

U.S. DEPARTMENT OF THE TREASURY

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Testimony by Secretary Henry M. Paulson, Jr. before the House Committee on Financial Services Hearing on Turmoil in U.S. Credit Markets: Recent Actions regarding Government Sponsored Entities, Investment Banks and other Financial Institutions

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Washington, DC-- Chairman Frank, Congressman Bachus, members of the committee, thank you for the opportunity to appear before you today. I appreciate that we are here to discuss an unprecedented program, but these are unprecedented times for the American people and our economy. I also appreciate that Congress and the Administration are working closely together so that we can help the American people by quickly enacting a program to stabilize our financial system.

We must do so in order to avoid a continuing series of financial institution failures and frozen credit markets that threaten American families' financial well-being, the viability of businesses both small and large, and the very health of our economy.

The events leading us here began many years ago, starting with bad lending practices by banks and financial institutions, and by borrowers taking out mortgages they couldn't afford. We've seen the results on homeowners – higher foreclosure rates affecting individuals and neighborhoods. And now we are seeing the impact on financial institutions.

These bad loans have created a chain reaction and last week our credit markets froze up – even some Main Street non-financial companies had trouble financing their normal business operations. If that situation were to persist, it would threaten all parts of our economy.

Every business in America relies on money flowing through the financial system smoothly every day – not only to borrow, expand and create jobs, but to finance their normal business operations and preserve existing jobs.

Since the housing correction began last summer, Treasury has examined many proposals as potential remedies for the turmoil that the correction has caused in our banking system. With the Federal Reserve, we have sought to address financial market stresses with as minimal exposure for the US taxpayer as possible. The Federal Reserve took bold steps to increase liquidity in the markets. And we worked together on a case-by-case basis – addressing problems at Fannie Mae and Freddie Mac, working with market participants to prepare for the failure of Lehman Brothers, and lending to AIG so it can sell some of its assets in an orderly manner.

We have also taken a number of powerful tactical steps to increase confidence in the system, including a temporary guaranty program for the U.S. money market mutual fund industry. These steps have been necessary but not sufficient. More is needed. We saw financial market turmoil reach a new level last week, and spill over into the rest of the economy. We must now take further, decisive action to fundamentally and comprehensively address the root cause of this turmoil.

And that root cause is the housing correction which has resulted in illiquid mortgage-related assets that are choking off the flow of credit which is so vitally important to our economy.

We must address this underlying problem, and restore confidence in our financial markets and financial institutions so they can perform their mission of supporting future prosperity and growth.

We have proposed a program to remove troubled assets from the system – a program we analyzed internally for months, and had hoped would never be necessary. Under our proposal, we would use market mechanisms available to small banks, credit unions, and thrifts, across the country – not just big banks. These mechanisms will help set values of complex, illiquid mortgage and mortgage-related securities to unclog our credit and capital markets, and make it easier for private investors to purchase these securities and for financial institutions to raise more capital.

This troubled asset purchase program has to be properly designed for immediate implementation and be sufficiently large to have maximum impact and restore market confidence. It must also protect the taxpayer to the maximum extent possible, and include provisions that ensure transparency and oversight while ensuring the program can be implemented quickly and run effectively, as it needs to get the job done.

I understand the view that I have heard from many of you on both sides of the aisle, urging that the taxpayer should share in the benefits of this plan to our financial system. Let me make clear – this entire proposal is about benefiting the American people, because today's fragile financial system puts their economic well-being at risk. When local banks and thrifts aren't able to function as they should, Americans' personal savings, and the ability of consumers and businesses to finance spending, investment and job creation are threatened.

The ultimate taxpayer protection will be stabilizing our system, so that all Americans can turn to financial institutions to meet their needs – financing a home improvement or a car or a college education, building retirement savings or starting a new business. The \$700 billion program we have proposed is not a spending program. It is an asset purchase program, and the assets which are bought and held will ultimately be resold with the proceeds coming back to the government. Depending on the rate at which our housing market and economy recover, the loss to the taxpayers should be much less than the purchase price of the assets. And those purchases will be spread out over time, occurring as warranted by market conditions.

I am convinced that this bold approach will cost American families far less than the alternative – a continuing series of financial institution failures and frozen credit markets unable to fund everyday needs and economic expansion.

I understand that this is an extraordinary ask, but these are extraordinary times. I'm encouraged by the bipartisan consensus for an urgent legislative solution. We need to enact this bill quickly and cleanly, and avoid slowing it down with unrelated provisions or provisions that don't have broad support. This troubled asset purchase program on its own is the single most effective thing we can do to help homeowners, the American people and stimulate our economy.

Earlier this year, Congress and the Administration came together quickly and effectively to enact a stimulus package that has helped hard-working Americans and boosted our economy. We acted cooperatively and faster than anyone thought possible. Today we face a much more challenging situation that requires bipartisan discipline and urgency.

When we get through this difficult period, which we will, our next task must be to address the problems in our financial system through a reform program that fixes our outdated financial regulatory structure, and provides strong measures to address other flaws and excesses. I have already put forward my recommendations on this subject. Many of you also have strong views, and we must have that critical debate, but we must get through this period first.

Right now, all of us are focused on the immediate need to stabilize our financial system, and I believe we share the conviction that this is in the best interest of all Americans.

Now let's work together to get it done. Thank you.