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TREASURY SECRETARY TIMOTHY F. GEITHNER

HEARING

BEFORE THE

CONGRESSIONAL OVERSIGHT PANEL

ONE HUNDRED ELEVENTH CONGRESS

FIRST SESSION

APRIL 21, 2009

Printed for the use of the Congressional Oversight Panel

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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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TREASURY SECRETARY TIMOTHY F. GEITHNER

TUESDAY, APRIL 21, 2009

U.S. CONGRESS,
CONGRESSIONAL OVERSIGHT PANEL,
Washington, DC.

The Panel met, pursuant to notice, at 10:05 a.m. in Room SD–628, Dirksen Senate Office Building, Elizabeth Warren, Chairman of the Panel, presiding.

Attendance: Elizabeth Warren [presiding], Timothy F. Geithner, Jeb Hensarling, Richard H. Neiman, Damon Silvers, and John E. Sununu.

OPENING STATEMENT OF ELIZABETH WARREN, CHAIR, CONGRESSIONAL OVERSIGHT PANEL

The CHAIR: This hearing is now called to order.

Mr. Secretary, thank you for coming. We know your time is valuable. And with the hope of setting an example, I am going to be brief, short on formalities here.

I also will begin by apologizing for my voice and my hacking. I am afraid I am not at the top of my game right now.

We have spent nearly six months, both at the direction of Congress and by our appointments, reviewing the response of two administrations to an unprecedented financial crisis. Today, we have an opportunity to speak directly to the American people about how their $590 billion has been invested in a financial system, an investment that eventually must profit them and not just people on Wall Street.

When the financial meltdown began, there was a strong sense of fear and uncertainty among the American people, and who can blame them? Every month since October more than half a million jobs have been lost. The net worth of American families has plummeted more than 20 percent in 18 months.

The sense of fear and uncertainty has not gone away, but it has been joined by a new sense of anger and frustration. People are angry that even if they have consistently paid their bills on time and never missed a payment, their TARP-assisted banks are unilaterally raising their interest rates or slashing their credit lines.

People are angry that small businesses are threatened with closure because they can't get financing from their TARP-assisted banks. People are angry that when they read the headlines of record foreclosures, even if they aren't personally affected, they see their own property worth less, and they see their communities declining as a result of the foreclosures around them.

People are angry because they are paying for programs that haven't been fully explained and have no apparent benefit for their families or for the economy as a whole, but that seem to leave enough cash in the system for lavish bonuses or golf outings. None of this seems fair.

I appreciate your repeated statements about your commitment to transparency and to accountability, and I appreciate the important steps that you have taken in this direction, Mr. Secretary. But we both know that more needs to be done. People need to understand why you are making the choices that you are making.

People want to see action described in terms that makes sense to them. They want to see that taxpayer funds aren't being used to shield financial institutions from the consequences of their own behavior. They want to see that money, taxpayer money, is used to advance the public interest and not just the interests of Wall Street.

They also want to see that their Government is moving to reform the regulatory system so that the economy will not veer into the ditch again, to see reforms that will prevent the financial system from taking huge and reckless risks with other people's money in the quest for short-term profits.

In measuring progress, as well as in assessing the current state of the economy and institutions, we shouldn't be afraid of facts. There may be initial pain as the market reacts and reprices, but the short-term pain is better than the problems we face with ongoing uncertainty and mistrust.

In a crisis, transparency, accountability, and a coherent plan with clear goals are essential to maintain the confidence of the public and capital markets. Sophisticated metrics to measure the success and failure of program initiatives is also crucial.

One final note—Congress formed this panel in large part to ask difficult questions and to provide an outside perspective. We all share a strong desire to help the economy recover and to protect taxpayers. I hope that the reports from this panel have been useful to you and to your team at Treasury, and I appreciate your offer to have your staff meet with our staff on a weekly basis. I hope this is the beginning of an ongoing dialogue between the two of us.

With trillions of dollars of taxpayer money at stake and the fate of the American economy in the balance, we need to work together to find the most effective strategies for restoring confidence, stabilizing our economy, and restoring prosperity for all Americans.

[The prepared statement of Ms. Warren follows:]

CONGRESSIONAL OVERSIGHT PANEL

Elizabeth Warren, Chair | Sen. John E. Sununu | Rep. Jeb Hensarling | Richard H. Neiman | Damon Silvers

Opening Statement of Professor Elizabeth Warren

Congressional Oversight Panel

April 21, 2009

Mr. Secretary, thank you for coming. We know your time is valuable. With the hope of setting an example, I will keep this statement very brief and, as a result, short on the customary formalities and background. We have spent nearly six months, at the specific direction of Congress and the appointment of the leadership, reviewing the response of two Administrations to an unprecedented financial crisis. Today, all of us have an opportunity to speak directly to the American public about its $590 billion investment in the financial system—an investment that ultimately must serve all Americans, not just Wall Street.

When the financial meltdown began, there was a strong sense of fear and uncertainty among many Americans. And who can blame them? More than a half million jobs have vanished each month since October, while the net worth of American families plummeted by 20 percent in less than 18 months. This sense of fear and uncertainty hasn't gone away, but it has been joined by a new sense of anger and frustration.

People are angry that even if they have paid their bills on time consistently and never missed a payment, their TARP-assisted banks are unilaterally raising their interest rates or slashing their credit lines. People are angry that small businesses are threatened with closure because they can't get financing. People are angry when they read headlines of record foreclosures because even if they aren't personally facing trouble with their mortgages, they see their own property worth less and their communities declining as a result of the foreclosures all around them.

People are angry because they are paying for programs that haven't been fully explained and that have no apparent benefit for their families or the economy as a whole, but still seem to leave enough cash in the system for lavish bonuses and golf outings. None of this seems fair.

I appreciate your repeatedly stated commitment to transparency and accountability, and I appreciate the important steps you have taken in this direction. But more remains to be done. People need to understand why you are making the choices you are making.

People want to see action described in terms that make sense to them and that seem fair. They want to see that taxpayer funds aren't being used to shield financial institutions from the consequences of their own actions. They want to see that their money—taxpayer money—is used to advance the public interest— not just the interests of Wall Street insiders. They also want to see that their

government is moving to reform the regulatory system so that the economy will not veer into the ditch again—to see reforms that will prevent the financial system from **taking huge and reckless risks with everyone else's money in the quest for short-term profits.**

In measuring progress, as well as in assessing the current state of the economy and institutions, we shouldn't be afraid of facts. There may be initial pain as the market reacts and re-prices, but that short term pain is better than the problems we face from ongoing uncertainty and mistrust. In a crisis, transparency, accountability, and a coherent plan with clearly delineated goals are essential to maintain the confidence of the public and the capital markets. Sophisticated metrics to measure the success and failure of program initiatives are also critical.

One final note: Congress formed this panel, in large part, to ask difficult questions and to provide an outside perspective. Secretary Geithner, we all share a strong desire to help the economy recover and to protect taxpayers. I hope that the reports from this Panel have proved useful to you and your team at the Department of Treasury, and we appreciate your recent offer to initiate weekly meetings between our staffs. I hope that this hearing will be part of an ongoing dialogue. With trillions of taxpayer dollars on the line, we all need to work together to find the most effective strategies for restoring confidence, stabilizing our economy and bringing prosperity to all Americans.

Thank you for coming here today.

Congressman Hensarling.

STATEMENT OF HON. JEB HENSARLING, MEMBER, CONGRESSIONAL OVERSIGHT PANEL

Mr. HENSARLING. Thank you, Madam Chair.

Mr. Secretary, welcome. We are very happy to see you here. We note that this is the first appearance, I believe, of any Treasury personnel, much less the Secretary, before the Congressional Oversight Panel. We certainly hope it is not your last.

I believe that this panel cannot effectively fulfill its congressional role without having unfettered access to Treasury personnel, having the receipt of prompt and accurate answers to our queries, and ultimately to have yourself and senior members of your team appear in public hearings as this.

And I hope, Mr. Secretary, that you feel that it is commensurate with your duties under Section 2—Subsection 2(d) of the act that provides for public accountability of your actions under the TARP program. I fear that without this level of access that the Congressional Oversight Panel could potentially evolve into yet another congressional advisory committee, unfortunately leaving the task of effective oversight perhaps to others.

Now, as a member of Congress, I voted against the original EESA, or as it has become known, the TARP bill. I respect those who voted for it. I understand their reasons. I personally, though, had a fear that we were looking at $700 billion in search of a program. I was concerned that once bailouts began, I am not sure how one bails out on the bailout program.

I was concerned that the program eventually may lead to the Federal Government being able to control the behavior of those who received the money and lead us to a partial nationalization of key sectors of our financial services industry.

Finally, I was concerned that the program might create a level of moral hazard that could create even greater economic turmoil down the road. I fear that many of my fears may actually prove well founded.

Nevertheless, TARP is the law of the land. And as a member of Congress and as a member of this Congressional Oversight Panel, I plan to do everything in my power to ensure that the program meets its intended goals and that it has proper oversight.

I look forward to your testimony in which I hope several key areas will be touched upon. Number one is a greater understanding by this panel and the general public of what the overarching strategy is for the program.

The public and this panel have a right to know how Treasury defines success and what the measurements of the success of the various initiatives that you are undertaking under EESA are. For many, it is difficult to discern success. For many, it is difficult to discern cause and effect.

Next, the public has a right to know what is the approach of Treasury with regard to assisting failing companies and firms. Is there any firm that is beyond the reach for taxpayer bailout assistance?

What started out as a program to shore up the financial system has now been used to aid automakers, which leads to the question "who is next?" The airline industry? The trucking industry? At what point does Starbucks get in line for some type of bailout?

Now besides being on the hook for $700 billion under EESA, the taxpayer is facing an incredible amount of increased liability, much of it outside of EESA. We have had a $1.13 trillion stimulus plan, costing the average American household $9,810; a $410 billion omnibus plan, costing the average American household $3,534.

Bloomberg has recently stated that the actions of Treasury, combined with those of the Federal Reserve—I am sure you have seen the reports, Mr. Secretary—that the total taxpayer liability under various bailout, economic recovery initiatives now totals $12.8 trillion, or over $110,000 per American household.

Now I, for one, don't believe that the ultimate exposure will be anywhere near that figure. But for those who maintain that the taxpayer will actually make money on this deal, number one, I hope you are right. And number two, as history is my guide, I severely doubt it.

I believe that also, given that taxpayer protection is the number-one item that you are to consider under your programs, there are legitimate questions to be asked about press reports that say a number of the TARP recipients are interested in repaying the taxpayer, but apparently Treasury is not interested in receiving that money.

In addition, there are serious concerns on whether or not the funding is being used as, again, a road to partial nationalization as preferred stock is converted to common stock. And I hope, Mr. Secretary, that you will address these issues in your testimony, since many people have not been overly impressed with the management of AIG, much less Fannie and Freddie.

Again, Mr. Secretary, we appreciate you being here. We know these are tough times. We know that you are doing what you think is best in the Nation's interest, and I look forward to hearing your testimony.

And I yield back, Madam Chair.

The CHAIR. Thank you, Congressman.

Mr. Silvers.

STATEMENT OF DAMON SILVERS, DEPUTY CHAIR, CONGRESSIONAL OVERSIGHT PANEL

Mr. SILVERS. Thank you, Madam Chair.

Good morning, Mr. Secretary, and welcome. Like my fellow panelists, I am very pleased that you are able to join us here at the Congressional Oversight Panel. And as my colleague Jeb Hensarling notes, this hearing does mark the first public appearance of a Treasury official before our panel, and we are honored by your presence.

I think every member of the panel recognizes the gigantic task that faced the new team at Treasury upon their arrival in January and the challenges that the transition represented to you, Mr. Secretary, in terms of staffing changes, policy review and formulation.

In that context, this hearing seems to come at the right time. Our task this morning is to learn where Treasury thinks we stand

as a Nation in addressing the financial crisis and, in particular, what Treasury's strategy is in relation to the job of stabilizing our financial system and reviving the underlying economy.

The Obama administration inherited from the Bush administration a number of programs under the Emergency Economic Stabilization Act of 2008, the EESA that Jeb referred to, and you have announced a number of initiatives of your own. We may not be able to cover every aspect of this effort today, and we may also not have the opportunity to fully address the administration's plans in the area of regulatory reform.

So let me just commend the administration's announced plans for regulatory reform for their general direction and urge the Treasury Department to make a close study of this panel's regulatory reform report.

I would like to use what remains of my time to address those areas where I think, Mr. Secretary, that your team and the Obama administration has made significant progress and then to summarize what I see as the fundamental strategic issue facing the administration and the Nation. Then I hope to return to this set of—the strategic issue in the question period.

First, the Treasury Department's commitment to address the roots of the financial crisis and the fate of American families facing home foreclosure is an extremely positive step. The program could be more robust, particularly around principal reduction. But the basic design is thoughtful. The commitment to getting lender and servicer involvement is real, and the percentage of income targets—the key number in any such program—those targets are the right ones.

Mr. Secretary, you deserve real credit for your leadership in this area, and I am happy to extend it, at least on my own behalf, this morning.

Second, when you came into office, you told our panel you were committed to greater transparency. I have been very pleased to see that the Treasury Department has turned a corner under your guidance. I understand that Treasury has produced 10,000 documents to the panel staff yesterday in response to a letter sent to you on March 24, 2009, asking for materials related to AIG.

This progress is certainly encouraging, and I hope it is indicative of a change in the way that the Treasury Department plans to handle future requests. In the past, our document requests have sadly been answered by prolonged silence. Hopefully, you can provide some reassurance today that those days are over.

Third and finally, I view the stress tests and a variety of the statements you and your colleagues have made as acknowledgments that not all large banks are equally healthy. This is a departure from the approach of the prior administration, which tried to treat all large banks as though they were in the same financial condition, resulting, according to our February report, in a $78 billion taxpayer subsidy to the banks in the course of the Capital Purchase Program and SSFI transactions.

I commend you on that change. Candor is a good thing, and I hope that the stress tests are conducted and the results made public in a continuing spirit of candor.

However, now you and your team face a fundamental strategic choice as to how to manage the problem of undercapitalized large banks, the so-called "zombie banks." I note that the four largest banks in our system control more than 50 percent of bank assets.

In our April report, we looked at the history of bank crises in the United States and abroad. We found a pattern that started with President Roosevelt and President Hoover's Reconstruction Finance Corporation. Successful policy approaches to bank crises across time and place seem to all have three steps, and the order in which those steps are taken is important.

Step one is to have bank management that can be trusted to give an honest accounting of the state of bank balance sheets. In this regard, it can be a problem to ask the people who made the mess to tell you how big the mess is.

Step two is to get a realistic measure of the whole in bank balance sheets. This can be done by marking to market, and it also can be done by a hard valuation of expected cash flows by experienced and independent financial professionals. It cannot be done by asking the people who invested in the bad assets in the first place to tell the Government what those assets are worth.

Step three is to restructure bank finances—and "restructure" is the key word here—in the first instance, by requiring investors, particularly stockholders, to bear the losses. That is what capitalism is about.

Exactly who bears the losses and in what proportion must be determined carefully, balancing systemic risk considerations with taxpayer protection. Only then and only if necessary should public funds be involved.

And finally, with public money has to come a proportionate upside for the public. It is the only way to keep the cost to the taxpayer my colleague Congressman Hensarling was talking about—it is the only way to keep that cost at the end of the day at a bearable level.

I hope in this hearing we can compare this how-to manual that history provides us with the Treasury Department's thinking and its announced programs. And in conclusion, let me express my gratitude to you, Mr. Secretary, for joining us and my sympathy to you for taking on, on all of our behalf, the giant challenge of repairing the damage a mistaken deregulatory philosophy has done to our financial system, our economy, and, most of all, to America's working families.

[The prepared statement of Mr. Silvers follows:]

CONGRESSIONAL OVERSIGHT PANEL

Elizabeth Warren, Chair | Sen. John E. Sununu | Rep. Jeb Hensarling | Richard H. Neiman | Damon Silvers

Opening Statement of Damon Silvers

Congressional Oversight Panel

April 21, 2009

Good morning. Like my fellow panelists, I am very pleased to welcome Treasury Secretary Timothy Geithner to the Congressional Oversight Panel. This hearing marks the first public appearance of a Treasury official before our panel, and we are honored by the Secretary's presence.

I think every member of the Panel recognizes the gigantic tasks that faced the new team at Treasury upon their arrival in January, and the challenges that the transition represented in terms of staffing changes and policy review and formulation. In that context, this hearing seems to come at the right time.

Our task this morning is to learn where Treasury thinks we stand as a nation in addressing the financial crisis, and in particular what Treasury's strategy is in relation to the job of stabilizing our financial system and reviving the underlying real economy.

The Obama Administration has inherited from the Bush Administration a number of programs under the Emergency Economic Stabilization Act of 2008, and has announced a number of initiatives of its own. We may not be able to cover every aspect of this effort today. We also may not have the opportunity to address the Administration's plans in the area of regulatory reform in sufficient detail so let me just commend the Administration's announced plans for their general direction and urge the Treasury Department to make a close study of this Panel's Regulatory Reform Report.

