

# U.S. DEPARTMENT OF THE TREASURY

## Press Center

### Interim Assistant Secretary for Financial Stability Neel Kashkari Testimony

12/10/2008

HP-1322

#### ***Before the U.S. House of Representatives Financial Services Committee***

**Washington-** Good morning. Mr. Chairman, Ranking Member Bachus, and Members of the Committee, thank you for asking me to testify before you today regarding oversight of the Troubled Asset Relief Program.

We are in an unprecedented period and market events are moving rapidly and unpredictably. We at Treasury have responded quickly to adapt to events on the ground. Throughout the crisis, we have always acted with the following critical objectives in mind: one, to stabilize financial markets and reduce systemic risk; two, to support the housing market by avoiding preventable foreclosures and supporting mortgage finance; and three, to protect taxpayers. The authorities and flexibility granted to us by Congress have been essential to developing the programs necessary to meet these objectives.

Today, I will focus my remarks on compliance and oversight of the TARP and on measuring the results of this program, which are two very critical issues to the Treasury Department (Treasury). The American people provided Treasury with broad authorities to stabilize the financial system and it is essential we communicate our actions in an open and transparent manner to maintain their trust. I will describe the many steps we are taking to ensure compliance with both the letter and spirit of the law and what measurements we look at to gauge the success of our programs. A program as large and complex as the TARP would normally take many months or years to establish. But, we don't have the luxury of first building the operation, then designing our programs and then executing them. Given the severity of the financial crisis, we must build the Office of Financial Stability, design our programs, and execute them - all at the same time. We have made remarkable progress since the President signed the law only 68 days ago.

#### **Oversight**

The first topic I will address is oversight of the TARP. In addition to the normal oversight provided by Congressional committees of jurisdiction, the Congress established four important avenues of oversight: one, the Financial Stability Oversight Board; two, the Special Inspector General; three, the Government Accountability Office; and four, the Congressional Oversight Panel. I will review Treasury's interaction with each body in detail.

First, we moved immediately to establish the Financial Stability Oversight Board, which, by law, includes: the Secretary of the Treasury, the Chairman of the Federal Reserve Board, the Chairman of the Securities and Exchange Commission, the Secretary of Housing and Urban Development, and the Director of the Federal Housing Finance Agency.

The law required the first board meeting to take place within fourteen days. We moved very quickly, and the Oversight Board met within four days. At that initial meeting, the members of the Board selected Chairman Bernanke to be Chairman of the Oversight Board. The law requires the Board to meet once a month, but it has already met four times in the just two months since the law was signed, with numerous staff calls between meetings, and expects to meet again this week.

We have also posted the bylaws and minutes of the Board meetings on Treasury's website. In addition, the Oversight Board has interacted with other oversight bodies, such as the GAO and the Congressional Oversight Panel.

Second, the law also requires appointment of a Senate-confirmed Special Inspector General to oversee the program. We welcome the Senate's confirmation on Monday December 8 of Neil M. Barofsky as the Special Inspector General. I spoke with him on Tuesday December 9 and we look forward to working closely with his office. In the interim, we have been coordinating closely with Treasury's Inspector General. We held our first meeting with Treasury's IG on Monday, October 6, and have had numerous meetings since then to keep Treasury's Inspector General apprised of all TARP activity. We look forward to continuing our active dialogue with both the Treasury IG and with the Special IG as he builds up his office.

Third, the law calls for the Government Accountability Office to establish a physical presence at Treasury to monitor the program. Treasury provided workspace for our auditors within days of the President signing the law and Secretary Paulson had his first call with the Acting Comptroller General, Gene Dodaro, on Tuesday, October 7. The Acting Comptroller General and his team met with our team for the first

time on Thursday, October 9. Since then, I have participated in multiple briefings with the GAO and our respective staffs are meeting almost daily for program updates and also to review contracts.

