

U.S. DEPARTMENT OF THE TREASURY

Press Center

Secretary of the Treasury Timothy F. Geithner Written Testimony before the Congressional Oversight Panel

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Introduction

Chair Warren, Representative Hensarling, and members Neiman, Silvers and Atkins, thank you for the opportunity to testify before you again.

Since I last appeared before this panel, U.S. financial and economic conditions have continued to improve. Borrowing costs have fallen, and businesses have raised substantial capital from private sources. The contraction in bank lending has moderated. Residential mortgage lending by banks actually expanded last month. The economy started growing again in the third quarter, a trend that private economists predict will continue. And the pace of deterioration in the labor market has moderated.

These improvements are remarkable. One year ago, we faced one of the most severe financial crises of the past century, and the economy was contracting sharply. Fear of a possible depression froze markets and spurred businesses to lay off workers and pull back from investment.

A coordinated government response turned this around. Action taken last fall by the Department of the Treasury, the Federal Reserve, the FDIC, and other government agencies averted a catastrophic collapse of our financial system. As your latest report states, the Troubled Asset Relief Program (TARP), which was established by Congress in the Emergency Economic Stabilization Act of 2008 (EESA), played a significant role in that success. But when the Obama Administration took office, the financial system was still extremely fragile, and the economy was shrinking rapidly. The Administration swiftly initiated financial and fiscal policies to address both challenges. In particular, the Financial Stability Plan helped to shore up confidence in our financial institutions and markets, while mobilizing private capital. The Administration also redirected public support from large financial institutions to households, small banks, and small businesses.

As a result of these policies, confidence in our financial system has improved, credit is flowing, and the economy is growing. Moreover, the government is exiting from its emergency financial policies and taxpayers are being repaid. Indeed, the ultimate cost of those policies is likely to be significantly lower than previously expected. In particular, while EESA provided the Secretary of the Treasury with the authority to invest \$700 billion, it is clear today that TARP will not cost taxpayers \$700 billion. Banks have already repaid nearly half of TARP funds they received over the past year, and we now expect a positive return from the government's investments in banks. We also plan to use significantly less than the full \$700 billion in EESA authority. As a result, we now expect that TARP will cost taxpayers at least \$200 billion less than was projected in the August Mid-Session Review of the President's Budget.

This week, Treasury published the first annual financial statements for the Office of Financial Stability, which implements TARP. Audited by the GAO, these statements discuss the impact of the program and provide cost estimates for it. Today, I will provide highlights from these statements.

I will also discuss the significant financial and economic challenges that remain and what the Administration is doing to address them. We need to continue to find ways to help mitigate foreclosures for responsible homeowners and to get credit to small businesses. We also must maintain the capacity to address potential threats to our financial system, which could undermine the recovery we have seen to date.

Further, we need to reform our laws to provide stronger, more effective regulation of our financial system and to protect consumers. Doing so will decrease the need for future intervention.

In this context, I will lay out an exit strategy for TARP. There are four broad elements to that strategy:

1. terminating and winding down programs that have supported large financial institutions;
2. limiting new investments to housing, small business, and securitization markets that facilitate consumer and small business loans;

3. maintaining the capacity to respond to potential financial threats; and
4. continuing to manage equity investments acquired through TARP in a commercial manner, while protecting taxpayers and unwinding those investments as soon as practicable.

Extending TARP authority is necessary for this strategy to succeed. Therefore, earlier this week I extended that authority until October 3, 2010. While we work to return taxpayer dollars, this Administration will not waver in its commitment to preserve the stability of our financial system and to help restore economic opportunity for American families and small businesses.

TARP Performance

The primary purpose of TARP was to restore the liquidity and stability of our financial system. That system plays a critical role in our economy, for example, by helping businesses raise funds and pay employees, providing consumers with convenient forms of credit, financing education, and allowing millions of Americans to own homes. The success or failure of TARP must be evaluated first and foremost on whether it has achieved that primary purpose.

Second, EESA required that TARP be used in a manner that maximized overall returns to taxpayers, while preserving home ownership and promoting jobs and economic growth.

As I will discuss, TARP has been successful by each measure, although challenges remain that require us to refocus initiatives, particularly toward mitigating foreclosure and getting credit to small businesses.