I would like to use what remains of my time to address those areas where I think the Obama Administration has made significant progress, and then to summarize what I see as the fundamental strategic issue facing the Administration and the nation. I hope to return to this issue in the question period.

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the state of bank balance sheets. In this regard it can be a problem to ask the people who made the mess to tell you how big the mess is.

Step two is to get a realistic measure of the hole in bank balance sheets. This can be done by marking to market, and it can be done by a hard valuation of expected cash flows by experienced and independent financial professionals. It cannot be done by asking the people who invested in the bad assets to tell the government what those assets are worth.

Step three is to restructure bank finances, if possible, by forcing investors in the banks to bear the losses. Who bears the losses and how they are apportioned must be determined carefully, balancing systemic risk considerations with taxpayer protection. Only then, if necessary, should public money be involved. Finally, with public money has to come a proportionate upside for the public -- it is the only way to keep the cost to the taxpayer at the end of the day at a bearable level.

I hope in this hearing we can compare this how-to manual that history provides us with the Treasury Department's thinking and its announced programs.

Again, let me express my gratitude to the Secretary for joining us and my sympathy to him for taking on, on all our behalf, the giant challenge of repairing the damage a mistaken deregulatory philosophy has done to our financial system, our economy, and most of all, to America's working families.

The CHAIR. Thank you, Mr. Silvers.

Senator Sununu.

STATEMENT OF HON. JOHN E. SUNUNU, MEMBER, CONGRESSIONAL OVERSIGHT PANEL

Senator SUNUNU. Thank you, Madam Chair.

Thank you, Secretary Geithner, for being here today.

And without question, your attendance here is extremely important, but it is also extremely valuable. I think you understand that, but it is worth emphasizing because it is fair to say there has been some reluctance on the part of the Treasury staff to appear or to schedule a hearing in public with the oversight panel.

I think the value is that this is the best possible forum for you to describe the characteristics, the proposals, the ideas behind each of the different programs created under the TARP. And of course, it is the best possible way for the oversight panel to get clear and accurate information that we will act on in preparing our monthly oversight reports.

I view our role as looking carefully at the structure of the different TARP programs, their operation, and their performance. Some of these programs are relatively straightforward. Some of them are very complex. But our job is to look hard at those details, present them clearly to Congress and to the public, and the importance of that role is twofold.

First, we want good information in the hands of the public because their confidence in the operation of the programs, their confidence in Treasury and in the Government and being able to deal with the current financial crisis is going to depend on the clarity of that information and, of course, the way they interpret that information.

And then, second, the information that is provided by the panel and that is provided by the Treasury with regard to the structure and performance and operation of these programs is going to affect the way markets behave. Markets will react and respond based on whether they think these programs are well designed, effective, and whether they think the burden and the cost of the program is being shared fairly, as Damon Silvers just described.

And unless that information is provided to the public, our markets won't strengthen. They won't operate efficiently. Credit won't be available to the families and small businesses that we want to see it made available.

So I think that is a central role of the panel. I think it serves the interest of Treasury, and I think it should be easier to establish this kind of a forum.

It is also particularly important because, in my opinion, over the last few weeks, as Treasury has put out various statements regarding the different programs, you have left more questions unanswered than answered. On the stress tests, it is unclear what the motivation is behind making information public, what information is going to be made public, and how does Treasury expect both the general public and the markets to react to that.

On the TALF program, why is it that participation in the TALF wasn't as great as Treasury expected? On the new capital access program, under what conditions is Treasury and the Government

going to ask for conversion into common stock? What would be the criteria? Will there be objective criteria, or will they be subjective criteria?

And along that same vein, on the prepayment issue that Congressman Hensarling brought up, are we going to operate under the existing term sheets and conditions under which banks originally received funding through the CPP, or is Treasury now going to come up with a new list of subjective criteria that banks have to meet in order to be allowed to repay taxpayer funds?

Those are significant questions in that they create uncertainty in the mind of the public, and they also create a good deal of uncertainty in the marketplace. And the marketplace won't operate efficiently, the financial markets won't operate effectively for consumers or small businesses and the other credit services we need unless they feel they are getting good, clear, consistent information not just from Treasury, but from Congress as well.

We need more of this interaction, not less. I think it is in your interest. I think it will help the panel to do a better job, and I look forward to both your testimony and the questions today.

Thank you, Madam Chair.

The CHAIR. Thank you, Senator.

Mr. Neiman.

STATEMENT OF RICHARD H. NEIMAN, MEMBER, CONGRESSIONAL OVERSIGHT PANEL

Mr. NEIMAN. Thank you.

Good morning, Mr. Secretary. And I am also very pleased that you are here today with us to share your perspective.

This is a unique opportunity not just for our panel, but for the American people watching us today. I believe it is critically important for us to have this dialogue now, early in your term, to facilitate our working relationship going forward and to inform the American public about your efforts.

Speaker Nancy Pelosi asked me to serve on this panel in part to be a voice for the States and their residents. I am also, as you know, the New York State superintendent of banks, and in that capacity, I feel my job is about more than just overseeing banks. It is also about helping people in financial distress.

Under New York Governor David Patterson, we have taken aggressive actions at the State level in response to the crisis, from borrower outreach and increased enforcement to one of the most comprehensive legislative actions regarding mortgage reform in the country. But the fact is that States cannot bring an end to the foreclosure crisis or get us out of this recession without a Federal partner.

However, people across the country aren't sure if the Treasury efforts are working, which makes your job even harder at the Federal level. I hope to use this hearing to ask you some tough questions, but to also give you a chance to demonstrate that Treasury's plan can work.

You may be aware that I placed a blog post on a prominent Web site yesterday that asked people to submit questions to you. I placed it on the Huffington Post because that blog reaches over 10

million readers per month, thus representing a good, but imperfect cross-section of American opinion.

Literally, within hours of the posting, there were hundreds of responses that expressed deep concerns and even skepticism about the program, many accompanied by deeply personal stories. I read these questions on the train ride down to Washington last night, and it made me think a lot. It gave me a better sense of people's views, but it also made me really wonder why aren't people seeing progress in the Treasury's plan?

Perhaps it is because it is hard to see results in 1, 2, or 3 months. But perhaps it is because things are not working out as well as we would like.

So it seems to me that what is needed is a better system for measuring success that Treasury could provide to inform the American taxpayer. For instance, how should we measure whether the financial system is stabilizing? Should we be looking at credit default spreads or tangible capital ratios or some other metrics? How will we know that we are making progress?

How do we measure if the program has increased the amount of bank lending to consumers, to small businesses, to corporations? What is the impact of the decline in borrower demand versus a tightening of underwriting standards by banks?

Mr. Secretary, does Treasury have its own metrics for determining success in reaching its goals? And if so, can they be shared with the American public and be posted on your Web site so that all citizens can see how your plan is measuring up?

My worry is that if you do not, one of the most common questions I encounter when I hear from people about your plan will remain unanswered. One person put it quite bluntly on the blog, stating, "When are those banks going to stop sitting on all that money and start lending again?"

That question is undoubtedly a common question. And yet the recent snapshots from Treasury shows banks are making progress and attempting to be responsive in meeting credit needs. However, additional information is clearly needed to get to the bottom of this.

Metrics would help, and our panel will be issuing a report on this question in May that will specifically look at credit availability and small business and consumer lending, including your programs to restart the securitization market.

It is my personal view that although disagreement exists among some very smart people in this country, including Nobel Prize winners on both sides of the issues, you have a plan that can work. But it can only work with the support of the American people. And to support it, people need to understand it, and they need to feel that they can adequately judge it.

So I see this hearing as an important contribution to an inclusive process, and my questions today will reflect comments and concerns that I have received from a broad range of Americans. I hope today is only the beginning of a more collaborative relationship, and I look forward to your remarks.

Thank you very much.

[The prepared statement of Mr. Neiman follows:]

CONGRESSIONAL OVERSIGHT PANEL

Elizabeth Warren, Chair | Sen. John E. Sununu | Rep. Jeb Hensarling | Richard H. Neiman | Damon Silvers

Opening Statement of Richard H. Neiman

Member, Congressional Oversight Panel

April 21, 2009

Good morning. Secretary Geithner, we are pleased to have you here with us today to share your perspective.

This is a unique opportunity not just for our Panel but also for the American people watching us today; it is the Panel's first hearing with the Treasury Secretary from either Administration. We were disappointed that your predecessor, Secretary Paulson, was not available for a formal hearing with the Panel. I believe it is critically important for us to be having this dialogue now, early in your term, to facilitate our working relationship going forward and to inform the public about your efforts.

Speaker Nancy Pelosi asked me to serve on this Panel in part to be a voice for the states and their residents. I am also New York State's Superintendent of Banks, and in that capacity I feel my job is about more than overseeing banks- it is also about helping people in financial distress.

Under New York Governor David Paterson, we have taken aggressive action at the state level in response to the crisis, from borrower outreach and increased enforcement to one of the most comprehensive pieces of mortgage reform legislation in the nation.

But the fact is that the states cannot bring an end to the foreclosure crisis or get us out of this recession by themselves without a federal partner. However, people across the country just aren't sure if the Treasury's efforts are working, which makes your job harder at the federal level.

I hope to use this hearing to ask you some tough questions, but also to give you a chance to demonstrate that Treasury's plan can work. You may be aware that I placed a blog post on a prominent website yesterday that asked people to submit questions to you. I placed it on the Huffington Post because that blog reaches over ten million readers per month, thus representing a good, but imperfect, cross section American opinion. Literally, within hours of the posting there were hundreds of responses that expressed deep concerns and even skepticism about the program- many accompanied by deeply personal stories.

I read every one of these questions on the train ride down to Washington last night and it made me think a lot. It gave me a better sense of people's views, but it also made me really wonder why people aren't seeing progress in Treasury's plan. Perhaps it is because it is hard to see results in one, two, or three months, but perhaps it is because things are not working as well as we would like. It seems to me that what is needed is a better system for measuring success that Treasury could provide to inform the American taxpayer. For instance:

How should we measure whether the financial system is stabilizing? Should we be looking at credit default spreads or tangible capital ratios or some other metrics? How will we know that we are making progress?

How do we measure if the program has increased the amount of bank lending to consumers, small businesses, and corporations? What is the impact of the decline in borrower demand versus a tightening of underwriting standards by banks?

Mr. Secretary, does Treasury have its own metrics for determining success in reaching its goals? If so, can they be shared with the American public and posted on your website so that all citizens can see how your plan is measuring up?

My worry is that if you do not, one of the most common questions I encounter when I hear from people about your plan will remain unanswered. One person put it quite directly on the blog, stating "I would ask the same question that almost everyone is asking: when are those banks going to stop sitting on all that money and start lending again?"

That question is undoubtedly a common question, yet the recent snapshot reports from Treasury show banks are making progress and attempting to be responsive in meeting credit needs. However, additional information is clearly needed to get to the bottom of this. Metrics would help, and our panel will be issuing a report on this question in May that will specifically focus on credit availability and small business and consumer lending, including your programs to restart the securitization markets.

It is my personal view that, although disagreement exists among very smart people including Nobel Prize winners on both sides of the issues, you have a plan that can work. But it can only work with the support of the American people. To support it, people need to understand it and need to feel that they can adequately judge it.

I see this hearing as an important contribution to an inclusive process, and my questions today will reflect comments and concerns that I have received from a broad range of Americans. I hope today is only the beginning of a more collaborative relationship and I look forward to your remarks.

The CHAIR. Thank you, Mr. Neiman.

Secretary Geithner, we will enter your formal testimony in the record, of course, but we encourage or welcome your oral remarks. If you could hold them to 5 minutes so that we could go to the questioning, I would appreciate it.

STATEMENT OF HON. TIMOTHY F. GEITHNER, U.S. SECRETARY OF THE TREASURY

Secretary GEITHNER. Thank you, Chairwoman Warren, Representative Hensarling, members Neiman and Silvers, and Senator Sununu, for the chance to come before you today.

Those were very thoughtful opening statements, very sensible questions and concerns, and I look forward to the chance to begin to address those as we continue a process of dialogue and engagement.

And I want to start by applauding the work of the panel to date. These are very complicated questions. You have done a very nice job in helping to frame the most important questions for the American people. I respect and admire what you have done, what you are trying to do, and it is a very important part of the framework of oversight that Congress set up to monitor use of these programs.

The United States and the world economy are still in the midst of a very severe financial crisis, the worst in generations. And as you know, no crisis like this has a single or simple cause. But to state it simply, countries around the world borrowed too much, and allowed the financial system to take on irresponsible levels of risk.

And as in any crisis, the damage has been brutally indiscriminate, causing damage on Main Streets across the Nation. Ordinary Americans and small businesses who did the right thing, who played by the rules, who were prudent and careful in their financial decisions, are suffering from the actions of those who took on too much debt, took on too much risk.

I want to outline today the steps taken by this administration to restore the flow of credit, to help get our economy back on track. And I want to start by just saying at the time the administration took office, there had already been very substantial actions by the Government, using the authority provided by the Congress, to help stabilize the financial system.

And those actions were critical, and they were very effective in helping avert a systemic financial crisis. But the very sharp decline in growth, both here and around the world, that continued over the fourth quarter of last year was placing additional pressure, acute pressure on the financial system, on banks in this country and countries around the world.

Issuance of securities, which had been a principal source of credit to the economy as a whole, had fallen to virtually nothing. Lending terms and conditions were tightening. The cost of many forms of credit remained extremely high. Banks were unable to raise equity.

Now that was the situation when we came into office. And leaving that situation, that challenge, unaddressed would have risked, in our judgment, a deeper recession, more damage to the productive capacity of the American economy. It would have resulted in higher unemployment, more business failures, greater damage to

our future growth and productivity, and, as a result, higher long-term budget deficits.

Without action to strengthen the capacity of the financial system to provide credit, the substantial spending and tax incentives in the American Reinvestment and Recovery Act would have been less effective, far less effective.

Now, in response to these challenges, we outlined a broad new strategy to repair the financial system and strengthen its capacity to support recovery. We started with a series of reforms to improve transparency, accountability, and oversight. We published the detailed terms of financial assistance provided to individual banks. We put in place new protections for determining eligibility for assistance. We required financial institutions to report monthly on details about what is happening to lending activity.

We outlined new conditions on assistance to protect the taxpayer, and the President outlined a set of broad reforms to compensation practices to help ensure that taxpayer assistance was used to support lending rather than excessive compensation for executives.

Alongside these reforms, we launched a program of initiatives to address four challenges that were at the heart of this financial crisis, and I want to review briefly each of those challenges and our response to those challenges.

First, falling home prices and rising unemployment were making it difficult—are still making it difficult for many responsible borrowers to meet their mortgage payments and stay in their homes. Rising foreclosures risk contributing to further declines in house prices, a further pullback in credit, and further job losses.

So, in response, this administration established a program we call the Making Home Affordable Program to help keep mortgage interest rates low, to help responsible homeowners refinance into affordable mortgages, and to modify at-risk loans in order to help millions of Americans lower their monthly mortgage payments and stay in their homes.

Second, concern about future losses has led many banks to pull back on lending. So, in response, we outlined a new program to ensure that the Nation's major banks have a sufficient buffer of capital to provide credit for recovery.

As part of this effort, the Federal banking agencies, led by the Fed, are completing a forward-looking assessment of the capital needs of the 19 largest banks in the country to determine which banks may need to raise additional capital.

Those banks that need more capital will have an opportunity to raise that capital from the private markets or to request capital from the Treasury in the form of a convertible preferred security. It is important to recognize a dollar of capital generates between $8 and $12 of lending capacity.

Third, the breakdown of key markets for new securities has constrained the ability of even credit-worthy small borrowers—businesses, families—to get the loans they need. Securities markets in our financial system typically account for 40 to 50 percent of the credit provided to the economy, and the crisis caused issuance of new securities to grind to a halt.

So, as a complement to our program to bring more capital into banks, we launched the Consumer and Business Lending Initiative,

which expanded dramatically a program with the Federal Reserve called the Term Asset-Backed Securities Loan Facility. And these programs, as you know, provide financing to help catalyze issuance of securities backed by student loans, credit cards, small business loans, auto loans, corporate and commercial real estate loans.

Treasury has also put in place a program to provide direct support to small business loans through SBA supported programs. And these programs have had some effect—I will come to this at the end—in helping to promote new flows of credit through the issuance of securities and to help reduce rates in those markets.

The CHAIR. Mr. Secretary, could I ask you just to wrap up?

Secretary GEITHNER. Yes, but this is very important for me to do.

The CHAIR. Of course, it is.

Secretary GEITHNER. Because you have asked me to lay out our broad strategy and progress, and this is my first chance to do it. I will take just a few more minutes, but I will leave time for questions.

