

# U.S. DEPARTMENT OF THE TREASURY

## Press Center

### Treasury Secretary Tim Geithner Opening Remarks – As Prepared for Delivery Congressional Oversight Panel

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Thank you Chair Warren, Representative Hensarling, members Neiman and Silvers and Senator Sununu for the opportunity to testify before you today.

Last October Congress established the Congressional Oversight Panel to ensure that all government actions taken to stabilize the economy are in the best interest of the American people. That is a shared goal at the Treasury Department. I applaud the work done by the panel to date and I look forward to a strong, continued relationship going forward.

The United States and the world economy are still in the midst of the most severe financial crisis in generations. No crisis like this has a simple or single cause, but countries around the world, borrowed too much and allowed the financial system to take on irresponsible levels of risk.

As in any financial crisis, the damage has been brutally indiscriminate, causing damage on Main Streets across the nation. Ordinary Americans and small business owners who did the right thing and played by the rules are suffering from the actions of those who took on too much debt.

Today I will outline the steps taken by the Obama Administration to restore the flow of credit to get our economy back on track and Americans back to work.

At the time the Obama Administration took office there had been substantial actions by the government, using authority provided by Congress, to help stabilize the financial system.

These actions were successful in averting a systemic financial crisis, but the sharp decline in growth both here and around the world, is placing additional pressure on the financial system because of expectations of future losses.

Issuance of asset-backed securities, which had been a principal source of credit to the economy as a whole, had fallen to virtually zero. Lending terms and conditions were tightening and the cost of many types of credit remained extremely high. Banks were unable to raise equity

Leaving that situation unaddressed would have risked a deeper recession and more damage to the productive capacity of the American economy. It would have resulted in higher unemployment and more business failure, greater damage to our future growth and productivity, and as a result higher long term budget deficits. Without action to strengthen the capacity of the financial system to provide credit, the substantial spending and tax incentives in the American Recovery and Reinvestment Act would be less effective.

In response to these challenges, we outlined a broad new strategy to repair the financial system and strengthen its capacity to support recovery.

We started with a series of reforms to improve transparency, accountability and oversight. We published the detailed terms of financial assistance provided to individual banks.

We put in place new protections for determining eligibility. We required financial institutions to report monthly on details of lending activity. We outlined new conditions on assistance to protect the tax payer. And the President outlined a set of broad reforms to compensation practices to help ensure that tax payer assistance was used to support lending rather than excessive compensation for executives.

Alongside these reforms, we launched a program of initiatives to address the four major challenges at the heart of the financial crisis.

I'd like to take a few minutes to discuss each.

First, falling home prices and rising unemployment have made it difficult for many responsible homeowners to meet their mortgage payments and stay in their homes. Rising foreclosures risk contributing to further declines in home prices, a further pull back in credit, and more job losses.

In response, the Obama Administration established the Making Home Affordable<sup>®</sup> Program to keep mortgage rates low, allow responsible homeowners to refinance into affordable mortgages and modify at-risk loans in order to help millions of homeowners lower their monthly mortgage payments. Alongside the Fed we have helped push mortgage rates to historic lows, increasing refinancing nationwide. And we have signed contracts with top servicers covering a majority of loans nationwide for our loan modification program.

Second, concern about future losses has led many banks to pull back on lending.

In response, we outlined a new program to ensure that the nation's major banks have a sufficient buffer of capital to provide credit for recovery. As part of this effort, the federal banking agencies will complete a forward looking assessment of the 19 largest banks to determine which institutions need to raise additional capital. Those banks that need more capital will have an opportunity to raise that capital from private sources or to request capital from the Treasury in the form of convertible preferred stock. A dollar of capital generates between eight and twelve dollars of lending capacity.

Third, the breakdown of key markets for new securities has constrained the ability of even creditworthy small businesses and families to get the loans they need. The securities markets typically account for a very substantial share of the supply of credit to our economy. The crisis caused issuance of new securities to grind to a halt.

As a complement to our program to help bring more capital into the banking system, we launched the Consumer and Business Lending Initiative, which expanded dramatically a program with the Federal Reserve, called the Term Asset-Backed Securities Loan Facility (TALF). These programs provide financing to help catalyze issuance of securities backed by

student loans, credit cards, small businesses, auto loans, corporate and commercial real estate loans. Treasury also put in place a program to help directly support small business lending. These programs have helped promote new flows of credit through new issuance of securities, and to reduce increase rates in those markets.

Fourth, a range of legacy assets, such as real estate related loans made during the housing boom, remain on the books of major banks, limiting their ability to extend credit and to raise new equity.

In response, the Obama Administration created an innovative new program to provide a market for these assets. Under this program, private investors, such as pension fund managers, will compete for the right to access capital from the Treasury and financing from the Federal Reserve and the FDIC, to purchase real estate related loans and securities. Private investors will set the purchase price, protecting the government from paying too much. The government will share in the returns on those investments. Professionals will manage the assets. Together this will help reduce the risk of loss to the tax payer. Over time, this program will help improve liquidity in these markets, free up room on bank balance sheets to expand lending, and, by making it easier for banks to clean up their balance sheets, help them raise private capital and ultimately replace capital investment already made by the Treasury.

