protections with the private sector and hired vendors to help oversee the portfolios that collateralized loans. The emergency programs that have closed have not incurred losses and FRBNY does not project any losses on its outstanding loans. To manage risks posed by these new lending activities, Reserve Banks implemented new controls and FRBNY strengthened its risk management function. In mid-2009, FRBNY created a new risk management division and enhanced its risk analytics capabilities. But neither FRBNY nor the Federal Reserve Board tracked total exposure and stressed losses that could occur in adverse economic scenarios across all emergency programs. Further, the Federal Reserve System's procedures for managing borrower risks did not provide comprehensive guidance for how Reserve Banks should exercise discretion to restrict program access for higher-risk borrowers that were otherwise eligible for the Term Auction Facility (TAF) and emergency programs for primary dealers. To strengthen practices for managing risk of losses in the event of a future crisis, GAO recommended that the Federal Reserve System document a plan for more comprehensive risk tracking and strengthen procedures to manage program access for higher-risk borrowers.

While the Federal Reserve System took steps to promote consistent treatment of eligible program participants, it did not always document processes and decisions related to restricting access for some institutions. Reserve Banks generally offered assistance on the same terms to institutions that met announced eligibility requirements. For example, all eligible borrowers generally could borrow at the same interest rate and against the same types of eligible collateral. Because Reserve Banks lacked specific procedures that staff should follow to exercise discretion and document actions to restrict higher-risk eligible borrowers for a few programs, the Federal Reserve System lacked assurance that Reserve Banks applied such restrictions consistently. Also, the Federal Reserve Board did not fully document its justification for extending credit on terms similar to the Primary Dealer Credit Facility (PDCF) to affiliates of a few PDCF-eligible institutions and did not provide written guidance to Reserve Banks on types of program decisions that would benefit from consultation with the Federal Reserve Board. In 2009, FRBNY allowed one entity to continue to issue to the Commercial Paper Funding Facility, even though a change in program terms by the Federal Reserve Board likely would have made it ineligible. FRBNY staff said they consulted the Federal Reserve Board regarding this situation, but did not document this consultation and did not have any formal guidance as to whether such continued use required approval by the Federal Reserve Board. To better ensure an appropriate level of transparency and accountability for decisions to extend or restrict access to emergency assistance, GAO recommended that the Federal Reserve Board set forth its process for documenting its rationale for emergency authorizations and document its guidance to Reserve Banks on program decisions that require consultation with the Federal Reserve Board.