The fourth key challenge we addressed in our program was the challenge reflected in the fact that a range of legacy assets—these are mostly real estate-related loans made during the height of the boom—remain on the books of major banks, limiting their ability to extend credit and to raise new equity.

So, in response, the administration created an innovative new program to provide a market for those assets. Under this program, private investors, such as pension fund managers, will compete for the right to access capital from the Treasury and financing from the Federal Reserve and the FDIC to purchase these real estate-related loans and securities.

Private investors will set the purchase price, protecting the Government from the risk of paying too much. The Government will share in the returns on those investments. Professionals will manage the assets, and together, this will help reduce the risk of loss to the taxpayer over time.

Now these four programs are critical. They are designed to work together. Each will reinforce the effectiveness of the other. We may have to adapt and expand them over time, but they represent the foundation of any credible strategy to help ensure that this financial system is working for rather than against recovery.

Now, Chairman, I was going to summarize briefly our priorities on regulatory reform. I am going to leave that for a subsequent discussion. But I want to conclude by talking about some of the measurements of effectiveness of these programs.

The CHAIR. Mr. Secretary, I appreciate how many pages you are turning there. But if we could wrap up, I know we want some questions, too?

Secretary GEITHNER. So let me just conclude with a few observations on the impact of these programs on the availability and cost of credit. These are the most important measures of the state of the system, and to date, frankly, the evidence is mixed.

Now it is important to note that evaluating the impact of these programs is difficult because it is impossible to judge how the financial markets, how banks would have operated in the absence of these actions. In normal recessions, demand for credit falls. In re-

cessions that follow long periods of substantial borrowing, demand for credit falls more sharply. This is such a moment.

There is no past experience that provides a good guide as to what one could have expected to have occurred in our financial markets absent the policy actions that have taken place already. Indicators on interbank lending, on corporate issuance, and credit spreads suggest some improvement in confidence in both the stability of the system and some thawing in credit markets over the last several weeks and months.

Just to cite a few examples. The 3-month LIBOR–OIS spread, which is an indicator of the cost of unsecured lending or borrowing among banks, has fallen to about 90 basis points from a peak of about 365 in October. Nonfinancial corporate bond issuance was up sharply in the first quarter of 2009 after falling sharply at the end—in the second half of 2008.

Issuance of asset-backed securities rose in March after grinding to a halt in October and November, but it still remains at about half the level that occurred in the first half of 2008.

Despite these improvements, and these are material improvements, the cost of credit is still very high. Reports on bank lending show significant declines in lendings for consumer loans, for commercial and industrial loans, although mortgage refinancings have picked up considerably.

Now we are looking carefully at how to improve measurement, as you are, of what is happening in credit markets and tie those directly to the impact of these programs, and we look forward to working with you on how to do that.

And I just want to end by saying that our central objective, our obligation, is to ensure that the financial system is stable and it is able to provide the credit necessary for economic recovery. But stability itself is not enough. We need a financial system that is not deepening or lengthening the recession. And once the conditions for recovery are in place, we need a financial system that is able to provide credit on a scale that a growing economy requires.

Meeting this obligation requires actions by the Government. It requires the Government to take risks. The lesson of financial crises throughout history is that early action, forceful action, sustained action to repair financial systems to promote the flow of credit is essential to limit the damage recessions cause and to make it possible to bring recovery about at least cost to the taxpayer over time.

Now we need a financial system to support sustainable economic growth, and we need to put in place a comprehensive set of regulatory reforms to deter fraud and abuse, to protect American families when they buy a home or get a credit card, to reward innovation and tie pay to performance, and to end these past cycles of boom and bust. This is our commitment, and we have a lot to do.

Thank you for having me here, and I look forward to our conversation this morning.

[The prepared statement of Secretary Geithner follows:]

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Statement by

Timothy F. Geithner

U. S. Secretary of the Treasury

before the

Congressional Oversight Panel

April 21, 2009

INTRODUCTION

Good morning. Thank you for the opportunity to appear before you.

The challenges that our financial system faces are complex, interrelated, and the result of developments over many years. Earlier in this decade, a combination of fundamental factors and financial innovations generated unsustainable bubbles in many housing markets across the country. When those bubbles began to burst, starting in early 2006, housing price declines led to a sharp acceleration in mortgage delinquencies and charge-offs. Those unanticipated losses revealed deep-seated problems in our financial and economic systems. A protracted period of rapid innovation, excessive risk taking, and inadequate regulation produced a financial system that was far more fragile than was generally appreciated during the boom times.

In the years before the crisis, businesses, consumers, and importantly financial institutions had become increasingly complacent about risk. The volatility of the U.S. economy appeared to decline after the stabilization of inflation in the early 1980s. In recent years, savings outside the United States surged, generating strong global demand for financial assets, particularly U.S. financial assets. Nominal interest rates generally trended lower, and became less volatile, in the years before the current crisis.

The financial system itself was evolving at a rapid pace in the decades before the current crisis. Advances in information technology dramatically reduced transaction costs and made it possible for banks and other financial institutions to introduce a tremendous range of new products, including everything from ATMs to new complex financial contracts. In some areas, such as transaction services and credit cards, new technologies created economies of scale that favored large institutions. Just a few large firms are now responsible for processing the preponderance of credit card transactions. In other ways, advances in information technology favored markets over institutions. In recent decades, securities markets have grown more rapidly than financial institutions. For example, the share of securitized products in overall private financial intermediation grew from just 4 percent in 1980 to 26 percent in 2007. Over the same period, the share of banks and thrifts, which rely primarily on deposits, fell from 62 percent to 30 percent. The explosive growth of financial derivatives was also fueled by rapid advances in information technology. Given that much of this development occurred in a relatively stable macroeconomic environment, financial innovation in many cases increased complexity without sufficient concern for how new products would respond to shocks.

The combination of a stable macroeconomic environment, with strong risk appetite, and significant structural changes in the financial system, led to a buildup of leverage and risk throughout the system. That buildup was compounded by compensation systems that were not aligned with the long-term interests of shareholders, giving many managers and employees

incentives to take excessive risks. Investors looked for higher returns by taking on greater exposure to the risk of infrequent but severe losses. At the same time, consumers, businesses, and a range of financial entities became too reliant on easy access to the credit that major financial institutions could readily provide. Misaligned incentives without transparency, market discipline, or appropriate regulation widened conflicts of interest throughout the financial system.

Our regulatory system did not respond adequately to the challenges inherent in this environment. Regulators did little to contain the risks posed by the growth in complex financial instruments. The structure of our regulatory system is unnecessarily complex and fragmented. It operates with large gaps in meaningful oversight. Investment banks, the holding companies and affiliates of large insurance companies, finance companies, and the government-sponsored enterprises were subject to only limited oversight. These highly leveraged institutions lacked strong, federal, prudential regulation and supervision, and they did not have established access to central bank liquidity. Moreover, they were permitted by law to choose among regulatory regimes, often allowing them to avoid a stronger regulatory authority that might have been applied if they had been supervised as bank holding companies.

Starting in 2007, unexpected losses experienced by major banks on mortgage-backed securities set off a vicious cycle. The losses reduced their capital, which forced them to pull back on lending. This put downward pressure on asset prices, which generated further losses for the banks. Tightening financial conditions became a drag on the broader economy. As workers lost jobs and as prospects for businesses darkened, prospective losses on consumer and business loans increased. As the scale of the potential financial losses increased, market concerns about the viability of individual institutions started to emerge.

In March of 2008, these pressures led to an acute funding crisis for the investment bank Bear Stearns. In an emergency operation, JP Morgan purchased Bear Stearns after the Federal Reserve agreed to effectively ring fence roughly $30 billion of Bear Sterns' assets. Following the Bear Stearns rescue, pressures in financial markets eased for a time. But the economy continued to weaken, and alarm bells were sounded about the lack of tools available to the government to contain the emerging crisis.

Amidst rising unemployment and a significant correction in housing prices, delinquencies on conventional mortgages increased sharply. This was a significant challenge for Fannie Mae and Freddie Mac, government sponsored enterprises (GSEs) operating in the secondary market for home mortgages. Market pressures on the GSEs intensified over the summer as housing prices fell sharply and the performance of conventional mortgages deteriorated further. Moreover, the GSEs' forays into investments in alternative mortgage products turned out to be a brutal mistake. In early September, the decision was taken to put Freddie Mac and Fannie Mae into conservatorship. That decision had adverse consequences for the GSEs' shareholders and this

heightened pressures on other troubled financial intermediaries. After intense discussions with federal authorities and potential private investors, Lehman Brothers filed for bankruptcy protection less than a week after the GSEs were put into conservatorship. Because the government lacked the necessary tools to contain the fallout, the Lehman failure had an immediate impact on short-term money markets, particularly money market mutual funds and the market for commercial paper. A few days later, the Federal Reserve stepped in to provide substantial support to AIG because of the broad potential for contagion to many other financial institutions that would have followed its failure. These events significantly heightened market participants' fears that rising losses might irreparably deplete the capital of major financial institutions. In this volatile environment, special guarantee programs for money market mutual funds and parts of the commercial paper market were established. Importantly, the U.S. Congress passed the Emergency Economic Stabilization Act of 2008 (EESA) establishing the Trouble Assets Relief Program (TARP). EESA also increased the limit on the Federal Deposit Insurance Corporation (FDIC) deposit insurance, and the FDIC established a new guarantee facility for medium-term bank borrowing.

Acute concerns about the viability of major U.S. financial institutions persisted, inducing a further retraction in the credit markets and a more severe economic contraction. As a result, the Department of the Treasury shifted the focus of TARP from purchasing "toxic" assets to providing new capital to banks. Treasury established the Capital Purchase Program (CPP) to provide capital support for U.S. banks using TARP funds with the goal of ensuring that they could continue to play their important role in the credit markets and maintain lending to consumers and businesses.

In early phases of the crisis, some financial institutions were able to raise significant amounts of private capital. But as the crisis deepened, and asset markets became more distressed, uncertainty about the value of bank assets became an obstacle to raising private capital. The initial thrust of CPP was to inject capital into all major institutions in an environment where systemic risk appeared significant.

The intense financial stresses generated by these developments in September and October of 2008 had a profound effect on the U.S. and global economies. U.S. consumers and businesses became much more cautious and cut back their spending as credit became scarce. The sharp fall in equity prices since the summer, in addition to falling house prices, generated significant declines in household wealth. Similar pressures emerged in other countries. The United Kingdom and Western Europe had been facing financial pressures similar to those in the United States since mid-2007. To some degree, this reflected the fact that European financial institutions held U.S. mortgage-backed securities. But it also reflected the fact that their financial systems suffered from many of the same problems as ours. Much of the global economy was already slowing over the summer of 2008, but acute financial stress in September and October also generated sharp declines in economic activity around the world. Domestic demand slowed in

much of the world, particularly where financial stresses were acute, but there was an almost unprecedented collapse in global trade. Capital flows to emerging economies were also affected. The negative feedback between financial stress and collapsing economic activity had become global.

THE OBAMA ADMINISTRATION'S RESPONSE

Policy interventions at the end of 2008 were, in the end, successful in achieving the vital, but narrow, objective of preventing a major systemic meltdown. Acute concerns about counterparty risk within the financial system that had peaked in the wake of the failure of Lehman Brothers eased towards the end of the year. For example, the spread between three-month interbank interest rates and the market's expectation for short-term rates over the same period, a measure of distress in money markets, fell from a peak of 365 basis points in early October to about 100 basis points in early January. Even with that improvement, the spread remained high relative to the levels before the crisis; it averaged about 10 basis points in the first half of 2007.

While overt concerns about systemic risk had diminished since October, as President-Elect Obama and his economic team prepared their economic program, they faced a grave and rapidly evolving set of challenges in the financial sector.

The outlook for the economy was deteriorating rapidly and that had important implications for the financial sector. Economic data that became available in November and December pointed to a very sharp fall of in economic activity. For example, U.S. auto sales for October, which were released on November 3, were reported at a 10.6 million annual rate. This compares to an average level of 12.9 million in the third quarter. On December 4, it was reported that payroll employment had fallen by 533,000 in November.[1] This was the largest monthly decline since the deep recession of 1973-74. Quickly worsening prospects for the economy meant that likely losses for U.S. financial institutions were rising sharply as well, and this heightened concerns about the adequacy of their capital.

The disruptions to the financial system were the major factor undermining the economy. Liquidity in a broader range of securities markets, including the market for long-term Treasuries, fell sharply. Credit spreads for virtually all credit products reached historic highs in the fourth quarter. Loan growth and bond issuance slowed in the fourth quarter. In particular, the issuance of new asset-backed securities (ABS) essentially came to a halt in October. Part of the decline in credit growth reflected falling demand for credit as consumers and businesses became more cautious. But a variety of factors pointed to meaningful constraints on the supply of credit. For example, a record number of banks reported tightening credit standards in the fourth quarter.

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[1] The estimated change in payroll employment in November was later revised to a decline of 597,000.

In this context, doubts about the viability of major institutions persisted. Fannie Mae, Freddie Mac, AIG, Citigroup and Bank of America had all received substantial government support by mid-October. But these institutions had complex and opaque balance sheets that were heavily exposed to the deteriorating economy. Given the economic and financial environment, including illiquid markets and "fire sale" asset prices, investors were not convinced that the actions taken to that point were sufficient to ensure that the institutions were sound. Those doubts were reflected in pressure on equity prices and credit spreads. Further actions were ultimately necessary to shore up market confidence in these institutions.

In this context, President Obama decided that a new approach was needed. Leaving that situation unaddressed would have undoubtedly risked a deeper recession and more damage to the productive capacity of the American economy. It would have resulted in higher unemployment and greater failures of businesses, and it would have greatly undermined the substantial spending and tax incentives in the American Recovery and Reinvestment Act (ARRA). In addition, given the substantial burden placed upon the American taxpayers, there was deep public anger, skepticism about whether the government was using taxpayer money wisely, and a perceived lack of transparency, all of which led to eroding confidence.

In response to this inheritance, President Obama, upon taking office, outlined a series of changes designed to improve transparency, accountability, and oversight. This included a number of new online resources so that Americans could see exactly how their money was being spent; a monthly lending and intermediation survey to better gauge, in ways readily accessible to the public, the performance of banks participating in the CPP; and strong taxpayer protections to ensure that Americans receive a return on these long term investments, and are not rewarding failure, including with respect to executive compensation.

Alongside the reforms, earlier this year we laid out a broad strategy designed to address the five major challenges facing the financial system.

First, since the onset of the crisis, major financial institutions have reported unprecedented losses. Looking ahead, substantial additional shortfalls are all but certain. Uncertainty about the real value of distressed assets and the ability of borrowers to repay loans has contributed to a decline in the confidence required for the private sector to make much needed equity investments in our major financial institutions. We must ensure that individual banks have sufficient capital to absorb future losses, even under adverse circumstances, and still be able to provide the credit the economy needs. Moreover, we cannot allow doubts about the viability of major institutions to undermine the financial system as a whole. The U.S. government must continue those policies critical to sustaining confidence in the core of the system.

Second, the breakdown of key markets for new securities has constrained the ability of even creditworthy small businesses and families to get the loans they need. In today's financial

system, markets for asset-backed securities, as opposed to just deposit-taking banks and thrifts, raise a substantial portion of the funds that ultimately support new credit creation. It is essential that we get these markets working again so that families and businesses can have access to credit on reasonable terms.

Third, a range of legacy assets remain on the books of major banks. Pressure on banks to shrink their balance sheets has depressed the prices of these assets to "fire sale" levels and liquidity for these assets is limited. Uncertainty about the value of legacy assets is undermining confidence in major banks and impairing their ability to raise capital. We need to increase liquidity for legacy assets, break the cycle of deleveraging, and improve price discovery.

Fourth, the ongoing adjustment in the housing market remains at the center of the economic and financial crises. Falling home prices are a major financial challenge for many families. At the same time, financial losses related to the housing sector adjustment continue to be a significant headwind for banks and other financial institutions. Foreclosures are particularly problematic because they not only impose significant financial and emotional burdens on families, they are also costly for communities and banks. For all these reasons, addressing the housing crisis and reducing foreclosures is an important objective.

Finally, the lack of a modern regulatory regime and resolution authority helped create the current crisis, and it will limit our ability to address future crises until we put in place fundamental reforms. We need to expand our capacity to contain systemic risk. We have to make sure that when households make the choice to borrow, or to invest their savings, there are clear and fair rules of the road that prevent manipulation, deception, and abuse. Our regulatory structure must assign clear authority, resources, and accountability for each of its key functions. We must also seek to ensure that international rules for financial regulation are consistent with the high standards we will be implementing in the United States. The Federal government needs new tools for dealing with situations where the solvency of major financial institutions is called into question.