The GAO published its first report on TARP to Congress on December 2, which the law required within 60 days of enactment. The GAO met with our team on Saturday, November 22, before their report was finalized. They provided a thorough review of the TARP programs and progress – essentially a snapshot at the 60 day mark of a large, complex project that continues to be a successful work in progress. As I noted above, given the intensity of the financial crisis, we must build our operation, design our programs and execute them all at the same time. The GAO report identified nine "areas that warrant Treasury's ongoing attention." We are pleased with our auditors' recommendations because the GAO had identified topics that we already had focused on. The report was quite helpful because it provided us with thoughtful, independent verification that Treasury is, indeed, focused on the right topics and Treasury agrees with the GAO on the importance of these issues.

Given the importance of the GAO's feedback, I want to spend a few minutes going through the nine areas that GAO identified and describe what we are doing in each case:

#### **1. Monitoring and reporting of financial institutions activities**

As the report indicated, given the number and variety of financial stability actions being put in place by multiple entities, it will be challenging to view the impact of the Capital Purchase Program in isolation and at the institutional level. Moreover, each individual financial institution's circumstances are different, making comparisons challenging at best, and it is difficult to track where individual dollars flow through an organization. Nonetheless, we are working with the banking regulators to develop appropriate measurements and we are focused on determining the extent to which the CPP is having its desired effect.

#### **2. Compliance of CPP participants with program requirements**

The key first step to effective compliance was developing effective program agreements and we have already accomplished that for publicly traded institutions and most private institutions. The CPP agreements are designed to require that the participants comply fully with the executive compensation restrictions set out by Congress in the legislation. We are now developing procedures to ensure that compliance with these restrictions is maintained.

#### **3. Formalize existing communication strategies to keep people informed about our strategy**

Treasury recognizes the importance of a more comprehensive communication strategy and we are looking at ways to enhance our communications, while recognizing that the TARP program is just one piece of a comprehensive response to the financial market crisis. Very detailed updates, such as this testimony, are part of that strategy.

#### **4. Develop a definitive transition plan**

Our team has been meeting regularly with the transition team and discussing our ongoing activities to ensure a smooth transition. We intend to have a fully functioning TARP organization in place as the new Administration takes office.

#### **5. Expedite hiring efforts to ensure the Office of Financial Stability has the needed personnel**

From day one, hiring has been a key focus area for the entire TARP team and we are making concrete progress every day as we staff up our team. Our Chief Operating Officer is coordinating an intense effort with our human resources office to identify and fill critical staff needs both for the immediate and long terms.

#### **6. Ensure sufficient personnel are assigned to oversee performance of contractors**

Working with the Treasury procurement staff, we are implementing a comprehensive process for monitoring contractors. We view staffing in this area as a high priority and are bringing staff on board now to make sure it is done right.

#### **7. Continue to develop a comprehensive system of internal controls**

Here, we appreciate the acknowledgement by GAO of the work we are doing in this area. Internal controls were one of the first areas that we addressed. For example, we contracted Price Waterhouse Coopers to help us develop a system of internal controls, and we contracted Ernst and Young to advise us on accounting procedures. While we have more to do, we are making excellent progress.

#### **8. Issue final regulations on conflicts of interest**

Treasury has drafted conflict of interest regulations and expects to publish them soon. We will then work diligently with our existing service providers to make any necessary adjustments to bring their mitigation plans into conformance with these regulations. In the meantime, Treasury is confident that our conflict of interest requirements are some of the toughest out there.

#### **9. Institute a system to manage and monitor the mitigation of conflicts of interest**

Treasury is requiring firms to provide detailed information about their compliance programs, potential conflicts, and their mitigation plans *before* any contracts are signed, and we are using this information to select the best vendors. In addition, we will soon have regulations in place with rigorous monitoring and certification requirements and we are considering third party reviews and audits as well.

The GAO report is just one example of our compliance with the tough oversight Congress has appropriately established over the TARP. Treasury will continue to have an open dialogue with the GAO through regular briefings to keep them informed of our progress and welcome their additional feedback as we move forward.

Finally, the law called for the establishment of a Congressional Oversight Panel to review the TARP. That Oversight Panel was recently formed and we had our first meeting with its initial members on Friday, November 21. We look forward to future discussions with the Panel.