Impact on the Financial System

Measuring the impact of TARP in isolation is challenging. The health of the overall system and its impact on the U.S. economy are the most important metrics by which we can measure the effectiveness of these policies. However, the cost of the financial system collapse that was averted by TARP and the other government actions taken in the fall of 2008 and since then will never be known. Moreover, it is difficult to measure separately the impact of TARP, as it was part of a coordinated government response to restore confidence in our financial system. Nevertheless, a few TARP programs were uniquely targeted to specific markets and institutions. In those instances, we can measure performance more directly.

At a broad level, confidence in the stability of our financial markets and institutions has improved dramatically over the past year. Interbank lending rates, which reflect stress in the banking system, have returned to levels associated with more stable times. Credit-default swap spreads for financial institutions, which measure investor confidence in their health, have also fallen significantly.

At the same time, borrowing costs have declined for many businesses, homeowners, and municipalities, allowing them to raise substantial capital from private sources. Corporations, for example, have raised over \$1 trillion from bond issuance this year. While much of the issuance early this year was supported by government guarantees, private investors have funded most new corporate debt without public support in recent months. Importantly, banks have raised substantial funds from private sources since federal regulators released the results of their "stress test" of major U.S. financial institutions. As a result, the U.S. banking system is better capitalized today. TARP investments provided our financial institutions with an important bridge to critical access to private capital.

More narrowly targeted programs have also had a significant impact. Securitization markets that provide important channels of credit for consumers and small businesses have improved, in large part because of the government's Term Asset-Backed Securities Loan Facility (TALF). Spreads in these markets have narrowed considerably in response to announcements and actions through the program. New issuance has picked up and is shifting from public support to purely private financing. Prices for impaired securities on bank balance sheets have improved significantly this year. Announcements for the Public-Private Investment Program have contributed to these improvements, and the recently-formed Public-Private Investment Funds have started to purchase troubled assets from banks. Meanwhile, housing markets are showing some signs of stabilizing. Thanks in part to federal government financial policies, mortgage rates remain near historic lows, and home prices and sales are increasing. Millions of Americans have refinanced their mortgages since we announced the Making Home Affordable[®] program, and over 650,000 trial modifications have been initiated under the Home Affordable Modification ProgramSM, which is largely funded by TARP.

As credit conditions have improved, the U.S. economy has started to grow again, and job losses have slowed. These are significant improvements from where we were last year.

However, the financial and economic recovery still faces significant headwinds. Unemployment remains very high, along with foreclosure and delinquency rates, and housing markets are still overwhelmingly dependent on government support. Lending standards are tight and bank lending continues to contract overall, although the pace of contraction has moderated and residential mortgage lending by banks has stabilized. Commercial real estate losses weigh heavily on many small banks, impairing their ability to extend new loans. Further, although securitization markets have improved, parts of those markets are still impaired, especially for securities backed by commercial mortgages. These conditions place enormous pressure on American families, homeowners, and small businesses, which rely heavily on bank lending. Later, I will describe how we are refocusing EESA-funded programs to mitigate this pressure.

In sum, TARP has largely succeeded in achieving its primary goal, and we are winding down many initiatives established under the program. However, four tasks remain for TARP: preserving financial stability, which is essential for long-term economic growth; mitigating foreclosure for responsible American homeowners; getting credit to small businesses; and supporting securitization markets that facilitate consumer and small business loans.

Financial Returns and Expected Cost

The expected cost of using TARP to stabilize our financial system has fallen dramatically. While EESA provided the Secretary of the Treasury with the authority to invest \$700 billion, the ultimate cost for taxpayers will undoubtedly be far less.

One way of evaluating the program's cost is its impact on the Federal deficit. We now expect that TARP's contribution to Federal deficits will be at least \$200 billion less than was projected in the August Mid-Session Review of the President's Budget, which assumed a \$341 billion cost. [1] And the expected budgetary impact of \$364 billion in funds disbursed in Fiscal Year 2009 has fallen from \$151 billion to \$42 billion.

This improvement is driven by two factors: (1) investments are generating higher returns than previously anticipated, and (2) we do not anticipate using the full spending authority granted by EESA. We now expect to make – not lose – money on \$245 billion of investments in banks. We estimate that in the aggregate, major bank stabilization programs funded through TARP will yield a positive net return of over \$19 billion, thanks to dividends, interest, early repayments, and the sale of warrants. In short, taxpayers are being repaid at a substantial profit by banks.