Capital Assistance Program

Currently, the vast majority of banks have more capital than they need to be considered well capitalized by their regulators. However, concerns about economic conditions – combined with the destabilizing impact of distressed "legacy assets" – have created an environment under which uncertainty about the health of individual banks has sharply reduced lending across the financial system, working against economic recovery. For every dollar that banks are short of the capital they need, they will be forced to shrink their lending by eight to twelve dollars. Conversely, every additional dollar of capital gives banks the capacity to expand lending by eight to twelve dollars. Providing confidence that banks have a sufficient level of capital even if the economic

outlook deteriorates is a necessary step to restart lending so that families have access to the credit they need to buy homes or pay for college, and businesses can get the loans they need to expand. Moreover, reassuring investors that banks have sufficient resources to weather even a very adverse economic scenario will make it possible for banks to raise additional private capital.

One of the major components of the Administration's Financial Stability Plan (FSP) is the Capital Assistance Program (CAP). The CAP is designed to ensure that individual banks have sufficient capital even in adverse circumstances. This strategy begins with the idea that in order to ensure our largest banks have adequate capital to weather a more severe economic scenario and continue to lend, we must first accurately diagnose their problems. Federal banking agencies will soon complete a forward looking assessment or "stress test" for the 19 largest banks. The stress tests will determine the capital needs of these banks by estimating losses that they might face if economic conditions were to deteriorate more than expected over the next two years, as well as the appropriate level for loss loan reserves at the end of the period. The analysis will take into account the likely path of earnings for individual banks over the same period. By focusing on individual banks, this approach allows the analysis to take into account the unique exposures that individual banks face as well their individual prospects for generating earnings.

If a judgment is made, in consultation with management, that a bank needs additional capital, it will be encouraged to raise that capital from private sources. Where needed, the CAP will provide additional capital in the form of convertible preferred stock as a backstop until private capital becomes available. Furthermore, all eligible banking organizations, not just the 19 organizations undergoing the stress test, will be able to apply to issue to Treasury convertible preferred stock equal to between one and two percent of their risk-weighted assets.

Because today's financial system is highly interconnected, a failure of a major financial institution can create severe challenges for the financial system and the wider economy. The events of last September and October are a concrete reminder of this very real threat. Maintaining confidence in key financial institutions, particularly as they raise new capital and restructure, has to remain a central objective of financial policy.

On February 10, Treasury, the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency, the Office of Thrift Supervision, and the Federal Reserve clearly stated their commitment to ensuring that confidence is maintained in the core of the financial system.[2] These institutions put in place a range of programs over the last year and are committed to continuing these programs to help reinforce confidence in core institutions, including a variety of guarantee programs, to ensure that key institutions continue to have access to stable funding.

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[2] See Treasury Press Release, February 10, 2009.

In March, the FDIC extended its Temporary Liquidity Guarantee Program (TLGP).[3] Under this program banks and other eligible financial institutions can issue medium-term debt that carries an FDIC guarantee. This program was an important factor in helping to stabilize the banking system in the wake of the failure of Lehman Brothers. Treasury has also recently extended its Money Market Funds Guarantee Program through September 18, 2009.[4]

CONSUMER AND BUSINESS LENDING INITIATIVE

Securitization has come to play a very important role in the U.S. financial system. Banks develop and maintain expertise in originating certain types of loans. This includes loans to individuals through credit cards, mortgages, student loans, and other forms of consumer credit as well as loans to businesses, particularly those that are not able to raise funds directly in securities markets. In recent years, an increasing portion of these loans have been aggregated into pools and sold as so-called ABS. The rapid growth of the market for ABS in the years before the current crisis increased the supply of credit available to individuals and small businesses because once banks pool and sell loans to the securitization market, it opens up their balance sheet to create new loans.

As the economy deteriorated over the summer of 2008, credit spreads on ABS began to rise, and the disruptions that followed the failure of Lehman Brothers severely disrupted the market of newly issued ABS. Issuance of consumer ABS averaged $20 billion per month in 2007, and $18 billion per month during the first half of 2008. However, ABS issuance slowed sharply in the third quarter before coming to a virtual halt in October 2008. The closure of this market is a major constraint on the supply of new credit to individuals and businesses, particularly in an environment where banks have little scope to expand their balance sheets.

An important part of the Obama Administration's FSP is a significant expansion of the Term Asset-Backed Securities Loan Facility (TALF) through the Consumer Business Lending Initiative. The TALF is designed to jumpstart the securitization markets, which in turn will increase lending throughout the economy. Under the TALF, the Federal Reserve extends loans to investors who purchased newly issued ABS. Treasury has committed funds under the TARP program to provide a degree of credit protection for the Federal Reserve's TALF loans. The program was initially proposed in November 2008, with a focus on highly-rated ABS backed by student loans, auto loans, credit card loans, and loans guaranteed by the Small Business

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[3] See http://www.fdic.gov/regulations/resources/TLGP/index.html.

[4] See "Treasury Announces Extension of Temporary Guarantee Program for Money Market Funds," Treasury Press Release, March 31, 2009. http://www.treas.gov/press/releases/tg76.htm

Administration (SBA). As part of President Obama's FSP, we announced an expansion of the size and scope of the program, increasing the scale of potential ABS funding under TALF.

In March, the first transactions – Four deals, including three auto securitizations and one credit card securitization, were brought to the market. These transactions totaled approximately $8.5 billion, with just under $5 billion financed through TALF. Recently, Treasury and the Federal Reserve expanded TALF to include newly or recently issued AAA-rated ABS backed by four additional types of consumer and business loans – mortgage servicing advances, loans or leases relating to business equipment, leases of vehicle fleets, and floor plan loans.

The terms of the funding provided under TALF, including fees, are set in a way that is designed to limit the risks faced by U.S. taxpayers while still meeting the objective of encouraging lending to consumers and small businesses. The amount and cost of funding that is provided varies depending on the perceived riskiness of the assets being financed. Treasury and the Federal Reserve used conservative assumptions when calibrating the limits on the funding provided given the uncertain economic environment.

In recent years, securitization has supported over 40 percent of lending guaranteed by the Small Business Administration. As a result of the severe dislocations in the credit markets that began in October 2008, however, both lenders that originate loans under SBA programs and the "pool assemblers" that package such loans for securitization have experienced significant difficulty in selling those loans or securities in the secondary market. This, in turn, has significantly reduced the ability of lenders and pool assemblers to make new small business loans. As a result, while the SBA typically guarantees about $20 billion in loans annually, new lending was trending below $10 billion earlier this year.

On March 16, 2009, Treasury announced a program to unlock credit for small businesses as part of the Consumer and Business Lending Initiative. As part of the program, Treasury will make up to $15 billion in TARP funds available to make direct purchases to unlock the secondary market for the government-guaranteed portion of SBA 7(a) loans as well as first-lien mortgages made through the 504 program. These purchases, combined with higher loan guarantees and reduced fees implemented under the American Recovery and Reinvestment Act of 2009, will help provide lenders with the confidence that they need to extend credit, knowing that if they make an SBA loan, they will be able to sell it and access the liquidity necessary to do further lending.

PUBLIC PRIVATE INVESTMENT PROGRAM

A variety of troubled legacy assets is congesting the U.S. financial system. The vicious cycle of deleveraging has pushed some asset prices to low levels. The difficulty of obtaining private financing on reasonable terms to purchase these assets has reduced secondary market liquidity and disrupted normal price discovery. While economic fundamentals have deteriorated substantially in this crisis, there is ample evidence that current market prices for many legacy

assets include substantial liquidity discounts.[5] Such discounts constrain the economic capital of U.S. financial institutions, reducing their ability to provide new credit. Moreover, uncertainty about the value of legacy assets is constraining the ability of financial intuitions to raise private capital.

The Public Private Investment Program (PPIP) is intended to restart the market for these assets while also restoring bank balance sheets as these devalued loans and securities are sold. Using $75 to $100 billion in capital from EESA and capital from private investors – as well as funding enabled by the Federal Reserve and FDIC – PPIP will generate $500 billion in purchasing power to buy legacy assets, with the potential to expand to $1 trillion over time. By providing a market for these assets, PPIP will help improve asset values, increase lending capacity for banks, and reduce uncertainty about the scale of losses on bank balance sheets – making it easier for banks to raise private capital and replace the capital investments made by Treasury.

By following three basic principles, PPIP is designed as part of an overall strategy to resolve the crisis as quickly as possible with the least cost to the taxpayer. First, by partnering with the FDIC, the Federal Reserve, and private sector investors, we will make the most of taxpayer resources under TARP. Second, PPIP will ensure that private sector participants invest alongside the government, with the private sector investors standing to lose their entire investment in a downside scenario and the taxpayer sharing in profitable returns. Third, the program will use competing private sector investors to engage in price discovery, reducing the likelihood that the government will overpay for these assets. By contrast, if the government alone purchased these legacy assets from banks, it would assume the entire share of the losses and risk overpaying. Alternatively, if we simply hoped that banks would work off these assets over time, we would be prolonging the economic crisis, which in turn would cost more to the taxpayer over time. PPIP strikes the right balance, making the most of taxpayer dollars, sharing risk with the private sector, and taking advantage of private sector competition to set market prices for currently illiquid assets.

The program has two major components, one each for securities and loans. The Legacy Securities Program initially will target commercial mortgage-backed securities and residential mortgage-backed securities. Treasury will partner with approved asset managers. Pre-approved asset managers will have an opportunity to raise private capital for a public-private investment fund ("PPIF"). Treasury will invest equity capital from the TARP in the PPIF on a dollar-for-dollar basis with participating private investors.[6] Additional funding will be available either

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[5] See "White Paper: Public Private Investment Program," U.S. Treasury, March 23, 2009, http://www.treas.gov/press/releases/reports/ppip_whitepaper_032309.pdf

[6] Additional information on the terms and conditions of the Legacy Securities Program are available at: http://www.treas.gov/press/releases/reports/legacy_securities_terms.pdf

directly from Treasury or through TALF. The program is designed to encourage participation by a wide range of investors, and we extended the application deadline to facilitate that objective.

The Legacy Loans Program is designed to attract private capital to purchase eligible legacy loans and other assets from participating banks through the availability of FDIC debt guarantees and Treasury equity co-investments. Under the program, PPIFs will be formed – with up to 50 percent equity participation by Treasury – to purchase and manage pools of legacy loans and other assets purchased from U.S. banks and savings associations. The FDIC will provide a guarantee of debts issued by PPIFs and collect a guarantee fee. The FDIC will be responsible for overseeing the formation, funding, and operation of legacy loan PPIFs and for overseeing and managing the debt guarantees it provides to the PPIFs.[7]

The terms of the funding provided under both parts of PPIP, including fees, will be set in a way that is designed to limit the risks faced by U.S. taxpayers while still meeting the objective of generating new demand for legacy assets. In addition, those participating in the program will be subject to a significant degree of oversight to ensure that their actions are consistent with the objectives of the program.

HOUSING

As we are all painfully aware, the collapse of the housing price bubble, and the sharp reversal in lending standards that helped fuel that bubble, has had a devastating effect on the financial sector and on homeowners alike, with dire consequences for the economy overall. In addition to reducing household wealth across the country, and thereby further intensifying the economic contraction, falling home prices and extraordinarily tight lending standards have trapped homeowners in their old mortgages. Even many homeowners who made what seemed to be conservative financial decisions three, four, or five years ago find themselves unable to benefit from the low interest rates available to unencumbered borrowers today. At the same time, increases in unemployment and other recessionary pressures have continued to impair the ability of some otherwise responsible families to stay current on mortgage payments.

As a result, as many as 6 million families are expected to face foreclosure in the next several years. Foreclosures have massive negative externalities – such as reducing surrounding home values, and increasing vacancies, homelessness, and violent crime. In some studies, foreclosure on a home has been found to reduce the prices of nearby homes by as much as 9 percent.

Since January, the Administration has made significant progress in developing and implementing a comprehensive plan for stabilizing our housing market, the centerpiece of which is the Making

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[7] Additional information on the Legacy Loans Program is available at: http://www.treas.gov/press/releases/reports/legacy_loans_terms.pdf

Home Affordable Program (MHA). By reducing foreclosures around the country, the average homeowner could see their house price bolstered by as much as $6,000 as a result of this plan, and up to 9 million homeowners may increase the affordability of their mortgages and avoid preventable foreclosures.

MHA targets the root causes of the foreclosure crisis directly. First, the refinancing program expands access to refinancing for families whose homes have lost value. Second, the modification plan commits $75 billion to loan modifications that will provide sustainably affordable mortgage payments for borrowers. The focus of the plan is affordability because providing borrowers with payments they can afford, including those with negative equity, will keep millions from being foreclosed on in a way that is most effective for taxpayers. A third part of the plan supports refinancing more generally by increasing confidence in the GSEs.

MHA's design centers on two key ideas. First, MHA creates detailed standard industry guidelines for loan modifications, with the goal of helping to transform the industry standard to a product better for all borrowers, both within and outside of MHA. In the past, a lack of common standards has limited loan modifications, even when they are likely to both reduce the chance of foreclosure and raise the value of the securities owned by investors. Second, the innovative pay for success structure of the program aligns the incentives of servicers, investors, and borrowers to voluntarily modify mortgages in a way that will be affordable for borrowers in the long-term, cost-effective for taxpayers, and profitable for lenders. In addition, when Hope for Homeowners has been expanded and improved, we also intend to position this program as a critical part of MHA.

Our progress in implementing MHA to date has been substantial. We have introduced detailed guidelines for loan modifications which will establish a new standard practice for affordable modifications in the industry. We have already signed contracts with the top servicers covering a majority of loans nationwide for our loan modification program. Servicers have begun executing refinancings and modifications under our program, and our program has helped push interest rates to historic lows, increasing refinancing nationwide. For example, Fannie Mae did $77 billion in refinancings in March, its largest one-month volume since 2003.

We have launched MakingHomeAffordable.gov, a consumer website for the program, which has had 11.2 million page views in less than a month. These are just a few of the many steps that have been taken to implement these programs.

We have also expanded the efforts of the federal government to combat mortgage rescue fraud and put scammers on notice that we will not stand by while they prey on homeowners seeking help under our program.

We are also supporting or are working on additional measures to stabilize housing, all of which are aimed at supporting the success of MHA in keeping homeowners in their homes or in finding

alternative and less damaging "exit strategies" for borrowers who own homes that they are clearly unable to afford, even under favorable mortgage terms. These measures include reform of the bankruptcy code to allow judicial modifications of home mortgages, a second lien program under MHA, further details on a short sales and deeds-in-lieu program, and, as noted, the strengthening of Hope for Homeowners.

We will continue to explore additional ways to help the housing market and report on ongoing progress as we push forward.

REGULATORY REFORM

The programs outlined above are designed to help rehabilitate our financial sector and, as quickly as possible, turn it into a source of support for our economy rather than a drag on it. But this effort will not be fully successful unless a broader set of reforms is put in place. Our regulatory and market infrastructure has to catch up to significant changes that have occurred in our financial sector in recent decades.

The rapid growth of the largest financial institutions, and their increasing interconnections through securities markets, have heightened systemic risk in the system. In response, we need to expand our capacity to contain systemic risk. This crisis – and the cases of firms like Lehman Brothers and AIG – has made clear that certain large, interconnected firms and markets need to be under a more consistent and more conservative regulatory regime. It is not enough to address the potential insolvency of individual institutions – we must also ensure the stability of the system itself.

Financial innovation has expanded the financial products and services that are available to consumers. These changes have brought many benefits. But we have to make sure that when households make choices to borrow, or to invest their savings, there are clear and fair rules of the road that prevent manipulation, deception, and abuse. Lax regulation has left too many households exposed to deception and abuse. While outright fraud like that perpetrated by Bernie Madoff is already illegal, these cases highlight the need to strengthen supervision and enforcement across the financial sector. We need meaningful disclosures that actual consumers and investors can understand. We need to promote simplicity, so that financial choices offered to consumers are clear, reasonable, and appropriate. Further, there needs to be clear accountability for protecting consumers and investors alike.

The rapid pace of development in the financial sector in recent decades has meant that gaps and inconsistencies in our regulatory system have become more meaningful and problematic. Financial activity has tended to gravitate to parts of the system that are regulated least effectively. Looking ahead, our regulatory structure must assign clear authority, resources, and accountability for each of its key functions.

The financial landscape has become ever more global in recent years. Advances in information technology have made it easier to invest abroad, which has expanded and accelerated cross-border capital flows. Greater global macroeconomic stability has also helped to accelerate financial development around the world. To keep pace with these trends, we must ensure that international rules for financial regulation are consistent with the high standards we will be implementing in the United States. Additionally, we must seek to materially improve prudential supervision, tax compliance, and restrictions on money laundering in weakly-regulated jurisdictions.

Finally, the recent financial crisis has shown that the largest financial institutions can pose special risks to the financial system as a whole. In addition to regulating these institutions differently, we must give the Federal government new tools for dealing with situations where their solvency is called into question. Treasury has proposed legislation for a resolution authority that would grant additional tools to avoid the disorderly liquidation of systemically significant financial institutions that fall outside of the existing resolution regime for banks under the FDIC.

