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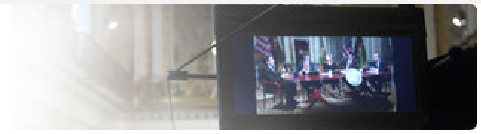

Statement by Secretary Henry M. Paulson, Jr. on Financial Markets Update

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Washington, DC-- Good afternoon. Last Friday Congress finalized and President Bush signed into law the bipartisan Emergency Economic Stabilization Act. The EESA provides the Treasury, the Federal Reserve and the FDIC with important new authorities to complement existing ones. We will continue to coordinate with other federal regulators to use these tools to implement our strategy to address the four key challenges in our financial markets today - confidence, capital, systemic risk and liquidity. Although we are facing particularly difficult circumstances, I remain confident that we will work through this challenge, as we have always successfully worked through every economic challenge in the history of the United States. We are a strong and wealthy nation, with the resources to address the needs we face. I am confident that, with the right public policy response, time and effort, we will conquer these challenges as well.

U.S. and global financial markets continue to be severely strained. A chain of events caused by the ongoing housing correction has reverberated through U.S. banks and financial institutions, and has seriously impacted the underlying economy, reaching American households and businesses. A root cause of this situation is the housing correction and a lack of confidence in mortgage assets, as well as a lack of confidence in many of the financial institutions that hold these assets. Because of this widespread uncertainty, investors are hesitant to commit capital to financial institutions. Investor confidence is critical to restore liquidity and enhance the stability of our financial system.

This financial market turmoil is now directly affecting more families and businesses. When banks can not finance at reasonable levels, and can not or are not willing to lend, everyone in our economy who depends on credit suffers. The capital markets are the pipes through which money flows to finance student loans, car loans, home loans and small businesses' payroll and inventory. And uncertainty and a lack of confidence have clogged our basic financial plumbing. While our actions have been aimed at restoring financial markets and institutions, our purpose is to prevent financial market difficulties from further impacting businesses and families across the country.

New Authorities Needed to Address Challenges

Over the last six months, the U.S. Government has addressed a number of significant problems on a case by case basis. In my judgment, these actions, a number of which were quite significant, were necessary but not sufficient. By September, uncertainty had led to a credit market freeze and it became clear that we needed to take a systemic approach on a significant scale, to get at the underlying cause of much of this turmoil.

We went to Congress and asked for broad new authorities to address the current troubles affecting our financial markets, including the root cause of the financial system freeze --- the illiquid mortgage assets weighing on bank balance sheets. And Congress met the very difficult challenge of providing these authorities by passing the EESA.

Specifically, the EESA empowers Treasury to use up to $700 billion to inject capital into financial institutions, to purchase or insure mortgage assets, and to purchase any other troubled assets that the Treasury and the Federal Reserve deem necessary to promote financial market stability. The new law also gives the Federal Reserve the authority to pay interest on reserves, and temporarily increases FDIC and NCUA deposit insurance from $100,000 up to $250,000.

Two days ago the members of the President's Working Group on Financial Markets, the PWG, made clear that we will coordinate the use of our existing and new authorities to restore market confidence by strengthening financial institutions, preventing systemic impact from bank failures, increasing liquidity to financial markets and keeping mortgage credit available and affordable.

Strengthening Financial Institutions

The Treasury Department is moving rapidly to implement the EESA to help strengthen financial institutions while also protecting taxpayer interests. As I have said before, the ultimate taxpayer protection will be a stable financial system that supports normal economic activity.

Towards that goal, the EESA adds broad, flexible authorities for Treasury to buy or insure troubled assets, provide guarantees, and inject capital. We will use all of the tools we've been given to maximum effectiveness, including strengthening the capitalization of financial institutions of every size. We will design programs that encourage healthy institutions to participate. Much attention has focused on the use of auctions to purchase troubled assets from financial institutions. We are moving as quickly as possible to organize and implement the most effective process possible. We expect it will be several weeks before our first purchase.

Consistent with EESA, I have appointed an interim Assistant Secretary to manage the program and begin its rapid implementation. I am currently working with the President to identify a leader to submit for confirmation, as called for in the legislation, to manage the program and help ensure its long-term success. I will also consult with congressional leaders and Senator McCain and Senator Obama during this process. It is our intent to have an appointee confirmed by the Senate as soon as possible, and I look forward to working with the Senate when they return in November, to ensure we maintain strong leadership and continuity for this unprecedented effort.

