AUTHENTICATED
U.S. GOVERNMENT
INFORMATION
GPO

THE ADMINISTRATION'S PROPOSALS FOR FINANCIAL REGULATORY REFORM

HEARING

BEFORE THE

COMMITTEE ON FINANCIAL SERVICES
U.S. HOUSE OF REPRESENTATIVES

ONE HUNDRED ELEVENTH CONGRESS

FIRST SESSION

SEPTEMBER 23, 2009

Printed for the use of the Committee on Financial Services

Serial No. 111–76

U.S. GOVERNMENT PRINTING OFFICE

54–867 PDF WASHINGTON : 2010

For sale by the Superintendent of Documents, U.S. Government Printing Office
Internet: bookstore.gpo.gov Phone: toll free (866) 512–1800; DC area (202) 512–1800
Fax: (202) 512–2104 Mail: Stop IDCC, Washington, DC 20402–0001

HOUSE COMMITTEE ON FINANCIAL SERVICES

BARNEY FRANK, Massachusetts, *Chairman*

PAUL E. KANJORSKI, Pennsylvania
MAXINE WATERS, California
CAROLYN B. MALONEY, New York
LUIS V. GUTIERREZ, Illinois
NYDIA M. VELÁZQUEZ, New York
MELVIN L. WATT, North Carolina
GARY L. ACKERMAN, New York
BRAD SHERMAN, California
GREGORY W. MEEKS, New York
DENNIS MOORE, Kansas
MICHAEL E. CAPUANO, Massachusetts
RUBÉN HINOJOSA, Texas
WM. LACY CLAY, Missouri
CAROLYN McCARTHY, New York
JOE BACA, California
STEPHEN F. LYNCH, Massachusetts
BRAD MILLER, North Carolina
DAVID SCOTT, Georgia
AL GREEN, Texas
EMANUEL CLEAVER, Missouri
MELISSA L. BEAN, Illinois
GWEN MOORE, Wisconsin
PAUL W. HODES, New Hampshire
KEITH ELLISON, Minnesota
RON KLEIN, Florida
CHARLES A. WILSON, Ohio
ED PERLMUTTER, Colorado
JOE DONNELLY, Indiana
BILL FOSTER, Illinois
ANDRÉ CARSON, Indiana
JACKIE SPEIER, California
TRAVIS CHILDERS, Mississippi
WALT MINNICK, Idaho
JOHN ADLER, New Jersey
MARY JO KILROY, Ohio
STEVE DRIEHAUS, Ohio
SUZANNE KOSMAS, Florida
ALAN GRAYSON, Florida
JIM HIMES, Connecticut
GARY PETERS, Michigan
DAN MAFFEI, New York

SPENCER BACHUS, Alabama
MICHAEL N. CASTLE, Delaware
PETER T. KING, New York
EDWARD R. ROYCE, California
FRANK D. LUCAS, Oklahoma
RON PAUL, Texas
DONALD A. MANZULLO, Illinois
WALTER B. JONES, JR., North Carolina
JUDY BIGGERT, Illinois
GARY G. MILLER, California
SHELLEY MOORE CAPITO, West Virginia
JEB HENSARLING, Texas
SCOTT GARRETT, New Jersey
J. GRESHAM BARRETT, South Carolina
JIM GERLACH, Pennsylvania
RANDY NEUGEBAUER, Texas
TOM PRICE, Georgia
PATRICK T. McHENRY, North Carolina
JOHN CAMPBELL, California
ADAM PUTNAM, Florida
MICHELE BACHMANN, Minnesota
KENNY MARCHANT, Texas
THADDEUS G. McCOTTER, Michigan
KEVIN McCARTHY, California
BILL POSEY, Florida
LYNN JENKINS, Kansas
CHRISTOPHER LEE, New York
ERIK PAULSEN, Minnesota
LEONARD LANCE, New Jersey

JEANNE M. ROSLANOWICK, *Staff Director and Chief Counsel*

CONTENTS

	Page
Hearing held on:	
September 23, 2009	1
Appendix:	
September 23, 2009	49

WITNESSES

WEDNESDAY, SEPTEMBER 23, 2009

Geithner, Hon. Timothy F., Secretary, U.S. Department of the Treasury	8

APPENDIX

Prepared statements:	
Bachmann, Hon. Michele	50
Marchant, Hon. Kenny	52
Geithner, Hon. Timothy F.	54