STATUS OF TARP

TARP, established under EESA, has been a vital part of our efforts to rehabilitate the financial sector. Since the Congress released the second half of the $700 billion allocated to Treasury through EESA, we have unveiled our FSP in an effort to use the full range of tools at our disposal to create the foundations for an economic recovery. Table 1 below summarizes current projections concerning the remaining funds available as part of the FSP.

When President Obama took office, Treasury had already committed over half of the funds allocated for the Troubled Assets Relief Program. Today, Treasury estimates that there is at least $134.6 billion in resources authorized under EESA still available. This figure assumes – as reported by the Government Accountability Office – that the projected amount committed to existing programs will be $590.4 billion (of which $355.4 billion was committed under the previous administration), but also anticipates that $25 billion will be paid back under the CPP over the next year. Because the most relevant consideration is what funds will remain available for new programs, we believe that our estimates are conservative for two reasons. First, our estimates assume 100 percent take-up of the $220 billion made available for our housing and liquidity programs, which require significant voluntary participation from financial participants. If any of those programs experience less than full take-up, additional funds will be available. Secondly, our projections anticipate only $25 billion will be paid back under CPP over the next year, a figure lower than many private analysts expect.

In the attached table, we have broken down our commitment of EESA funds under four categories:

- Exceptional Relief: Funds committed for exceptional relief to specific financial institutions and the auto industry.
- Capital Purchase Program.
- Housing and Liquidity Initiatives: New initiatives directed towards addressing weaknesses in the housing and credit markets.
- Paybacks.

In addition to the programs discussed above, Treasury has stated its intention to provide additional support to the auto industry – contingent on an acceptable restructuring – as well as capital under the Capital Assistance Program. We believe that even under the conservative estimate of available funds described here, we have the resources to move forward in implementing all aspects of our FSP.

Indicators on interbank lending, corporate issuance, and credit spreads generally suggest that credit conditions have improved significantly in the past few months. The LIBOR-OIS spread, an indicator of major banks' willingness to lend, has fallen to about 90 basis points, down from its October peak of 365. Additionally, corporate bond issuance and issuance of asset back securities both rose in March after grinding to a halt in October and November.

However, reports on bank lending show significant declines in consumer loans, including credit card loans, and commercial and industrial loans. It is also important to point out that the cost of credit and terms of credit, even where they have recently declined, are still elevated.

TRANSPARENCY

Upon taking office, President Obama committed to increased transparency, accountability, and oversight in our government's approach to stabilizing the financial system. Treasury is committed to an open and transparent program with appropriate oversight.

We have launched a reinvigorated public communications initiative designed to more directly communicate how our policies will stabilize the financial system and restore the flow of credit to consumers and businesses. A key element to this enhanced public outreach effort is providing user-friendly resources online. Last month, Treasury launched a new website, FinancialStability.gov, that details financial stability programs in a simplified format. In addition, Treasury has taken a number of steps to better measure whether financial stability programs are increasing the flow of credit to consumers and businesses. In January, we launched a monthly lending and intermediation survey to better gauge, in a way readily accessible to the public, the performance of banks participating in the CPP. The most recent results, covering February 2009, demonstrate that the largest CPP banks continue to lend and refinance despite the increasingly severe headwinds posed by this economic downturn. Absent Treasury capital provided through the CPP, lending levels would likely have been substantially lower.

Treasury announced on January 28, 2009, that it would begin posting all of its investment contracts on our website within ten business days of each transaction's closing. Treasury is in the process of posting all the contracts signed prior to January 28 to the website as well.

Treasury looks forward to continuing to work with our four oversight bodies – the Financial Stability Oversight Board, the Inspector General, the Comptroller General, and the Congressional Oversight Panel. Transparency will not only give the American people comfort in our stewardship of these funds, it will give the markets confidence that we are stabilizing and strengthening the financial system.

EXECUTIVE COMPENSATION

Compensation systems in many financial institutions played a material role in creating this financial crisis. They gave individuals incentives to focus on short-term profits at the expense of long-term value. In many institutions they did not reward sound risk management. Going forward, it is important that everyone in financial institutions – from traders to executives – have compensation that is closely and tightly aligned with sound risk management and long-term value for their financial institution and the economy as a whole. We have to be careful, however, not to destroy beneficial forms of incentive compensation or to restrict financial firm compensation packages so severely as to drive the most talented people out of the U.S. financial sector. We will engage in a thorough review of this issue, and we want to hear the ideas and analysis of experts throughout the country. I anticipate that we will look for ways to orient compensation towards long-term performance. Had this been done earlier, I think a certain amount of the pain caused by this financial crisis and the resulting loss of public trust that has resulted could have been mitigated.

In accordance with ARRA provisions, Treasury will be conducting a review of TARP recipient compensation for the 25 most highly-compensated employees. In addition, the Administration is currently working to develop an Interim Final Rule (IFR) that will set clear standards of acceptable compensation for recipients of federal assistance under EESA. While the IFR will be effective immediately upon publication, Treasury will invite public comment during a sixty-day period and will consider all comments in developing a final rule.

Table 1:
Projected Use of TARP/Financial Stability Plan Funds

($U.S., billions)

Exceptional Relief	**152.4**
Of which:	
AIG	70
Citigroup/Bank of America (Targeted Investment Program and Guarantees)	52.5
Autos	24.9
Auto Suppliers	5
Capital Purchase Program	**218**
Housing and Liquidity Initiatives	**220**
Of which:	
Housing	50
Consumer and Business Lending Initiative	
TALF 1.0	20
TALF Asset Expansion (New Issuance)	35
TALF for Legacy Securities	25
Unlocking SBA Lending Markets	15
Public Private Investment Program (Net $75.0)	100
Conservative Estimate of Paybacks	**-25**
Total	**565.4**
Total Remaining	**134.6**
Additional Funding	
Autos:	-
(To be determined)	
Capital Assistance Program:	-
(Ability to convert existing preferred stock from CPP, plus mandatory convertible capital to be determined)	

MAJOR INITIATIVES

February 10, 2009: Treasury Introduced the Financial Stability Plan (FSP)

To address the financial crisis – a crisis of confidence, of capital, of credit, and of consumer and business demand - FSP is designed to attack the credit crisis on all fronts. Restarting our economy and creating jobs requires ensuring 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. To protect taxpayers and ensure that every dollar is directed toward lending and economic revitalization, FSP will institute a new era of accountability, transparency and conditions on the financial institutions receiving funds.

February 18, 2009: Treasury Introduced the Making Home Affordable Plan (MHA)

The collapse in home prices served as the catalyst for the current financial crisis, harming both household balance sheets as well as much of the financial sector. MHA includes a refinancing program that provides the opportunity for 4 to 5 million homeowners to refinance their mortgages and reduce their monthly payments, a $75 billion loan modification program that keeps 3 to 4 million families in their homes, and provides support for low mortgage rates by strengthening confidence in Fannie Mae and Freddie Mac.

Since the introduction of MHA, consumers have seen record low interest rates helping to alleviate pressure on homeowners. Also, the first loan modification contracts have already been signed in an effort to bring monthly payments to sustainable levels.

February 25, 2009: Treasury Introduced the Capital Assistance Program (CAP) and Measuring Capital Needs

Treasury launched CAP in order to ensure that institutions have enough capital to lend - even during tougher economic times. CAP requires that banks maintain a capital buffer as an insurance policy against worse-than-expected economic conditions. The country's largest banks are undergoing a forward looking "stress test" designed to determine how large a capital buffer is necessary to ensure that those banks would be well capitalized in even a severe economic scenario. The results of this exercise are expected to be released during the first week of May.. Many banks will not need additional capital, but in cases where an additional buffer is needed, Treasury is making government capital available as a bridge to private capital through CAP. In order to ensure transparency, over the last several months bank supervisors have been conducting forward looking assessments of the balance sheets of the 19 largest banks to determine the strength of their capital and capital needs.

March 3, 2009: Treasury Introduced the Consumer and Business Lending Initiative

Treasury announced the Consumer and Business Lending Initiative (CBLI) including a significant expansion of the Term Asset Backed Securities Loan Facility (TALF) - a program

developed to help improve credit market conditions by addressing the securitization markets. TALF was expanded in collaboration with the Federal Reserve to ease the pressure on credit markets. New asset classes expanded from credit cards, auto loans, student loans, and SBA loans to rental, commercial and governmental vehicle fleet leases, small ticket equipment and heavy equipment leases, agricultural equipment loans and leases and commercial mortgage backed and older securities.

March 16, 2009: Treasury Introduced the SBA Loan Purchase Program

Treasury announced a program to unlock credit for small businesses as part of the Consumer and Business Lending Initiative. As part of the program, Treasury will make up to $15 billion in TARP funds available to make direct purchases to unlock the secondary market for the government-guaranteed portion of SBA 7(a) loans as well as first-lien mortgages made through the 504 program. These purchases, combined with higher loan guarantees and reduced fees implemented under the American Recovery and Reinvestment Act of 2009, will help provide lenders with the confidence that they need to extend credit, knowing that if they make an SBA loan, they will be able to sell it and access the liquidity necessary to do further lending.

March 23, 2009: Treasury Introduced the Public-Private Investment Program (PPIP)

Treasury introduced PPIP in order to address the vicious market cycle and troubled assets clogging the balance sheets of financial institutions. By using government financing in partnership with the FDIC and the Federal Reserve and co-investment with private sector investors, PPIP will create substantial purchasing power to create a new market for legacy assets and make the most of taxpayer resources. PPIP ensures that private sector participants invest alongside the taxpayer, with the private sector investors standing to lose their entire investment in a downside scenario and the taxpayer sharing in profitable returns. To reduce the likelihood that the government will overpay for these assets, private sector investors competing with one another will establish the price of the loans and securities purchased under the program.

In order to accommodate increased participation in the Legacy Securities Program, the deadline for asset manager applications was extended to Friday April 24th, 2009.

March 31, 2009: Treasury Extended the Federal Guarantee of Money Fund Assets

Treasury extended the money market fund guarantee in order to support ongoing stability in financial markets. As a result of this extension, the temporary guarantee program will continue to provide coverage to shareholders up to the amount held in participating money market funds as of the close of business on September 19, 2008. All money market funds that currently participate in the Program and meet the extension requirements under the Guarantee Agreements are eligible to continue to participate in the program.

The CHAIR. Good. Thank you, Mr. Secretary.

Mr. Secretary, I am going to start the questions this morning with accountability, a theme that this panel has talked about repeatedly, and clarity in government policy. So here is the question I want to start with.

The auto industry has received taxpayer money, but it has been linked to changes in management, changes in business practices, breaking labor contracts, and causing bondholders to take losses at a minimum. The banks have received 10 times more money than the auto industry, and yet they seem to be receiving very different treatment.

So the question I have is why the different treatment, and in particular, do you think that the banks are better managed than the auto companies were?

Secretary GEITHNER. A very important question and reasonable question. Let me say a few things in response.

First of all, everything we are trying to do to get the financial system working again is important to the success of the restructuring and rehabilitation of our automobile industry. It is true for the economy as a whole and the industry of the United States, without a financial system that is working to provide credit, you are going to see much more damage, much more challenge, much greater head winds for businesses across the country.

Second basic point: If you step back, you know, we are five quarters into this recession, and we are at least that long into a very substantial, dramatic adjustment we saw following this unprecedented financial boom. So there has been very, very dramatic restructuring already across the financial system.

If you just look at the largest institutions in the world that existed 2 years ago and look at how many exist today, there has been a very dramatic restructuring.

Third point, as your colleague said at the beginning, in assessing what was necessary going forward to solve the problems that we inherited, we made it clear that where we are going to provide capital in the future, we want to target it to where it is necessary. We want to do it on a differentiated basis. We want to do it with conditions—not unconditionally, but with conditions not just to help protect the taxpayer, but to try to help ensure that the system emerges stronger, not weaker.

That is a very important principle. And we have said, the President has said publicly, that where we provide exceptional assistance, because that is necessary to make sure there is capital in the system, it will come with conditions to make sure there is restructuring, accountability, to make sure these firms emerge stronger in the future.

Now——

The CHAIR. So let me just make sure I am understanding you to this point. I just want to be sure that I am following here.

Secretary GEITHNER. Sure.

The CHAIR. Are you saying that the difference in treatment between how the banks were treated and how the auto industry has been treated is effectively one of timing and that, going forward, the banks will be treated with the same kind of accountability at a minimum that has been demanded from the auto industry?

Secretary GEITHNER. Well, I am trying to be candid. They are different challenges. They require different solutions. But there is less difference than your question suggests.

Just to cite a couple of examples, if you look at where the Government had to act early in substantial force, in some of the largest and weakest parts of the system, in that context—both in the context of Fannie and Freddie and in the context of AIG—we were very clear that the conditions in that context came with changes in board and management for exactly the reasons you said.

Now there has also been——

The CHAIR. I am sorry. I just want to make sure I am following. You are saying that there have been changes in management at financial institutions——

Secretary GEITHNER. Where the Government acted—absolutely.

The CHAIR [continuing]. That have received TARP funds?

Secretary GEITHNER. Well, as I said, in the context of the interventions taken in Fannie and Freddie and AIG, just to cite three examples——

The CHAIR. I am asking about the financial institutions.

Secretary GEITHNER. Well, those are financial institutions.

The CHAIR. I am asking about the banks.

Secretary GEITHNER. But the principle is important in this case. And as I said, the President has said this publicly. I have said it publicly. Going forward, where institutions need exceptional levels of assistance, we will make sure that assistance comes with conditions that provide for the necessary degree of accountability to help ensure these firms emerge stronger rather than weaker. And that is an important principle. We are committed to do it.

Now what is necessary in each specific case is a judgment we are going to have to make, but I think that is a very important principle. It is at the core of our program.

The CHAIR. Good. Thank you, Mr. Secretary.

I have a second question on accountability. In the last few weeks, banks have been announcing—a few banks—that they have quarterly profits. But there has also been a renewed acceleration of home mortgage foreclosures and new examples of raising fees on customers who have met all of their contract terms and raising interest rates, even for consumers paying on time.

So I want to ask, do you think that banks receiving TARP funds should be engaging in these practices?

Secretary GEITHNER. I just wanted to underscore our commitment, the administration's commitment to doing everything we can to help mitigate the damage homeowners are facing across the country.

The CHAIR. I understand.

Secretary GEITHNER. Now if you look at the programs we have put in place, they are very comprehensive, very aggressive, very dramatic programs to make sure that people are getting relief where they need it. And just to point out how powerful these are already, if you look at the programs we have put in place they have made it possible for already hundreds of thousands of Americans to refinance and take advantage of lower interest rates. That is a core part of our program now.

And you are right that we are also moving quickly to put in place these programs to help prevent foreclosures, and allow modifications. And we are making a lot of progress in that area.

As a condition for Government assistance, banks have to agree to participate in these loan modification programs, and we are going to make sure that they are doing so and that the American people are going to see data on performance, on modifications, and have a better chance to judge for themselves what is happening on the modification front.

The CHAIR. Good. I will return to the question about changing interest rates, but my time is up.

Congressman Hensarling.

Mr. HENSARLING. Thank you, Madam Chair.

Mr. Secretary, as you can tell, all members of this panel very much welcome your appearance here today. So let me ask you first a process question since, again, this is the first time we have had a member of Treasury appear before us in almost six months of existence.

If this panel chose to have a monthly oversight hearing, would you make either yourself available or I believe Mr. Allison is up for confirmation to head, I believe, the Office of Financial Stability? Would either—assuming he is confirmed, would you make yourself or him available for such?

Secretary GEITHNER. Congressman, I want to—let me say it this way, okay, and you can hold me to this. I believe in the importance of transparency, accountability, oversight. I think it is critical to our credibility, I respect what you are doing in this context.

I will commit to make sure that we have as effective a working relationship as possible so that you have the information you need and an intensity of interaction with us to help you do your jobs. That is in our interest because if you can't understand what we are trying to do and have a chance to assess it, then it is going to be harder for us to do what we want to do, just as you said at the beginning.

Now we have made it clear we are willing to meet weekly with the panel and the panel's staff, and I am prepared to examine any proposal, consider any proposal to have more formal meetings like this on a more frequent basis. But what I would like to do is when I have a confirmed team in place of senior officials at the Treasury, come back and we can work out something we can commit to, and adhere to.

What I don't want to do is commit to a frequency of interaction at the senior level that I am not going to be able to live up to because, as you know, we are doing a lot of things, have a lot to do. But if you give me a chance, once we have a confirmed team in place, I will——

Mr. HENSARLING. I appreciate that, Mr. Secretary. Do we at least have a commitment that this will not be your last appearance before this panel?

Secretary GEITHNER. Yes.

Mr. HENSARLING. Thank you. Thank you, Mr. Secretary.

In today's Wall Street Journal—you frequently appear in the Wall Street Journal—it doesn't have a quote from you, but it characterizes something you said as "Treasury Secretary Timothy

Geithner indicated that the health of individual banks won't be the sole criterion for whether financial firms will be allowed to repay bailout funds."