Repayments are already substantial. To date, banks have returned \$116 billion in taxpayer investments – nearly one-third of all TARP disbursements to date. Further, we anticipate that total repayments could reach \$175 billion by the end of next year; that is, nearly half of TARP disbursements to date.

These early repayments are testaments to the success of the government's efforts to stabilize and rehabilitate our financial system. Private investors now have much greater confidence in the prospects of our major financial institutions. This is reflected in the significant private fundraising by banks this year. Just last week, Bank of America raised \$19.3 billion in common equity – after it announced that it would repay \$45 billion of government investments. More broadly, the largest U.S. banks have raised over \$110 billion in common equity and other regulatory capital since we announced the results of the "stress test" in May. That nearly matches the \$116 billion in repayments we have received.

TARP programs have already generated significant income – roughly \$15 billion – which has been used to pay down the debt. Our outstanding equity investments continue to generate substantial income through dividends. And we are adding to the taxpayer's return by auctioning warrants. Last week, for example, we raised nearly \$150 million from the sale of Capital One warrants. We expect substantial income from additional warrant sales over the next few weeks.

However, we do not expect all TARP investments to generate positive returns. There is a significant likelihood that we will not be repaid for the full value of our investments in AIG, GM, and Chrysler. But here too the outlook has improved. We now expect these institutions to repay \$14 billion more than was originally projected.

Furthermore, expenditures through the Home Affordable Modification Program were never intended to generate revenue. Consistent with the mandate of EESA, this program was created to help mitigate foreclosure for responsible but at-risk homeowners. The program requires mortgage lenders to share the financial burden of meeting that goal.

In sum, the ultimate return on TARP investments will depend on how the economy and financial markets evolve, and whether we can reform financial regulation and consumer protection in meaningful, efficient ways. But the bottom line is as follows. In combination with other government programs, TARP helped prevent a financial collapse that would likely have plunged this country into a much deeper recession, led to staggering job losses, and further reduced tax revenue. The financial system continues to improve, private capital is replacing public support, and the economy is growing again. Taxpayers should get back the vast majority of funds invested through TARP. And the ultimate fiscal cost of the program will be substantially less than originally expected, thereby reducing the burden on current and future taxpayers.

Exit Strategy for TARP

Next, I will lay out our exit strategy for TARP. There are four broad elements to that strategy.

First, we will continue terminating and winding down many of the government programs put in place to address the crisis. That process is already well underway. In September, Treasury ended its Money Market Fund Guarantee Program, which guaranteed at its peak over \$3 trillion of assets. The program incurred no losses, and generated \$1.2 billion in fees. New issuance under the FDIC's Temporary Liquidity Guarantee Program (TLGP) ended in October. Credit extended through Federal Reserve liquidity programs has declined substantially as market conditions have improved, and most of these programs are scheduled to expire at the beginning of February.

With respect to TARP, support for large financial institutions is coming to an end. The Capital Purchase Program, under which the bulk of support to banks has been provided, is effectively closed. Before this Administration took office, nearly \$240 billion in TARP funds had

been committed to banks. Since January 20, we have committed approximately \$7 billion to banks, much of which went to small institutions. Major U.S. banks subject to the "stress test" conducted last spring have raised over \$110 billion in high-quality capital from the private sector. And banks have repaid \$116 billion of TARP funds.

Second, we must fulfill EESA's mandate to preserve home ownership, stimulate liquidity for small businesses, and promote jobs and economic growth. To do so, we will limit new commitments in 2010 to three areas.

- We will continue to mitigate foreclosure for responsible American homeowners as we take the steps necessary to stabilize our housing market.
- We recently launched initiatives to provide capital to small and community banks, which are important sources of credit for small businesses. We are also reserving funds for additional efforts to facilitate small business lending.
- Finally, we may increase our commitment to the Term Asset-Backed Securities Loan Facility (TALF), which is improving securitization markets that facilitate consumer and small business loans, as well as commercial mortgage loans. We expect that increasing our commitment to TALF would not result in additional cost to taxpayers.

Third, beyond these limited new commitments, we will not use remaining EESA funds unless necessary to respond to an immediate and substantial threat to the economy stemming from financial instability. As a nation we must maintain capacity to respond to such a threat. Banks are still experiencing significant new credit losses, and the pace of bank failures, which tend to lag economic cycles, remains elevated. At the same time, many of the Federal Reserve and FDIC programs that have complemented TARP investments are ending. This creates a financial environment in which new shocks could have an outsized effect – especially if an adequate financial stability reserve is not maintained. As we wind down many of the government programs launched initially to address the crisis, it is imperative that we maintain this capacity to respond if financial conditions worsen and threaten our economy. However, before using EESA funds to respond to new financial threats, I would consult with the President and Chairman of the Federal Reserve Board and submit written notification to Congress. This capacity will bolster confidence and improve financial stability, thereby decreasing the probability that it will need to be used.