We have also identified and retained other very experienced interim leaders for the office, including an interim Chief Financial Officer. We have published guidelines on our procurement and conflict management processes. We have already sent out several essential Requests for Proposals that require 48 hour turnaround so we can contract with private sector experts --- some even as early as later this week --- who will bring complementary skills and expertise to the Treasury team.

We have several policy teams designing detailed programs to purchase mortgage-backed securities, whole loans, and equity-related instruments. In addition, we have begun work on compliance, executive compensation guidelines, foreclosure mitigation, and oversight. Our teams have already been working with Treasury's Inspector General and are scheduled to meet with the General Accounting Office. Yesterday, we held our first meeting of the program's Oversight Board and we are committed to transparency in all aspects of the program.

We will implement our new authorities with one simple goal – to restore capital flows to the consumers and businesses that form the core of our economy.

Prevent Systemic Impact from Bank Failures

One thing we must recognize – even with the new Treasury authorities, some financial institutions will fail. The EESA doesn't exist to save every financial institution for its own sake.

Therefore, a second prong in our strategy is designed to mitigate financial market disruption when a bank fails. In addition to insuring deposits up to the new, temporary level of $250,000, the FDIC has the ability to use its insurance fund and its substantial lines of credit with the Treasury to address systemic financial risk that may be posed by a bank failure.

It is the policy of our federal government to use all resources at its disposal to make our financial system stronger. In light of current conditions, the FDIC, with the full support of the Fed and the Treasury, will use its authority and resources, as appropriate to mitigate systemic risk, by, as appropriate, protecting depositors, protecting unsecured claims, guaranteeing liabilities and adopting other measures to support the banking system.

Increasing Liquidity to Financial Markets

As we address issues of capital and financial strength in our banks, we must also address the liquidity of our markets. The Federal Reserve has introduced innovative facilities and policies to enhance the liquidity that is vital to market stability, and has frequently done so in coordination with the European Central Bank. Today's announcement of a coordinated rate cut, including Europe, China and other large economies, is a welcome sign that central banks around the world are prepared to take the necessary steps to support the global economy during this difficult time. The EESA granted the Fed permanent authority to pay interest on depository institutions' required and excess reserve balances held at the Federal Reserve. This will allow the Fed to expand its balance sheet to support financial stability while maintaining its monetary policy priorities.

In recent weeks, the commercial paper market has suffered severe stress and illiquidity. Businesses ranging from financial institutions to industrial companies rely on the commercial paper market every day to fund their business activities. In particular, financial institutions sell commercial paper, and use the funds to lend to millions of consumers and businesses across the nation. In the wake of the uncertainty surrounding financial institution balance sheets, many investors are reluctant to buy commercial paper from financial institutions – in essence, unwilling to hold this unsecured debt for any significant length of time, even when the particular institution is healthy, because of the fear of not having access to liquid markets.

Yesterday, the Federal Reserve announced a new facility to provide a liquidity backstop to U.S. issuers of commercial paper. Through a special purpose vehicle the Fed will purchase three-month unsecured and asset-backed commercial paper directly from eligible issuers. I expect this initiative to significantly improve the availability of funding for financial institutions and corporations that depend on the commercial paper market. Until those that depend on commercial paper can issue it again in significant maturities, funding pressures will continue to ripple through our economy, dramatically shrinking the availability of credit to support families and businesses.

Mortgage Credit Availability and Affordability

As I have long said, the housing correction is the root cause of the current financial market turmoil. We must continue to keep mortgage credit available and support the housing market, so that we can more quickly turn the corner on the housing correction.

To provide critical additional funding to our mortgage markets, FHFA has directed Fannie Mae and Freddie Mac to increase their purchases of agency mortgage-backed securities (MBS). Supporting the availability of mortgage finance is the mission of the GSEs. There is headroom of over $150 billion between the current GSE portfolios and their regulatory limit. FHFA will supervise the growth in these portfolios, under its expanded authorities to monitor GSE risk-management. We also expect Fannie and Freddie to increase direct support to the mortgage market through their ongoing securitization activities.