Again, if there are firms that wish to repay taxpayers their money, if the taxpayer money is at risk, if their relevant regulator certifies that commensurate with safety and soundness of the financial institution, they can return that capital, if this is an accurate assessment of your position, why wouldn't you take the money back?

Secretary GEITHNER. In those conditions, we would welcome it. It would be very helpful, help differentiate, help show progress. It helps underscore the basic point that the institutions of our financial system are in very different circumstances.

But I just want to underscore what is really important. And I said this at the end of my testimony, but I want to underscore it again. My basic obligation and our responsibility is to make sure that the system as a whole, as a whole, has the ability to provide the credit that recovery requires. And so, we need to make a careful judgment about what policies are going to best promote that objective.

Under the laws and conditions established in the Recovery Act, the judgment about when institutions can repay is a judgment that the Federal banking agencies have to make, and they are in the process of looking now at what set of standards and principles should guide repayment.

Ultimately, though, we have to look at two things. One is do the institutions themselves have enough capital to be able to lend, and does the system as a whole, is it working for the American people for recovery? And that is the standard we are going to look at.

But, of course, nothing would make me happier than for that——

Mr. HENSARLING. I am sorry, Mr. Secretary. My time is limited at the moment. But just to understand then, there will be other considerations besides the individual institution's financial stability? I am a little confused on what——

Secretary GEITHNER. Well, I am not sure I would say it that way, and as I said, this is a judgment that I don't make. It is a judgment that the Federal banking agencies make under the conditions that were established in the Recovery Act. And they are in the process now, the Fed and the other agencies, are in the process of working through how to make these judgments.

But again, the critical thing we care about is whether the system as a whole is in a position where it has the capacity to support the credit the recovery requires. That is the ultimate test.

Mr. HENSARLING. Mr. Secretary, my time is running short here. One more question, and that is there is great concern among many on an apparent plan to convert the preferred stock positions in many of the financial institutions to common stock, thus having essentially converting Uncle Sam into a control shareholder of many of our largest financial institutions.

Is that the plan, and why?

Secretary GEITHNER. That risk worries me, too. So let me just say a few things about what our objectives are.

Again, what we want to make sure is that there is the capital the system requires and that it is targeted to where it is needed.

So the process we put in place that the Fed is running now to do an assessment of capital needs in a potentially deeper recession is designed to make sure that there is more clarity, more transparency on bank balance sheets, that those institutions that may need additional capital are identified. They have the opportunity to raise that.

Now they will have a variety of different ways where they can raise that capital. They will have the choice to raise it in the market. They will have the choice to do a range of conversions, or they will have the choice to take it from the Government. And they will be examining those options in cooperation with their Federal regulator over the next few weeks.

The CHAIR. Thank you, Mr. Secretary.

Thank you, Congressman.

Mr. Silvers.

Mr. SILVERS. Mr. Secretary, we have spent a fair amount of time this morning on the question of the banks and what happens after the stress tests and capital. This panel's statutory mandate, as I think has been referenced by a number of my fellow panelists, is to oversee the effectiveness of the—in part is to oversee the effectiveness of the program from the standpoint of minimizing long-term cost to the taxpayers and maximizing the benefits for the taxpayers. And I am quoting from the statute.

Now we have a case study, a precedent under the act for dealing with a sick bank, and that precedent is Citigroup. Citigroup has come to the Treasury for additional funding in circumstances that I think everyone recognized as dire in November. As a result of that second funding, plus its initial funding under the Capital Purchase Program, if you look at Citigroup's capital structure on a mark-to-market basis, the cash we have put in is the majority of the capital of Citigroup today.

Some would say that we have crossed the nationalization line already, and this chart represents that. This chart underestimates—this puts it nicely. This chart underestimates the extent of public investment in Citigroup and public funds at risk because it doesn't account for an asset guarantee of $300 billion, of which $270 billion is Government money.

If you put that in there—it is hard to price. If you put that in there, it would shift things very dramatically.

Now in contrast to capital at risk, public money at risk in Citigroup, the upside that we have today in Citigroup—and this is all, of course, as a result of transactions before January 20th. The upside in Citigroup is 7.6 percent, according to our staff.

And again, this underestimates the degree of disparity because the warrants that we have in Citigroup are not priced at the current common stock price. So the price of Citigroup could go up 400 percent, and a lot of our warrants wouldn't kick in at all yet.

And as it has been mentioned before in this conversation, we have the downside of ownership. We have a tiny bit of the upside of ownership, and we have none of the control of ownership.

Now, obviously, there are going to be some changes here. They haven't happened today, but there are going to be some changes. Those changes seem to point in two different directions at once. They would appear to increase the upside from the current 7.6 per-

cent, according to Citigroup's Web site, to about 35 percent. Still not commensurate with the risk.

But on the other hand, they would give away our senior position, as we move from preferred to common. Unlike, for example, Warren Buffett, who holds his senior position as preferred and takes his upside as warrants.

Now, Mr. Secretary, my question to you about this is do you believe this is the right way to go? Is this the model for what we are going to do for the next sick bank? And secondly, what are we going to do about this, all right? Is this the appropriate way to treat the taxpayer?

And I recognize that in certain respects you are making changes, and I would hope you would address those in that context.

Secretary GEITHNER. Mr. Silvers, I am not sure this is going to satisfy you, but I want to just say a couple of things.

It is very difficult for me to talk about any individual institution ever, given my responsibilities for the system, and I think you understand that. And as you said, you are describing a state of play that existed on January 20th, I believe.

Mr. SILVERS. Well, Mr. Secretary, it exists today as a legal matter. This is the state of affairs today.

Secretary GEITHNER. It does. But as you said, it is in the process of changing. So I guess I want to step back a little bit and make some broader points. But of course, you will have a chance to judge us by what we do going forward, and this is one way to evaluate the tradeoffs and judgments we are making.

But let me just underscore one important point. We are not a private investor. We are the Government of the United States. When we act to provide assistance for banks, we don't do it for the benefit of those banks.

The cost benefit returns to the American economy you cannot evaluate by looking at the narrow financial terms of that particular transaction. You have to look at the action through the prism of what motivates it, which is how to make sure we have a financial system that is stable, able to lend, and support recovery.

And that is important because, as you know and as you said nicely in your opening statement, that is sort of an essential precondition for limiting damage for recession and recovery.

Now, just because you can't look at the economic case for how taxpayer dollars are being used and structure the conditions through the narrow prism in which the transaction itself occupies. You have to look at the transaction in the context of the broader benefit it creates relative to the alternatives. And this is true for any action we take.

Mr. SILVERS. Mr. Secretary, I have 10 seconds. How does protecting Citi's common shareholders at the expense of taxpayers benefit our economy?

Secretary GEITHNER. Well, let me do it in a slightly different way again. But it requires us to go back a little bit. If you look at the last 4 months of 2008, you can see catastrophic damage caused by judgments about the level of failure you can tolerate throughout a financial system. And as I said, the damage caused by those actions and judgments were brutal, indiscriminate, and catastrophic.

They affected—as you said, Chair Warren, at the beginning of the hearing—they affected the fortunes and lives of millions of Americans here and around the world. They helped precipitate the deepest loss in economic activity that the world has seen in a generation.

Now, so you have to think about these choices through that broader prism, not through the narrow confines of the specific investment.

The CHAIR. Okay. Thank you.

Thank you, Mr. Silvers.

Senator Sununu.

Senator SUNUNU. Mr. Secretary, explain the process that will be used to determine whether or not Treasury requests the conversion of preferred shares under the CPP into common.

Secretary GEITHNER. Again, this is something that the primary supervisor is in the process of thinking through and designing strategy on, but I want to say it simply again. This capital assessment they are undertaking will reach a judgment about whether and to what extent individual banks could use an additional buffer of capital to make sure they can withstand deeper losses——

Senator SUNUNU. Let me stop you there. You are using phrases like "could use." I am sure every bank could use a little bit better capital buffer.

Secretary GEITHNER. All right. Let me say——

Senator SUNUNU. So we need to be specific about whether or not it is required and whether there is an objective measurement of the requirement.

Secretary GEITHNER. Right. So the measurement—and again, you are going to see the details of the parameters laid out by the Federal Reserve in the coming days that will help you decide that. But that will be a defined measure of what additional capital, I will use your word, should be required.

Now banks will have a range of different options for meeting that capital requirement. And as the Fed has already said directly, what is important is not just the overall level of capital, but the quality of capital, including the amount of tangible common equity or Tier 1 common equity in the system.

Banks will have a range of different ways to meet those tests. They will be able to work out with their supervisor how they are going to meet that test. And as I said, in simple terms, their ability is to take—raise more capital from the market or take capital from the Government.

Senator SUNUNU. So what you describe there is a relatively objective process with clear criteria where sort of subjective measurements either don't enter in or enter in to a very limited degree. In other words, it will be an objective process that people can easily understand. Fair enough?

Secretary GEITHNER. Well, I won't say there won't be judgment in it. But that will be judgment that the supervisors work out and judgments carefully informed by other independent measures of risk, losses, earnings potential, those things.

Senator SUNUNU. I think it is important that it be as objective as possible.

Secretary GEITHNER. I agree with you.

Senator SUNUNU. And I think this also applies to the question raised by Congressman Hensarling with regard to repayment. You indicated that there would be a relatively objective approach based on whether they have met the requirements under the regulator. But then you alluded to the question that would be asked of is the credit system working? Then finally, you said but that is going to be asked at the regulatory level.

But I would suggest it is not really the job of regulators at the OCC or OTS or at the State level to make subjective determinations about whether our credit system is working and whether a particular institution is playing their role in that credit system and, therefore, conclude that we are not going to let them repay, even though they met all of the objective regulatory criteria.

So I will ask what level of subjectivity is going to come into play on the repayment question?

Secretary GEITHNER. I actually wasn't trying to reinforce your concern or Representative Hensarling's concern. I was just trying to state it cleanly, which is that they are going to have to make that judgment. That is the way the law is written.

Senator SUNUNU. Who is going to have to make it?

Secretary GEITHNER. The relevant Federal banking agency will have to make that judgment, and they are going to have to look at——

Senator SUNUNU. You are going to expect and ask the regulators to make a subjective judgment about whether or not our national system of credit and lending is working?

Secretary GEITHNER. No, I don't—I didn't mean to imply it that way. They are going to have to make a judgment of whether it is tenable, makes sense for that individual institution. I was just trying to underscore the fact that the basic objective that is guiding what we do is to make sure the system is working as a whole.

But I understand your concern, and everybody wants clarity, objectivity. Because they are working through this now, I can't tell you today whether they are going to fully meet that test, but you will know that relatively soon.

Senator SUNUNU. I simply underscore objectivity in this regard is absolutely essential. Otherwise, you are going to be creating more uncertainty than you intend, and you will be potentially doing more harm than good along these same veins, agreed?

Secretary GEITHNER. Can I say that I agree with that? And as I said, we would welcome, okay, capital coming back to the Treasury and the taxpayer as a result of the effectiveness of these programs.

Senator SUNUNU. Excellent. Ah, releasing stress test results. You indicated that you were going to release some results. Then Treasury pulled back in the sense that you haven't been clear about what information you are going to release or in what context it will be released.

First question is why release data publicly at all? It certainly isn't typical for bank examiners to release specific information about the institutions they examine. So why release that information? And to the best that you can describe here, what will be released?

Secretary GEITHNER. Well, again, it's awkward because of the timing of this hearing. But those are questions that the Fed and their counterparts are working through right now. But I want to underscore again that I do believe it is valuable, and this is the core of the objective of this process that we worked out with the Fed, to bring more transparency, more disclosure to potential losses on bank balance sheets.

Without that, it is harder for banks to raise capital. Without that, they are going to live with a deeper cloud of uncertainty over their financial health than they need to. Transparency will be helpful in resolving that, and they are in the process of working through now what is going to be sensible.

But I agree with your concerns. I understand your concerns about this. But they are careful, thoughtful, pragmatic people, and they will get it right.

The CHAIR. Thank you, Mr. Secretary.

Thank you, Senator.

Mr. Neiman.

Mr. NEIMAN. Thank you.

I would like to come back to the foreclosure efforts and give you a little more opportunity to expand on those. I agree and we all have focused on the fact that housing created this problem and has to be solved if we are going to get out of it.

As you know, our March report focused on foreclosure efforts. It looked at the drivers to delinquency, the interaction between affordability and negative equity, and set out a lot of the impediments to a successful mitigation program. We also made an initial assessment of your program that was announced on March 4th and how it addressed many, but not all of the impediments that we identified.

In my role in leading the State's Foreclosure Prevention Task Force, in talking to a lot of housing counselors, what we are hearing back is there is still a sense of uncertainty as to when and the timing around servicers and lenders signing on to those programs. Can you give me and the panel a sense of the degree of industry participation that you expect and a sense of the timing?

Secretary GEITHNER. We are moving very quickly. I think Treasury is now—I think that the majority of servicers in the country have signed onto the new standards, and we are moving quickly to put that in place and lay out the additional details in public.

But I think it is going to take a little time for us to be able to judge what is actually happening. You know, this program provides very substantial economic incentives for participation and for modifications. And that was based on a set of judgments that we made about what was going to be necessary. But we won't know really until we see the pattern of modifications going forward, and until we see how those work for a time, we won't know how successful they are in helping economically viable homeowners remain in their home.

But we are moving, and I think reasonably quickly, given the pressure and challenges we are facing.

Mr. NEIMAN. Do you see any other potential impediments that will need to be addressed or the program tweaked or changed?

Secretary GEITHNER. We can't tell now. But it is a very complicated program, as you know, and it is a complicated set of incentives we are trying to change. But we are going to be pragmatic about this. Where we see problems and opportunities, we will adapt the program.

It is a challenge because, as many of your colleagues said, you want clarity quickly. You want people to hold to those basic lines. But if there are things around design or practical impediments to better participation, we will try to fix those.

Mr. NEIMAN. Being last on the questioners, there is never confidence of whether it will come around to me again. So I do want to bring us back to regulatory reform, which you did not get a chance to in your opening, particularly from the role of the States and the role that States play in consumer protection.

As you know, Secretary Paulson's blueprint in establishing a regulatory framework eliminated the role of the States in consumer protection and safety and sound supervision. I would like to get your thinking as to where do the drivers for consumer protection fall out in your regulatory proposal?

Secretary GEITHNER. We are going to be outlining in the next couple of weeks a set of detailed proposals for how to change the basic framework of consumer protection in the credit area in particular, both on credit cards, on mortgages, and other credit products. And you will see, following that, we will lay out the broader changes to the oversight framework that we think are necessary to make these new rules of the game work.

I would expect States to have an important role going forward still, but the precise nature of that role you will see laid out in the suggestions we make about what should happen at the Federal level.

I just want to say, though, that I want to just say it starkly: We had systematic failures in consumer protection. They caused enormous damage not just to the people who were taken advantage of, but to the stability of the entire financial system. And it is going to require very, very substantial changes to fix that.

Mr. NEIMAN. Great. All right. Thank you very much. My time has expired.

The CHAIR. Actually, it hasn't.

Mr. NEIMAN. Oh, okay.

The CHAIR. But you are welcome to——

Mr. NEIMAN. Fifty seconds left, I think I will pass. Thank you.

The CHAIR. Okay, that is fine. Thank you.

Actually, Mr. Secretary, I want to go back to the point about foreclosures, and I must ask is an amendment to the bankruptcy laws to deal with underwater mortgages a central element of your foreclosure mitigation plan?

Secretary GEITHNER. As you know, the President has supported and we are supportive of changes, the carefully designed changes to the bankruptcy plan. We think you can do it in a way that would help reduce these problems. That process is now working through the Congress. We are working closely, of course, as part of that process.

The CHAIR. If——

Secretary GEITHNER. It is a difficult balance to get right, as you know. But the President is supportive of this, and we are—and we would like to work to see if we can find a good balance.

The CHAIR. If those changes are not made, what happens in States like Nevada, Arizona, California, Florida, Illinois, where the number of underwater mortgages is high, where we know that this is related not only to the initial foreclosure but to redefault when we try to do workouts. Are there any other proposals for dealing with underwater mortgages when they are a great deal underwater?

Secretary GEITHNER. Well, let me just say two things in that context. One is the President has proposed and there is a lot of support in Congress for substantial changes to the Hope for Homeowners Program. And that program is designed to be somewhat more responsive to that set of specific challenges.

But the President's program also does provide meaningful payment relief to families that have very high loan-to-value ratios.

The CHAIR. Right.

Secretary GEITHNER. And does provide very substantial incentives for those payments to come down through reductions in interest and principal payments.

But our program is not going to solve all of these problems. It is designed to target those homeowners that were relatively responsible in the amount of debt they took on, but you will have to look at them in the context of the full range of other programs that Congress has authorized and the President is proposing to help mitigate the damage caused by the recession across the American economy.