In order to meet these challenges, earlier this week I notified Congress that I extended the temporary authority provided to me under EESA to October 3, 2010. Even with this extension, we expect that TARP will cost taxpayers at least \$200 billion less than was projected in the August Mid-Session Review of the President's Budget, including \$25 billion in potential costs from TARP commitments in 2010. We expect that the vast majority of these potential costs would come from mitigating foreclosure for responsible American homeowners as we take the steps necessary to stabilize our housing market.

By stabilizing our financial system, assisting responsible homeowners, and getting credit to small businesses, EESA authority will continue to improve the outlook for our economy and American workers. And it will do so within the limits established by Congress in EESA. Further, while we are extending the \$700 billion program, we do not expect to deploy more than \$550 billion. We also expect up to \$175 billion in repayments by the end of next year, and substantial additional repayments thereafter. The combination of the reduced scale of TARP commitments and substantial repayments should allow us to commit significant resources to pay down the federal debt over time.

Fourth, we will continue to manage the equity investments acquired through EESA in a commercial manner, while protecting taxpayers and unwinding those investments as soon as practicable. We will exercise our voting rights only on core issues such as election of directors, and not interfere in the day to day management of individual companies. In addition, as the steward of taxpayers' funds, Treasury will manage investments in a manner that ensures accountability, transparency and oversight. And we will work with recipients of EESA funds and their supervisors to accelerate repayment where appropriate. We want to see the capital base of our financial system return to private hands as quickly as possible, while preserving financial stability and promoting economic recovery.

Conclusion

In conclusion, I can report significant improvements in our financial markets and economy, as well as the positive financial results of our TARP programs. However, our job is far from finished. History suggests that exiting too soon from policies designed to contain a financial crisis can significantly prolong an economic downturn. While we exit our emergency financial policies, we must not waver in our resolve to ensure the stability of the financial system and to support the nascent recovery that the Administration and Congress have worked so hard to achieve. Improvements in the financial performance of TARP programs put us in a better position to address the financial and economic challenges that many Americans still face. The Department of the Treasury looks forward to continuing to work with you and the Congress to achieve these goals.

Appendix: U.S. Credit Conditions

Confidence in the stability of our financial markets and institutions has improved dramatically over the past year. Interbank lending rates, which reflect stress in the banking system, have returned to levels associated with more stable times. For example, the spread of one-month Libor to the overnight index swap has fallen from a peak of about 340 basis points last fall to roughly 10 basis points today. Credit-default swap spreads for financial institutions, which measure investor confidence in their health, have also fallen significantly. An aggregate measure of credit-default swaps for the largest U.S. banks reached over 450 basis points last fall and is roughly 100 basis points today.

Borrowing costs have declined for many businesses, homeowners, and municipalities. Investment-grade corporate bond rates have fallen by over 70 percent since last fall, and high-yield bond rates have fallen by more than half. Fears of default on these bonds have receded, providing further relief on prices. The CDX investment-grade index, an aggregate measure of credit-default swaps for highly-

rated companies, has fallen about 35 percent from its October peak. Further, conventional 30-year mortgage rates remain under five percent at historic lows. AAA municipal bond rates are three percent, down from five percent last fall.

As borrowing costs have come down, businesses have raised substantial capital from private sources this year. Corporations, for example, have raised over \$900 billion in investment-grade debt and over \$100 billion in high-yield debt this year. While much of the new issuance early this year was supported by government guarantees, private investors have funded most new corporate debt without public support in recent months. Nearly 50 percent of new issuance was guaranteed by the government in January. Only 14 percent was guaranteed in October. Importantly, banks managed to raise substantial private capital following the release of the results from the federal government "stress test" of major U.S. financial institutions. Since the results were released, banks have roughly \$90 billion in new common equity and about \$60 billion in debt that is not guaranteed by the federal government. As a result, the U.S. banking system is much better capitalized today. Furthermore, state and local governments have been able to issue debt at levels in line with recent years.