To further support the availability of mortgage credit, Treasury also has established a program to purchase agency MBS directly. The program began in September. This will complement the capital provided by the GSEs and help facilitate mortgage availability and affordability.

Stabilizing Fannie and Freddie to support mortgage availability has been constructive. As the rest of our markets experienced increased turmoil the interest rate on a 30-year fixed rate mortgage has come down from its peak of 6.6 percent earlier this year to as low as 5.9 percent this week – a decrease that helps American households reduce monthly mortgage payments and increases the potential for more homeowners to refinance mortgages at lower rates. As Treasury and the GSEs increase their purchases, mortgage affordability should improve for Americans. If we were not actively engaged at the GSEs, we would have expected that rate to increase and further slow the progress of the housing correction.

International Coordination

We see evidence every day that world economies and financial markets are more connected and interdependent than at any time in history. Economic momentum has slowed substantially across the industrialized countries as a consequence of the ongoing financial turmoil, the acute stresses facing our financial institutions, continuing housing markets adjustments in the United States and other countries, and volatile – albeit moderating – commodity prices. Emerging markets are also beginning to show signs of slowing. We see evidence that the freezing of credit markets is having a tangible impact on the everyday lives of citizens all around the world.

Addressing these challenges requires the dramatic steps we are taking here in the United States and it requires strong international partnerships. Governments have and must continue to take individual and collective actions to provide much-needed liquidity, strengthen financial institutions through the provision of capital and the disposition of troubled assets, prevent markets abuse, and protect the savings of our citizens.

We must also take care to ensure that our actions are closely coordinated and communicated so that the action of one country does not come at the expense of others or the stability of the system as a whole.

Over the past twelve months President Bush and I have been in regular contact with our international counterparts, and we have collaborated in a variety of ways. This weekend I will be meeting with my G-7 colleagues to discuss the steps that each of us are taking to confront this crisis and ways to further enhance our collective efforts. In addition, in consultation with Brazil, the G-20 President, I am calling for a special meeting of the G20 that will include senior finance officials, central bankers, and regulators from key emerging economies to discuss how we might coordinate to lessen the effects of global market turmoil and the economic slowdown on all of our countries.

Although the tasks are not easy, I am regularly heartened as I work with my international colleagues who are also committed to securing stability and growth in their domestic economies, and to promoting the orderly functioning of the international financial system.

The Road Ahead

While most Americans understand that economic cycles occur, we are experiencing some extraordinary and difficult challenges at home and abroad – challenges that make it clear Congress was correct to take swift and bold action, and that we have no time to waste implementing the new law. We also know that getting it right is as important as getting it done quickly. We can and will do both. The Presidents Working Group on Financial Markets and all financial regulators are working together to achieve our necessary goal of restoring stability and orderliness to our financial markets. Every effort will require careful analysis, deliberation and transparency, and some measure of patience from the American people as we create the most effective process possible.

We have already taken a number of extraordinary bold actions on the liquidity front that I am convinced have been exactly the right policy steps, including the emergency action to provide a guarantee to our money market funds, actions to stabilize the GSEs and drive down mortgage rates, and the Fed's new program to provide 90-day liquidity to commercial paper issuers.

It is the policy of the federal government to use all resources at its disposal to make our financial system stronger, to safeguard depositors and savers, to help ensure an adequate flow of credit, and to minimize systemic risk. The Congress has recently provided the Treasury with broad powers to acquire financial assets, to make capital available, and to strengthen the balance sheets of individual institutions. The Federal Reserve has also been given new authority to ensure that the system has sufficient liquidity. The FDIC has the authority and the access to resources necessary to protect the banking system. The Treasury, the Federal Reserve and the FDIC will use all their authorities to promote the process of repair and recovery and to contain risks to the financial system that might arise from problems at individual institutions.

But patience is also needed because the turmoil will not end quickly and significant challenges remain ahead. Neither passage of this new law nor the implementation of these initiatives will bring an immediate end to current difficulties. It will take time and bipartisan leadership, cooperation and collaboration, as well as well-conceived and executed policies to overcome the challenges our nation is facing. And we will overcome them. Despite our problems, the U.S. economy is the largest and wealthiest in the world. We will, as we have in the past, emerge stronger and better able to provide new opportunities for our workers and increased prosperity for our families. Thank you.

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