The CHAIR. Thank you.

I want to ask one other question as long as we are talking about structure here. In our most recent report, we talked about three ways to deal with troubled institutions—liquidation, reorganization, or subsidization. And in the report, we discussed the fact that Treasury seems mostly focused on subsidization and that——

Secretary GEITHNER. Treasury present or Treasury past?

The CHAIR. Well, I will let you address that question. And so, the question is, because I think that is the right way to put it, the extent to which all of the tools in the toolbox are on the table and the circumstances under which liquidation of failing financial institutions or reorganization in place of failing banks would be considered. Could you address that?

Secretary GEITHNER. That is a very sensitive, very important question. Again, what we have to do is we have to balance the critical objective of making sure our system is working better. That requires that the core institutions in our country, the largest institutions in our country are able to fund and meet their commitments. That is a central part of this process.

It requires that they have enough capital even to withstand a deeper downturn. And it requires that they have a board and management and that will earn the confidence of markets, not just their primary supervisor in the Government.

Now we want to protect the taxpayer. We want to achieve these things at least cost to taxpayers as a whole. But again, the system requires, the recovery requires, the economy requires small busi-

nesses, families across the country, they depend on it and require a better functioning financial system. And so, we will look at all actions we think are necessary against those two basic objectives.

One is get the system working better. Protect the taxpayer. Do that at least cost to the taxpayer. And what will be necessary will be different in particular cases. It is going to require adaptation and evolution. But those are the objectives we are going to balance.

And it is very hard, Chairwoman Warren, to tell you today what exact mix of conditions will require. What I can tell you for sure is——

The CHAIR. Fair enough, Mr. Secretary. I will stop with "all actions." You had me at "all actions." Let me——

Secretary GEITHNER. I don't want to mislead you, okay? Because, again, we have got a very careful balance, and I think anybody who lived through—like we all did, lived through the second half of last year, particularly the fourth quarter of last year, should be somewhat chastened and somewhat careful and cautious in thinking about how we get that balance right.

And our action will be shaped by that experience, not just by the core of the obligation we have, to try to make sure we are using the taxpayers' money wisely with appropriate conditions so that the system emerges stronger.

The CHAIR. Well, I think the question, though, started with the focus on are all the tools on the table—liquidation, reorganization, and subsidization? Am I hearing you say yes?

Secretary GEITHNER. Well, we will take all sensible actions that are consistent with those obligations we have to the American people. And again, the determination about what is least costly and most effective will require a careful balance in these areas.

But Chairwoman, we will be careful and pragmatic and as effective as we can in reducing the ultimate cost to the taxpayer, trying to get the system back to recovering at least risk to the overall economy, at greatest benefit to the economy as a whole.

The CHAIR. I must set a better example and stop with my time. So, Congressman Hensarling.

Mr. HENSARLING. Thank you, Madam Chair.

Mr. Secretary, I take some comfort in your testimony that we share a number of goals. I would take a little less comfort that there are policies in place to necessarily achieve some of those goals.

With respect to both taxpayer protection and preventing the nationalization of key segments of our financial services industry, let me revisit again the plan of the conversion of preferred stock to common. At the end of the day, the financial institution after that conversion has no new capital in a practical definition. It has no new capital. So it is a bookkeeping entry.

And yet, what has happened, is the taxpayer clearly is at greater risk, and I would assume you would agree with the position of common stock, than the taxpayer was with the preferred stock.

And then, in addition, you have got a much stronger mechanism for Government control of that institution when we are already seeing the prospect of essentially the President of the United States hiring and firing CEOs of Fortune 500 companies, determining compensation levels, the prospect of some of my colleagues in Con-

gress telling Detroit what kind of automobiles they need to produce to become profitable.

Many of us don't want to go down that road, and I am having a lot of trouble here seeing the upside to any strategy for the conversion. So could you further elaborate on what you would be trying to achieve? And again, going to Senator Sununu's point, what is the most objective criteria that can be applied to that decision-making process?

Secretary GEITHNER. Congressman, they are thoughtful questions. And as you can see from the diversity of views on your panel, there are very different views about how we balance these different objectives and constraints.

I am concerned about the potential damage you do to franchise value and expectations across the financial system. If you have this expectation of creeping, long-term Government involvement, Government ownership, I agree with you that can cause damage. We have seen one compelling example of that today, and that is something that troubles me.

On the other hand, it is important that we get a better capitalized financial system. And you are right that a conversion itself doesn't add to the overall level of regulatory capital. It does change the composition in ways that actually could be helpful to a bunch of the objectives that firms face.

So let me just underscore this basic principle. At the conclusion of this process that the Fed is undertaking to assess the potential, the capital needs of banks going forward, where there is a need for additional capital, total capital and common capital, then those banks will have a series of options for how they meet that need. And they will work out with their primary supervisors what is the best mix of those options.

And they will be balancing lots of different considerations, including the ones you described in that context, but I can't tell you today exactly where they are going to come in that context. That is a process they are going to have to undertake, and it is going to require a fair amount of care and effort.

And they will make different choices, I suspect. Different firms will make different choices, and they will have different judgments about what they want to do to the composition of capital.

Mr. HENSARLING. Related to that, Mr. Secretary, let me segue into AIG since, clearly, it is easier to invest in these companies than it is to divest. We have now had, I believe, four different infusions of taxpayer capital—two by the Fed, two by Treasury under TARP. I believe we are at roughly $180 billion of taxpayer liability exposure and counting.

I believe the Federal Reserve Chairman recently testified before the House Financial Services Committee that had he had the ability to place AIG into receivership late last year, he would have done it. One can question whether or not he had the ability to do that, as Chairman of the Federal Reserve. But I assume either you or he, as the taxpayer representative, owning 80 percent of AIG, certainly you have the ability to do that today.

What is the exit strategy from AIG?

Secretary GEITHNER. The United States Government came into this financial crisis without a legal framework that allowed it to in-

tervene and manage more effectively the risk posed by institutions like AIG. It was a tragic failure of the country.

A lot of the trauma we faced in the course of the fall was the result of that basic failure. We still do not have that authority today.

Mr. HENSARLING. Not as majority shareholder?

Secretary GEITHNER. No. We do not now have the ability nor the tools that were designed in the wake of the financial crises of the last decades that were given to the FDIC for individual banks and thrifts to allow the Government to intervene more quickly, earlier and more effectively to protect against the damage posed by weakness of these institutions.

And we would like to work with Congress to legislate authority over the coming weeks and months. But even with that authority, we would face very difficult judgments again, because in that context you are dealing with the potential risks to financial stability more generally, to other institutions, to insurance companies around the United States from the potential failure of a large firm like that.

But that imperative of getting better authority in place is a centerpiece of what the President is trying to work with Congress to achieve now.

The CHAIR. Thank you.

Thank you, Congressman.

Mr. Silvers.

Mr. SILVERS. Mr. Secretary, before I come to my question, let me just say that I very much welcome and appreciate your comments about the value of transparency earlier in response to Senator Sununu's question. I appreciate your comments about the centrality of consumer protection, and I very much support and agree with the notion that there needs to be a broader resolution authority.

Now I want to return to the theme of my first questions, but now turning to the public-private investment partnerships. I take at face value the representation that these partnerships are not designed to be a covert method of subsidizing the banks, that they are designed to get fair prices for the assets that are being purchased.

My concern, which I wish you to address, is that again, as in the case of Citigroup, there seems to be a profound and inexplicable imbalance between public risk and public capital, taxpayer money, and private capital and private gain. And it ranges from—in the investment partnerships from the legacy securities program option one, where we have the fantastic amount of 33 percent of the capital coming from the private sector and 50 percent of the gain going to the private sector.

To add its far extreme, option two is only 25 percent private capital. And over in the legacy loans program, where there may be the greatest risk because loans have been less marked down than securities, the amount of private capital is 7 percent, but the gain to the private sector is 50 percent. And even that 7 percent of private capital could be obtained through the TALF at taxpayer risk.

Now I just don't get it, Mr. Secretary, how this represents protecting the taxpayer. And I would like you to explain why it does.

Secretary GEITHNER. Mr. Silvers, this is an important question, and the virtue of these programs is they are going to come with a level of transparency to allow everybody to evaluate what the economics are for the investor in the Government. And as you see the terms of these things refined in public, you will have a better basis for making that assessment.

Now, very important to underscore again, you can't measure the returns to the taxpayer through this narrow prism. It doesn't provide a full measure of it. And you are counting as capital—I haven't had a chance to look at these carefully. You were counting as capital in the left-hand panels of your charts, the financing the Government is providing at a price against a bunch of collateral with haircuts against that collateral.

And that is not capital in the same sense that you are looking at——

Mr. SILVERS. Can I just stop you there?

Secretary GEITHNER. That is financing against collateral at a price.

Mr. SILVERS. But can I stop you there?

Secretary GEITHNER. Yes.

Mr. SILVERS. What I am measuring here is money at risk, right? If it turns out——

Secretary GEITHNER. But the——

Mr. SILVERS. Mr. Secretary, if it turns out that the assets that these partnerships buy are not worth the price paid—not because of anything terrible, but because of just risk, all right? And if we eat through the equity in those partnerships, is it not the case that the FDIC and the Fed are on the hook?

Secretary GEITHNER. Absolutely. This is secured lending against collateral at an interest rate with pricing designed to help protect the Fed and the FDIC from that risk. But what I am saying is you are equating capital, which is fully at risk, with financing against collateral.

Now really the critical thing, as you know from our previous conversations, is compared to what? And the alternative programs that many have advocated for dealing with these legacy assets——

Mr. SILVERS. Well——

Secretary GEITHNER. It is important to let me finish this. The alternative programs have the Government taking on all the risk, taking on all the risk and mispricing the assets, taking all the downside risk and having all that protection.

Now they would get in return all the potential upside in this case. But that tradeoff is a bad tradeoff for the Government because the Government is highly unlikely to be in a position to be able to get the valuation right and will be at great risk for overpaying for those assets and having a much worse risk reward.

Mr. SILVERS. All right. Let me stop you right there. What I don't get—and I practice law, and you have been in banking—is a deal where——

Secretary GEITHNER. Actually—I have never actually been in banking. I have only been in public service.

Mr. SILVERS. Well, a long time ago. A long time.

Secretary GEITHNER. Actually never.

Mr. SILVERS. Investment banking I meant.

Secretary GEITHNER. Never investment banking. Spent my entire life in public service in the Treasury and at the Federal Reserve.

Mr. SILVERS. Well, all right. Very well then.

Secretary GEITHNER. But I would be happy to——

Mr. SILVERS. But 7 percent on the one hand, 50 percent on the other. What prevents us from hiring the very same bond managers that we are going to hire, work for the public, and get 100 percent of the gain for the public? I don't understand what the 7 percent—what is so important about the 7 percent——

Secretary GEITHNER. Let me try——

Mr. SILVERS [continuing]. That we give them 50 percent of the upside.

Secretary GEITHNER. Let me try and do it simply again. The left panels of your chart are not an accurate description of the risks to the taxpayer in the financing they have at risk. I would be happy to try and give you a better alternative measure of it, but it will require that you do a full assessment——

Mr. SILVERS. Is it mistaken in the legacy loan program that the private capital is 7 percent max?

Secretary GEITHNER. It is—just to say you are mixing capital with financing in a way that doesn't do justice to the economics of it. But the critical thing again is——

Mr. SILVERS. Mr. Secretary, I asked you a different question. Is it not 7 percent?

Secretary GEITHNER. It is not the right—you are mixing two different types of economic risk.

Mr. SILVERS. I think I understand 7 percent and 50 percent, and I don't——

Secretary GEITHNER. Again, I am not trying to be—it is just a——

Mr. SILVERS. My time has expired.

The CHAIR. Gentlemen?

Secretary GEITHNER. It is not an accurate representation. But can I answer this one question about the——

The CHAIR. Ten seconds.

Secretary GEITHNER. Okay. Mr. Silvers, in the alternative model where the Government sets the price for the assets, regardless of who manages, who it hires to manage, the Government will be at acute risk of overpaying, providing the subsidy you want to avoid, and having a tradeoff where the taxpayer is taking on at the outset a much greater share of the losses across the financial system.

That is what we are trying to avoid because we don't believe that is in the best interest of the taxpayer.

The CHAIR. All right. Mr. Silvers, will you continue?

Mr. SILVERS. No, we are done.

The CHAIR. Senator Sununu.

Senator SUNUNU. Thank you, Madam Chair.

Mr. Secretary, just for the record, I would never mistake you for an investment banker. [Laughter.]

Secretary GEITHNER. I don't think he meant that as a compliment, but I will take that as a compliment.

The CHAIR. I am not sure that makes me feel better.

Senator SUNUNU. In the first 3 weeks of April, there were two TALF auctions. The first one I would describe as modestly success-

ful, the second one as marginally successful. I think I am being very generous in using that description. The first one yielded, I think, $4.7 billion in financing, the second one $1.7 billion in financing.

To what do you attribute the relative lack of interest, and has Treasury, in working with the Federal Reserve Bank of New York that is, I think, managing these auctions, recommended or undertaken any changes in their structure?

Secretary GEITHNER. Let me just say one thing about the facts. Actually, my sense is that it was relatively good for an early program. The amount of issuance of securities that came in those first two auctions is about five times the level, substantially above the level in the previous 5 months, and you have already seen a material reduction in the price of credit raised in auto receivables, et cetera. So I actually think that it is pretty good in terms of impact initially, but it is early days.

The principal explanation that people say in the markets about why participation was lower than expected is concern about the conditions that come with the assistance in the program, the range of different conditions, uncertainty about whether they may change in the future, and that underscores an important point.

If we are going to get out of this crisis at less cost, ultimate risk to the taxpayer, we need the markets to be taking risk again. We went for a long period where they took too much risk. The risk now is they take too little. For them to be willing to take risk alongside the Government, they need to have some confidence in the rules of the game going forward, and that is going to be an important challenge we face together working with the Congress as we clarify these conditions.

Senator SUNUNU. Well, let us try to clarify because there are members of Congress now talking about applying the executive compensation limits to the public-private investment partnerships. Damon Silvers raises some concerns about the structure of those, but this is separate from that.

This is an issue of changing the rules after the fact or changing the rules in a way that would discourage participation. What is the administration and the Treasury Department's position on applying rules for compensation or other rules to the public-private investment partnerships?

Secretary GEITHNER. We are in the process now of concluding, completing a draft of a rule for applying those conditions. We are going to apply the law. We are going to put out in the public domain for comment a draft rule. That will give everyone the chance you here on the Hill are——

Senator SUNUNU. When will that be put out?

Secretary GEITHNER. It will hopefully be written in the next couple of weeks, relatively quickly. We are moving——

Senator SUNUNU. You are soliciting people to request participation as one of the lead partners or investors at the same time. Correct?

Secretary GEITHNER. Yes. You can't feel more strongly than me about the need for clarity early. But we need to go through a process to put out a draft rule for comments, solicit comment. But our obligation is to apply the law, and we are going to do so in a way

that is consistent with the requirements of the law and does as good a job as we can at making these programs work.

Senator SUNUNU. So there will be a rule forthcoming, and what is the Treasury's position on application of the executive compensation limits that are in law today to those partnerships?

Secretary GEITHNER. Well, you will see in the rule how we propose to strike that balance. But it is my judgment that those compensation restrictions do not need to apply to the programs you referred to.

Senator SUNUNU. The insurance guarantee programs. The insurance guarantees have been provided or portfolio insurance has been provided to Citigroup and to Bank of America. I believe at the end of March, there was an assessment done—the value of the portfolio, losses incurred in the portfolio.

Will there be a public disclosure of that assessment, and what can you tell us about the relative value of those portfolios relative to the book values that were insured?

Secretary GEITHNER. Senator, I am not sure I know the answer to that, but let me—I would be happy to talk to my colleagues at the Fed and have them report separately on that question.

My sense is, though, that the results of the stress test will give you some indication, give the market some indication about that question. But I should talk to my colleagues at the Fed and the banking supervisors and ask them to respond to your question directly.

Senator SUNUNU. Thank you, Madam Chair.

Thank you, Mr. Secretary.

The CHAIR. Thank you.

And our last round of questions here, Mr. Neiman.

Mr. NEIMAN. Thank you.

The greatest criticism that we read about and where there seems to be the greatest debate is over the viability of the Treasury's plan, particularly the program to purchase troubled assets. And it is around the assumption in the plan that the critics would assert that the values of those assets do represent the fundamental values. And the underlying assumption in your plan is that they do reflect a significant liquidity discount.

My question really goes around to understanding the interplay between the credit and the liquidity as the drivers of those asset prices because this really does underline the assumptions and the viability of that plan.

Secretary GEITHNER. That's an extraordinarily difficult, complicated question. Hard to know. You are right that the price of any security in the markets reflects not just a view of credit losses over time, but it reflects a judgment of illiquidity and a whole set of other risk premia that are about uncertainty.