## Reporting and Transparency

Next, I would like to discuss reporting requirements and transparency. Reporting results to the Congress and the American people is a critical responsibility of the TARP. People need to see what we are doing, understand why we are doing it, and know the effects of our actions. The law defined numerous reporting requirements for the TARP, which I will review here in detail. Treasury has met all of our reporting requirements on time, and we will continue to do so. All of our reports are posted on the Treasury website.

First, the law requires Treasury to publish a Transaction Report within two business days of completing each transaction. Many of our transactions are executed on the same day and so we have published four transaction reports on October 29, November 17, 25 and 26 for the 54 transactions we have completed so far. We will issue another transaction report tomorrow for the investments completed last Friday.

Second, the law requires Treasury to publish a Tranche Report to Congress within 7 days of each \$50 billion commitment that is made. The comprehensive report must provide details on the following topics: the transactions made to date, the impact on the financial system, the challenges that remain, and additional actions that may be necessary to address those challenges. To date, Treasury has published three Tranche Reports on November 3 and 21 and December 2.

Finally, the law requires Treasury to provide a detailed report on the overall program within 60 days of the first exercise of the TARP purchase authority. We sent that report to Congress last Friday, December 5, and it is available on our website.

## Measuring Results

People often ask: how do we know our program is working? First, we did not allow the financial system to collapse. That is the most direct, important information. Second, the system is fundamentally more stable than it was when Congress passed the legislation. While it is difficult to isolate one program's effects given policymakers' numerous actions, one indicator that points to reduced risk of default among financial institutions is the average credit default swap spread for the eight largest U.S. banks, which has declined more than 200 basis points since before Congress passed the EESA. Another key indicator of perceived risk is the spread between LIBOR and OIS: 1 month and 3-month LIBOR-OIS spreads have each declined about 100 basis points since the law was signed and about 180 basis points from their peak levels before the CPP was announced.

People also ask: when will we see banks making new loans? First, we must remember that just over half the money allocated to the Capital Purchase Program has been received by the banks. Although we are executing at record speed, it will take a few months to process all the remaining applications. The money needs to get into the system before it can have the desired effect. Second, we are still at a point of low confidence – both due to the financial crisis and the economic downturn. As long as confidence remains low, banks will remain cautious about extending credit, and consumers and businesses will remain cautious about taking on new loans. As confidence returns, we expect to see more credit extended.

The increased lending that is vital to our economy will not materialize as fast as any of us would like, but it will happen much faster as a result of having used the TARP to stabilize the system and increase capital in our banks.

We firmly believe that healthy banks of all sizes should use this program to continue making credit available in their communities. Treasury expects banks to continue their lending in a safe and sound manner as a result of these investments and we firmly support the statement issued by bank regulators on November 12 to that effect. The statement emphasized that the extraordinary government actions taken to strengthen the banking system are not one-sided; all banks – not just those participating in the CPP – have benefited from the government's actions. Banks, in turn, have obligations to their communities to continue making credit available to creditworthy borrowers and to work with struggling borrowers to avoid preventable foreclosures. At the same time, Treasury believes institutions must not repeat the poor lending practices that were a root cause of today's problems.

In addition, we are actively engaged with regulators to determine the best way to monitor CPP investments and bank lending. We may utilize a variety of supervisory information for insured depositories, including existing Home Mortgage Disclosure Act (HMDA) data, Community Reinvestment Act (CRA) data, call report data, examination information contained in the CRA Public Evaluations, as well as broader financial conditions.

## Conclusion

Treasury is committed to an open and transparent program with appropriate oversight. We look forward to continuing to work with the Financial Stability Oversight Board, the Special Inspector General, the Comptroller General, and the Congressional Oversight Panel as we execute this important program. 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.

While we have made significant progress, we recognize challenges lie ahead. As Secretary Paulson has said, there is no single action the federal government can take to end the financial market turmoil and the economic downturn, but the new authorities that you and your colleagues provided in October dramatically expanded the tools available to address the needs of our system. We are confident that we are pursuing the right strategy to stabilize the financial system and support the flow of credit to our economy. Thank you and I would be happy to take your questions.

-30-