U.S. DEPARTMENT OF THE TREASURY

Press Center

Interim Assistant Secretary Neel Kashkari Remarks on Implementation of the Emergency Economic Stabilization Act

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Washington- Good afternoon. Thank you, Faith, for that kind introduction. I have really enjoyed working with you over the past year. You are doing an excellent job leading HOPE NOW, getting servicers who are fierce competitors by day, to work together and with counselors toward the common goal of foreclosure prevention. The organization of Women in Housing and Finance is fortunate to have you as their President-Elect.

It is an honor for me to be here. Rather than give a long, formal speech, I would like to use this unique opportunity to do something a little different. I would like to give you a brief overview of our response to the credit crisis, and then spend most of the time taking your questions and having a thoughtful discussion.

The Treasury, the Federal Reserve and regulators in the U.S. and abroad have taken numerous unprecedented actions since the beginning of the crisis to reduce systemic risk and stabilize financial markets. Throughout the crisis, we have been strongly encouraging financial institutions to raise capital and to recognize losses. We have worked hard to adapt our policies to the rapidly changing circumstances on the ground.

Secretary Paulson and Chairman Bernanke recognized early that there may come a time when the private markets would become unwilling to provide the necessary capital to our financial system to deal with the large expected losses from the housing correction. In such a scenario, only the Federal government would be in a position to support the financial system – to step in to provide the needed capital to prevent collapse. Government intervention was not our first choice, as it often has unintended, far-reaching consequences.

We evaluated numerous alternatives and focused on a program to buy illiquid mortgage assets in very large scale to attract private capital to recapitalize our financial system.

We all hoped it would not come to this, but recognized the possibility and began contingency planning in early 2008.

In late summer, after the failure of Bear Stearns, the crisis intensified and our financial institutions came under even more pressure from deteriorating market conditions and the loss of confidence. In a very short period of time, some of our largest financial institutions failed or changed structure. In July, IndyMac bank failed. In the month of September alone, we witnessed the following: conservatorship of Fannie Mae and Freddie Mac, the sale of Merrill Lynch to Bank of America, the bankruptcy of Lehman Brothers, the rescue of AIG by the Fed, the conversion to bank holding companies by Morgan Stanley and Goldman Sachs, the distressed sale of Wachovia, and the failure of Washington Mutual.

As a result, in September, credit markets effectively froze. The commercial paper market shut down, 3-month Treasuries dipped below zero, and a money market mutual fund "broke the buck" for only the second time in history, precipitating a $200 billion net outflow of funds from that market.

Recognizing the threat to our financial system, Secretary Paulson and Chairman Bernanke knew the time had come and on September 18, they went to the Congress to ask for unprecedented authority to prevent a collapse of our financial system. Congress recognized the threat that frozen credit markets pose to the economy and to every American. Just two weeks later, on October 3, the Congress passed and President Bush signed into law the Emergency Economic Stabilization Act of 2008. We worked hard with the Congress to build tremendous flexibility into the legislation because the one constant throughout the credit crisis has been its unpredictability.

In our discussions with the Congress, we focused on our initial plan to purchase illiquid mortgage assets. In the two weeks between the time we submitted the draft legislation and the time the bill passed, credit markets deteriorated more quickly than we had expected. One key measure we looked at was LIBOR-OIS spread – a measure of perceived credit risk in the financial system. Typically, 5 – 10 basis points, on September 1, the one month spread was 47 basis points. By the 18th, when we first went to Congress, the spread had climbed

88 basis points to 135 basis points. By the time the bill passed, just two week later on October 3, the spread had climbed another 128 basis points to 263 basis points.

It was clear to Secretary Paulson and Chairman Bernanke, we needed to use the authority and flexibility granted under the EESA as aggressively as possible to quickly stabilize the system. We began immediately designing a capital program in addition to our asset purchase programs. We believed that purchasing equity in healthy banks would be the fastest way to inject much-needed capital into the financial system and restore confidence, which would restore the flow of credit. Illiquid asset purchases, which would take longer to implement, would follow.

Meanwhile, credit markets continued to deteriorate. On October 10, LIBOR-OIS spread had risen another 75 basis points to 338 basis points. So, four days later, on October 14, when our Capital Purchase Program was ready, we announced a plan to invest up to $250 billion in banks and savings institutions of all sizes, in combination with a guarantee of senior bank debt by the FDIC. These combined actions were taken to prevent a collapse of the financial system. We believe these actions were successful.

At the same time, we continued working hard on our illiquid asset purchase programs. We were keenly aware that, while $700 billion is a large sum of money, it is a finite amount. We needed to use the available funds to provide the maximum benefit to the system, while leaving enough dry powder to deal with contingencies. Throughout the process, we carefully monitored how the markets were responding to our actions and conditions in the broader economy. We asked ourselves: Would banks apply for the capital? Would credit markets respond? What was happening in the economy?

We were pleased that healthy banks of all sizes were signing up for the capital program and credit markets were showing signs of thawing. But the economic indicators were less positive. On October 31, data on third quarter GDP showed negative 0.3 percent growth. In addition, data released on October 28 showed that through August, home prices in 10 major cities had fallen 18 percent over the previous year.

It became clear we may need additional capital for both banks and non-bank financial institutions. To prevent the collapse of the financial system, we also had to restructure the Federal Reserve's loan to AIG, using $40 billion of TARP funds. With about half the original $700 billion available for asset purchases, would such a program still be the best approach? For an asset purchase program to be effective, it must be done in very large scale.

While we have taken actions to stabilize the banking sector, supporting the non-banking market is also important to helping consumers, businesses and our economy get the credit they need. The consumer securitization market appears to be a promising opportunity. This would help bring down rates of auto loans, credit cards and student loans and could be achieved with a more modest allocation from the TARP. And although we are not currently planning to initiate another capital program beyond those already announced, an emphasis on additional capital seems to us to be an appropriate focus today.

The EESA is not an economic stimulus plan, nor is it an economic growth plan. It was designed to stabilize the financial system. Today, the LIBOR-OIS spread has fallen 238 basis points from its peak to 100 basis points. We believe the combined actions of Treasury, the Federal Reserve and FDIC have stabilized the financial system and prevented a financial collapse. Nonetheless, the current crisis took years to build up and will take time to work through, and we still face some real economic challenges.

We will remain focused on ensuring the stability of the financial system and have begun working with our successors as we transition to the next Administration. With that brief overview, I would be happy to take your questions.

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