It is very hard to decompose those things. But the markets where you can tell—where you can say with complete confidence today that these markets are not working in part because of the absence of financing available to those markets.

So just to use the simple example, if you had to sell your house tomorrow in a market where no one could get a mortgage, and you had to sell tomorrow or the next week or 2 weeks, the value of your house would be substantially less than what you think it might be

worth if you were able to hold it over time or choose the timing, and there was a market for mortgages available.

So to help get these markets started again, it is necessary for there to be an alternative source of financing appropriately priced from the Government for a temporary period of time. And that will help establish a market and help separate out what is about credit losses, what is about liquidity risk premia.

And underlying your question is a thing that is uncertain, which is, is this going to prove attractive enough for it to actually work? Or is it going to be less valuable to potential investors and banks on both sides of the equation?

And as Mr. Silvers's charts indicate, there is a wide divergence of views at the moment about whether the financing is going to be provided in a way that is too attractive or not attractive enough.

Mr. NEIMAN. And the private-public partnership, what is the basis for why you think that is the mechanism to identify the appropriate pricing?

Secretary GEITHNER. Again, it is better than the alternatives. In that context, people with money at risk will make the judgments about what the risk is and what the values are. And they have to compete for the right to put up that capital. They are going to hire professional asset managers to do it. In our judgment, that is a better model than having the Government itself come in and independently try to value these things.

This is an, as you know, enormously complicated set of problems. The assets are enormously complicated. There is no precedent for what we are going through in this context, and the amount of uncertainty that you see in markets today is a reflection of that. So we just made the judgment that it is better for the taxpayer to use the incentive of an investor that is going to put capital at risk to help solve that valuation pricing problem.

Mr. NEIMAN. I would like to come back to your opening remarks where you talked about recognizing that 40 percent of consumer lending has historically come from the secondary markets and securitization. And this is the key point for us all to remember, how so much of consumer and small business lending is supported by the capital markets, and the TALF is designed to unfreeze those markets.

How should we be evaluating bank lending levels in light of the role of the security market and securitization, particularly in recycling capital?

Secretary GEITHNER. Very hard to do. You know, you can't expect banks to be able to fully compensate for the reduction in securitization activity, it is not tenable in a short period of time. That is why we are trying to move on both those channels of credit flows, make sure banks are able to provide enough credit and try to get these markets for securities working again.

But it is hard to know what the new system is going to look like in that context. And what we are trying to do is, again, make sure that the assistance we provide is priced so that as conditions normalize, demand for Government financing, for exceptional support will fade and—as you already see happening across some of the Fed's facilities.

Mr. NEIMAN. So in terms of my original questioning around metrics and even on the front page of the Wall Street Journal yesterday in terms of the diversity in interpreting this data, have you given more thought as to more appropriate metrics or greater clarity?

Secretary GEITHNER. I think the best thing is to be simple about it, and the best thing to do is to ask what is happening to bank lending by category of type of credit exposure like our new reports require? What is happening to the issuance of securities, asset-backed securities and other securities, and what is happening to the price of both bank lending and securities issuance?

Those three things capture what you need to do to measure it. Now it still doesn't tell you fully what is happening to demand for credit from economically viable borrowers, but that is a good place to start.

One more thing, the Fed's senior loan officer lending survey is another good qualitative measure of terms and conditions and that, if you look at it, showed it rising to very, very adverse peaks and starting to gradually improve. Those are four examples of things you can look at.

Mr. NEIMAN. And even though my time is out, I would like to reclaim my 40 seconds that I had put away in my first round.

The CHAIR. Forty seconds, you are using it up. Go.

Mr. NEIMAN. What I would like to do is in recognition of the fact that I have received hundreds of emails, both to my personal email and to the COP Web site as well as to the posting, I would like to categorize them, provide them to your staff——

Secretary GEITHNER. Send them to us.

Mr. NEIMAN [continuing]. And work on answers that we can respond and post publicly. So I appreciate that.

The CHAIR. Thank you.

Thank you, Mr. Secretary. I understand that you need to leave to meet with the President and that we are going to end now.

We are going to hold the record open for 1 week so that panelists may submit additional questions in writing so that you will have the opportunity to respond on the record.

I just want to say that I am very sorry that you had to turn through the pages on regulatory reform. It is a critically important issue, and I am sorry that our time is so constrained that we couldn't spend more time on it, particularly both the long time and the nearer term on regulatory reform, which I hope is going to address the consumer issues and in particular the question about repricing interest rates for small businesses and consumers who are paying their bills on time.

Also to address the systemic issues, very important. I think it is clear we have lots of questions. So I hope we will make this a regular meeting.

Thank you.

Secretary GEITHNER. Thank you for having me. A pleasure talking to you all. Excellent questions, as I said. Very thoughtful concerns. And we are trying to balance a lot of different considerations, and I know you will do what we do, which is look at these programs against the alternatives.

The CHAIR. Yes. Thank you.

Secretary GEITHNER. You can't judge anything except against the alternatives, and I know you will help us do that.

The CHAIR. Thank you, Mr. Secretary.

This hearing is adjourned.

[Whereupon, at 11:37 a.m., the hearing was adjourned.]

CONGRESSIONAL OVERSIGHT COMITTEE QUESTIONS FOR THE RECORD

United States Senate

Congressional Oversight Committee

Hearing by Congressional Oversight Panel

Treasury Secretary Timothy F. Geithner

April 21, 2009

Questions for the Record from Panelist Damon Silvers

1. Could you explain Treasury's approach to the following issues raised by the stress tests:

a. The problem of relying on initial work by bank finance teams managed by individuals with equity-linked compensation, who consequently have a personal financial interest in minimizing the need for new capital

The stress tests were designed and implemented by a team of economists, examiners, and supervisors from the bank supervisory agencies. The assessments took conservative estimates of losses and potential earnings over a 2-year period and applied them to existing reserves and capital. This result was compared against a strict minimum capital standard with a particular emphasis on the quality of capital, not just the quantity. The results were disseminated publicly providing an unprecedented level of transparency into the institutions.

b. The challenge of learning in the design of the stress tests from the failure of similar risk management models used by banks and bank regulators in the period prior to the financial crisis

The stress test was different than normal regulatory assessments in that it was a coordinated, forward-looking assessment designed to test whether or not banks had enough capital to continue lending in an adverse economic scenario.

c. The challenge of macroeconomic conditions that apparently are already approaching those that defined the "adverse" scenario, at least according to International Monetary Fund data.

Regulators applied a historically high set of loss estimates on securities and loans (greater than the peak losses over 2 years during the Great Depression), as well as a conservative view towards potential earnings that could act as a buffer against those losses. In total, the supervisors' estimates are close to those of the recently published IMF study.

2. Do you believe that if a given financial institution is systemically significant, that the government must subsidize every layer of the bank's capital structure—meaning must expend public funds to prevent any default or renegotiation of its fixed obligations, and must also maintain the price levels of its equity? If you do, why do you believe this? Please address this issue with respect to:

a-f. Common stock (with particular attention to what price level and what amount of dilution is necessary for the public good); Preferred stock (with particular attention to whether (1) deferring dividend payments presents a systemic risk, and (2) whether the prospect of having to convert to common equity might present systemic risks); Long bonds; Commercial Paper; Derivatives Contracts (understanding this is a heterogeneous category); Deposits

Governments have not, and should not, support all parts of the capital structure of systemically significant institutions. The primary function of capital in a financial institution is to be a

cushion to absorb losses. In adverse circumstances, dividends are often cut. New capital raising dilutes the claims of existing shareholders. These are natural and relatively common responses to unexpected losses. In the current crisis, common dividends have been cut at many institutions and new capital raising has caused substantial dilution. These actions have helped to reduce systemic risk by rebuilding the capacity of individual institutions to absorb losses.

Imposing losses further up the capital structure brings with it greater risk. Reductions in dividends for preferred equity can undermine confidence in the institution directly affected, and it can undermine confidence in other institutions that are perceived as having similar challenges. Under some circumstances, however, such actions are warranted.

Payments associated with derivatives and senior debt are contractual obligations. Financial institutions cannot forgo, or renegotiate such payments and continue to operate normally. One of the biggest problems we have faced in this crisis is the lack of an appropriate legal mechanism for dealing with large troubled financial institutions. As the experience of Lehman Brothers suggests, bankruptcy procedures are not well suited to financial institutions. A standard corporate bankruptcy process seeks to insulate the basic commercial operations of the firm in question from decisions about the firm's balance sheet. That is virtually impossible for a financial firm. The process laid out in FDICIA (Federal Deposit Insurance Corporation Improvement Act) for dealing with troubled systemic depository institutions works reasonably well. However, we currently do not have any comparable legal mechanism for dealing with other types of troubled systemic financial intuitions. That is why the Obama Administration has asked for new legislation to establish such a mechanism.

3. In the last year, in response to financial distress, and in most cases as a condition of government aid of one kind or another, the government has directly or indirectly either completely eliminated, heavily diluted, or forced the sale of the equity of Bear Stearns, Countrywide, Indymac, Washington Mutual, Fannie Mae, Freddie Mac, AIG and a number of smaller banks, in each case in the process of avoiding a Lehman-like collapse. Though the banks and thrifts were subject to FDIC resolution authority, the four largest of these firms were not. Citigroup and Bank of America have received government aid in similar moments of distress without comparable dilution of their equity in favor of the taxpayers. These transactions occurred under the Bush Administration, but they are relevant to your current policy choices. In your view, what if anything makes Bank of America and Citigroup different from all other systemically significant troubled banks and financial firms?

Each of these cases is unique in material ways. First, there are important differences in the scale of the problems these institutions faced relative to their capacity to absorb losses. Supervisory assessments suggest that Bank of America and Citigroup need modest amounts of new capital to meet their needs, even under an adverse scenario.

Second, the availability, or lack thereof, of a practical alternative to bankruptcy for intervening in these institutions while protecting the value of their core businesses as going concerns is important. The FIDICIA process, managed by the FDIC, is a reasonably efficient mechanism for some institutions. Fannie Mae and Freddie Mac could be put under control of a Federal conservator. However, Bank Holding Companies and non-bank operations are not covered by FDICIA or any other similar authority.

4. In your testimony before our Panel, you focused on the tiered nature of the risks associated with financing the Public Private Investment Partnerships. Could you explain your approach to measuring the degree of risk associated with the different layers of capital in those partnerships, and with the guarantees that will be provided under TALF and by the Federal Reserve and the FDIC, and how you approach the problem of pricing those guarantees? Specifically, is it your view that the pricing should fully reflect the value of the guarantees? If it does not, how in your view will PPIP contribute to setting prices with market credibility for the assets PPIP entities will buy?

As a result of the crisis, prices of these assets are currently trading below where they would be in normally functioning markets. This is impeding the flow of credit to businesses and consumers. Together, these programs restore liquidity and incent private investment in these markets. These programs have the government playing two principal roles depending on the program: as a lender and as a co-investor.

In cases where the government acts as lender, the relevant agency (Federal Reserve, FDIC, or Treasury) is in the process of conducting analysis to ensure that the access to these facilities is provided at an appropriate cost given the risk that is being taken by the government. It is important to strike a balance between achieving our overarching policy goals and ensuring that the taxpayer is appropriately protected and compensated.

As a Co-Investor, Treasury will invest equity capital alongside private investors. The fact that these investors are taking risk side-by-side with the taxpayer provides important protection against the risk that the taxpayer will buy assets at inflated prices. Through this mechanism, the pool of capital available to purchase assets could potentially expand and the taxpayer will share in the upside of the investments.

5. In the time since you announced Treasury's plan for mortgage relief, have you come to any conclusions, tentative or not, about what further steps Congress might take to assist in resolving the mortgage crisis?

We look forward to working with Congress to make our nation's efforts to stabilize the housing market as effective as possible. Since January, the Administration has made significant progress in developing and implementing a comprehensive plan for stabilizing our housing market, the centerpiece of our Making Home Affordable Program (MHA). By reducing foreclosures around the country, the average homeowner could see their house price bolstered by as much as $6,000 as a result of this plan, and up to 9 million homeowners may increase the affordability of their mortgages and avoid preventable foreclosures.

Our progress in implementing MHA to date has been substantial. We have introduced detailed guidelines for loan modifications that will establish a new standard practice for affordable modifications in the industry. Servicers covering more than 75 percent of loans in the country have now stated modifications and refinancing under the Administration's MHA Program. We have also launched MakingHomeAffordable.gov, a consumer website for the program, which had almost 16 million page views in less than 2 months, expanded the efforts of the federal government to combat mortgage rescue fraud, announced details of our Second Lien Program and strengthened Hope for Homeowners as a part of the MHA program.

The Administration applauds the significant efforts by Congress to help American homeowners during these difficult financial times. By working closely with Congress on our comprehensive plan to stabilize the US housing market and keep Americans in their homes, we look forward to further advancing our mutual goals of getting the economy back on track, providing assistance to US homeowners and preventing avoidable foreclosures.

The Administration supports enactment of legislation to strengthen the nation's housing sector and facilitate the goals of the Administration's MHA Program. Accordingly, the Administration supports S. 896, The Helping Families Save Their Homes Act of 2009, and looks forward to working with the Congress on the legislation.

In particular, the Administration supports legislative modifications to the Hope for Homeowners program that will ease restrictions on eligibility and enable refinancing of underwater mortgages for a greater number of borrowers. Appropriate legislative improvements to Hope for Homeowners should significantly improve the ability of underwater borrowers to benefit from the opportunities provided by Hope for Homeowners in the context of the Administration's housing plan. The Administration also supports appropriate legislative changes to facilitate cost-neutral loan modifications for federally guaranteed rural housing loans and FHA loans and continues to support balanced bankruptcy reform to allow judicial modification of mortgages for borrowers who have run out of other options.

6. You have spoken clearly about the importance of small business as an engine of job growth. What are your views as to the problems experienced by small and medium sized businesses in accessing conventional (non-SBA) credit? Are you planning to take any additional steps to ease credit in this area?

The Small Business Administration (SBA) – with its stated purpose of providing loans to facilitate the availability of credit to businesses that cannot access it elsewhere – serves a particularly important purpose at a time when so many small businesses have struggled to receive loans. As a result, Treasury has placed a particular emphasis on developing measures designed to help spur new SBA-guaranteed loans.. For example, Treasury announced that it will make $15 billion in direct purchases to unfreeze SBA secondary markets and has started to implement the Term Asset-Backed Securities Loan Facility (TALF), which will also assist small businesses in accessing credit. Combined with higher 7(a) loan guarantees and the temporary elimination of SBA fees – provisions Treasury worked with SBA to include in the American Recovery and Reinvestment Act – these programs should provide banks with greater confidence to extend credit, knowing that they will be able to sell new SBA loans and access the liquidity necessary to do additional lending.

We recognize, however, that the sharp decline in SBA-guaranteed lending during this recession is only part of a broader tightening that has affected small and medium-sized businesses attempting to access any kind of credit. In particular, both President Obama and I are keenly aware of the many small business owners around the nation who – despite strong credit histories – have seen their lines of credit cut due to no fault of their own. A major goal of our efforts to stabilize the financial system, restart secondary markets and ensure banks have the capital necessary to lend, even in a worse-than-expected economic scenario, is to get both SBA

and conventional loans flowing again to the small businesses that will be particularly important in driving an economic recovery. In recognition of that aim, Treasury instituted a new requirement that the 21 largest banks receiving government assistance must report their small business lending every month. Additionally, Treasury has pledged to work with bank regulators to require all banks to report small business data in their quarterly call reports, which should provide a better snapshot of lending across the financial system.

At the same time, Treasury remains committed to continuing its efforts to develop new programs targeted specifically at small businesses. On March 16, when President Obama and I announced our efforts to unlock secondary markets for SBA loans, we both made clear that we viewed that program as only a first step. Treasury is currently in the process of considering additional options that will help to increase the availability of credit to small business owners across the country.

7. This weekend the President is quoted in the New York Times about the changing relative significance of the financial sector in our economy as a whole going forward. Can you comment on your view of the longer term role of the financial sector in our economy, and how that view shapes the Treasury Department's policies in relation to its powers under the EESA?

The challenges that face the financial system are complex, interrelated, and the result of developments over many years. A protracted period of rapid innovation, excessive risk taking, and inadequate regulation produced a financial system that was far more fragile than was generally appreciated. The profits earned in the financial sector during the boom years were unsustainable and those profits probably distorted the allocation of high-skilled workers. Now that those profits have corrected we expect to see a different distribution of the "best and brightest." Such a rebalancing is underway and probably overdue.

An efficient financial system is essential for a well-functioning economy. The financial system must offer reliable payment and settlement services. It must collect savings and allocate those funds effectively to real investment. It must redistribute risk to those who want to hold it, but in a transparent way that does not generate systemic risk.

The government role must be to build a regulatory structure to ensure that the system is more stable. Within that structure the private managers must make the critical decisions about strategy and how individual firms are organized.