Securitization markets that provide important channels of credit for consumers and small businesses have also improved, in large part because of programs launched under the TARP. Announcements about the Term Asset-Backed Securities Loan Facility (TALF) helped narrow spreads in these markets even before the program began operating. This trend has continued, with spreads on TALF-eligible asset-backed securities (ABS) back to pre-crisis levels today, and spreads on non-TALF-eligible ABS more than 90 percent off their peaks from last fall. Issuance of ABS backed by consumer and business loans has averaged \$14 billion per month since the government launched TALF in March, compared to less than \$2 billion per month in the six months prior to the program's launch. And as with corporate bonds, new issuance in the ABS market is shifting from public support to purely private financing. Issuance of non-TALF eligible ABS increased from one percent of total issuance in August to 64 percent last month.

Prices for impaired securities that constrain bank lending have improved significantly this year. This is due in part to general market improvement and in part to announcements for the Public-Private Investment Program, which was designed to remove these securities from banks. Most of the Public-Private Investment Funds have now been formed and are starting to purchase legacy securities. The activity of these funds should continue to contribute to price improvements in these markets.

Meanwhile, housing markets are showing some signs of stabilizing and wealth is recovering, which should stimulate consumer spending -- vital to American economic growth. Thanks in part to federal government financial policies, mortgage rates remain near historic lows. Home prices have increased over the past six months, following consistent declines since 2006. For example, the seasonally adjusted S&P/Case-Shiller U.S. National Home Price Index rose by 1.8 percent and 1.9 percent in the second and third quarters, respectively. Since March, sales of existing single-family homes have increased by 20 percent. Over 2.7 million mortgages have been refinanced since Treasury-OFS announced its Making Home Affordable program, and over 650,000 trial modifications have been initiated under the Home Affordable Modification Program, which is largely funded by TARP. Household net worth increased by \$2 trillion in the second quarter, the first increase since the third quarter of 2007.

As credit conditions have improved, the U.S. economy has started to grow again and job losses have slowed. The economy expanded at an annual rate of 2.8 percent in the third quarter of 2009, snapping four consecutive quarters of negative growth. Private economists generally expect moderate growth over the next year. The unemployment rate fell to 10 percent in November. Between August and October, nonfarm payroll job losses averaged 135,000 a month. In November, payroll job losses were essentially unchanged.

However, the financial and economic recovery still faces significant headwinds. Unemployment remains high, along with foreclosure and delinquency rates. Although RealtyTrac's October report shows a third straight month of decreasing foreclosure activity, foreclosures are still up nearly 19 percent since October 2008. And delinquencies of subprime residential mortgages reached over 26 percent and conforming mortgages nearly seven percent in the third quarter. Further, according to First American CoreLogic, roughly one in four homeowners owed more on their mortgages than the properties were worth in the third quarter of 2009. These conditions place enormous pressure on American families and homeowners.

Bank lending continues to contract overall, although the pace of contraction has moderated and some categories of lending are growing again. For example, commercial and industrial loans contracted at an annual rate of 27 percent in the third quarter, but 16 percent since then. Such loans are particularly important for small businesses, which generally cannot raise money by issuing debt in securities markets. Meanwhile, residential mortgage loans from banks have increased at an annual rate of two percent since the third quarter.

The contraction in many categories of bank lending reflects a combination of persistent weak demand for credit and tight lending standards at the banks, amidst mounting bank failures and commercial mortgage losses. There have been 130 bank failures this year, compared with 41 over the decade that preceded the current recession. And the number of banks that the FDIC classifies as "problem institutions" has reached over 550 this year, compared with 76 in 2007 and 252 in 2008. Further, FDIC-insured commercial banks reported that net charge-offs--that is, losses that have occurred--increased to 2.9 percent as a share of loans and leases in the third quarter, up from 0.6 percent before the recession. And delinquencies of commercial real estate loans were nine percent in the third quarter and increasing.

Banks' willingness to lend also has a significant impact on consumer spending and, consequently, economic growth. Macroeconomic Advisors, a consulting firm, found that a 10-point increase in bank's willingness to make consumer installment loans yields a 0.3 percentage point increase in personal consumption expenditures. [2]

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[1] This amount reflects the estimated programmatic and administrative costs of TARP that impact on Federal deficits.

[2] Macroeconomic Advisers, "Banks' Willingness to Lend and PCE Growth," Oct. 8, 2008.

REPORTS

- [Charts](#)