These four programs are critical. They are designed to work together. Each will reinforce the effectiveness of the other. We may have to adapt and expand them over time, but they represent the foundation of any credible strategy to help ensure the financial system is working for, rather than against, economic recovery.

As we work to repair the financial system, we are working to put in place new rules of the road for the financial system, to help ensure that a crisis like this never happens again. Financial innovation has expanded the financial products and services that are available to consumers. We have to make sure that when households make choices to borrow, or to invest their savings, there are new rules that prevent manipulation and abuse.

In addition, the rapid pace of development in the financial sector in recent decades has meant that gaps and inconsistencies in our regulatory system are more meaningful and problematic. Financial activity has tended to gravitate to parts of the system that are regulated least effectively. Looking ahead, our regulatory structure must assign clear authority, resources, and accountability for each of its key functions, with much stronger protections for consumers and investors, and a safer more stable overall system.

We must also ensure that international rules for financial regulation are consistent with the high standards we will be implementing in the United States. This will compel a global race to the top rather than the bottom.

This financial crisis has shown that the largest financial institutions can pose special risks to the financial system as a whole. In addition to regulating these institutions differently we must give the Federal government new tools for dealing with situations where their solvency is called into question. Treasury has proposed legislation for a resolution authority that would grant additional tools to avoid the disorderly liquidation of systemically significant financial institutions that fall outside of the existing resolution regime for banks under the FDIC.

Now, in pursuing these steps to address the financial crisis, the Administration considered a range of options. And given the unprecedented nature of the challenges we face, it is not surprising that thoughtful analysts disagree on the best course for policy.

On one side is the argument that we should allow the financial system to adjust on its own. To be sure, failure should have consequences, in the financial system as in life. But in the context of a severe recession, letting the financial system adjust on its own would have dire consequences for the economy. We got a taste of these problems last fall, when the failure and near failure of a number of large institutions helped cause a catastrophic loss of confidence, huge damage to pension values, and the largest contraction in economic activity around the world in decades.

On the other side is the argument that we should act to take on a much larger share of the losses of banks and other institutions. Our approach is designed to resolve the crisis at least cost to the tax payer and with the least risk of further damage to the fabric of the American economy.

But to be clear, it is vitally important that our financial system emerge from this crisis stronger and that actions the government takes to stabilize the financial system do not sustain the weak at the expense of the strong. That is why it is so critical that the necessary restructuring of the system that has been underway for some time continues.

The last two years have been one of the most intense periods of structural change in the financial system in our history. Importantly, of the 20 largest financial institutions on the eve of the financial crisis 4 no longer exist as independent entities. Five of the 20 have been subject to major interventions by Federal authorities. Two others chose to change their legal form, and accept significant regulation, in order to have access to Federal Reserve support.

Of course wherever the government is providing assistance it is imperative that those funds come with safeguards to minimize the risk to the taxpayer and the broader economy. That is why transparency, accountability and oversight have been a top priority of this Administration from day one and continues to be so.

I want to conclude with a few observations on the impact of these programs on the availability and cost of credit. These are most important measures of the state of the financial system, and to date, the evidence is mixed.

Now, evaluating the impact of the range of programs intended to address the financial crisis from trends in the financial indicators is extremely difficult because it is impossible to judge how the financial markets would have operated absent these actions.

After all, in normal recessions demand for credit falls. In recessions that are following a long period of substantial borrowing, demand for credit falls much more sharply. This is such a moment. There is no past experience that provides a good guide as to what to expect to have occurred in our financial markets absent the intervention that took place.

Indicators on interbank lending, corporate issuance and credit spreads generally suggest improvements in confidence in the stability of the system and some thawing in credit markets.

The three month LIBOR-OIS spread, an indicator of major banks' willingness to lend to each other, has fallen to about 90 basis points, down from its October peak of 365. Nonfinancial corporate bond issuance was up sharply in the first quarter of 2009, after falling in the second half of 2008. And issuance of asset back securities rose in March after grinding to a halt in October and November, but still remains at about half the level that occurred in the first half of 2008.

Despite these improvements, the cost of credit is still very high. Reports on bank lending show significant declines in lending for consumer loans and for commercial and industrial loans, although mortgage refinancing has picked up considerably.

We are in the process of improving the measurement of activity on bank balance sheets, as well as working on a comprehensive interagency evaluation of TARP based on quarterly regulatory data already being provided by banks. This will help provide more details to the public on current conditions of the credit and lending markets so that, on a more frequent basis, they have the best possible information to evaluate the strengths of the financial system.

Let me conclude by saying that our central objective and our obligation is to ensure that the financial system is stable and that it is able to provide the credit necessary for economic recovery. But stability itself is not enough. We need a financial system that is not deepening or lengthening the recession, and once the conditions for recovery are in place, we need a financial system that is able to provide credit on a scale that a growing economy requires.

Meeting this obligation requires action by the government. It requires governments to take risks. The lesson of the financial crises throughout history is that early action, forceful action, sustained action to repair financial systems and promote the flow of credit, is essential to limit the damage of recessions, and makes it possible to do so at less ultimate cost to the tax payer.

We need the financial system to support sustainable economic expansion. And we need to put in place comprehensive regulatory reforms that deter fraud and abuse, protect American families when they buy a home or get a credit card, reward innovation and tie pay to job performance, and end past cycles of boom and bust.

This is our commitment.

Thank you.

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