ADDITIONAL MATERIAL SUBMITTED FOR THE RECORD

Waters, Hon. Maxine:	
Letter from Assistant Secretary Kim Wallace, U.S. Department of the Treasury, containing figures on Treasury's workforce diversity, dated August 13, 2009	62
Geithner, Hon. Timothy F.:	
Responses to questions from Representative Kanjorski, Representative Bean, Representative Foster, and Representative Wilson	67

THE ADMINISTRATION'S PROPOSALS FOR FINANCIAL REGULATORY REFORM

Wednesday, September 23, 2009

U.S. HOUSE OF REPRESENTATIVES,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The committee met, pursuant to notice, at 9:33 a.m., in room 2128, Rayburn House Office Building, Hon. Barney Frank [chairman of the committee] presiding.

Members present: Representatives Frank, Waters, Maloney, Gutierrez, Watt, Ackerman, Sherman, Meeks, Moore of Kansas, Hinojosa, Clay, McCarthy of New York, Baca, Lynch, Miller of North Carolina, Scott, Green, Cleaver, Bean, Ellison, Wilson, Donnelly, Foster, Carson, Speier, Minnick, Adler, Driehaus, Kosmas, Grayson, Himes, Maffei; Bachus, Castle, Royce, Lucas, Manzullo, Jones, Biggert, Capito, Hensarling, Garrett, Neugebauer, Price, McHenry, Bachmann, Marchant, McCarthy of California, Posey, Jenkins, Lee, Paulsen, and Lance.

The CHAIRMAN. The hearing will now come to order.

I just want to explain that there is a hearing in the Committee on Education and Labor at which I have to testify on the anti-discrimination bill, so I will leave and will be coming back.

We have the Secretary, whose prior effort to testify, which we appreciated, was interrupted by a voting pattern. We will have the Secretary's testimony this morning. Then we will have the other regulators this afternoon.

Tomorrow, we will have a hearing on the overall question of regulation, including particular emphasis on how to resolve the problem of "too-big-to-fail" and make that go away by appropriate remedies. On Friday, we will have a hearing on the bill sponsored by the gentleman from Texas, Mr. Paul, on auditing the Federal Reserve.

And then, we will begin next week, legislative hearings on the segments of financial reform. The media reports that it is dead for the year are inaccurate. We will begin hearings on specific bills. We have had a number of hearings, but people have asked that hearings be—and this is appropriate—on specific pieces of legislation. And, obviously, other members are welcome to propose and circulate among the members alternatives to that so that various drafts could be available.

But we will begin hearings next week on the legislative pieces. We intend to mark this overall regulatory package up in some pieces. At this point, it will be up to the leadership to decide whether it is done on the Floor in one sector or not.

I have told the leadership that, for example, if this bill were to come to the Floor as one piece, I would insist on at least 3 full days of debate. I intend to do everything I can to make sure—in fact, I will not, as chairman, call up the bill unless we have adequate time for amendments and debate. These are very important issues for the country, and it is essential that they be acted on in a fair manner.

So we will begin legislative hearings next week. It will be a very busy schedule for this committee. We will have legislative hearings and markups. No markup will be scheduled for a day when we will be leaving town. I expect, in many cases, we will be talking about 2-day markups on sections of this bill. If, in an extreme case, we have to do some more, as long as we are seriously engaged in that, we will go ahead with it.

And it is my expectation that the legislation we have been talking about—which really goes back and has its genesis in the April 2008 speech of Secretary Paulson. While we don't have, obviously, everything in there that he wanted and we have some things that he didn't talk about, this really is an effort that began with that speech. And we will be voting on this on the Floor of the House in November.

I have spoken to Senator Dodd. He has been consulting with his ranking member, Senator Shelby. They expect, I believe, also to be acting this year. So that is the expectation. That is the schedule.

I would just—you know, members have been alerted this is going to be a very time-consuming committee for the month of October and on into early November. I do look forward, as of Christmas, to ignoring most of the subjects we will be covering for some period of time. But that is where we are.

Now we will begin this hearing with the Secretary of the Treasury. I alluded in my opening comments to our schedule. I wanted to address one particular issue that I think has not gotten enough attention, and that is the collection of actions that are proposed by the Administration and that we intend to go forward with, with some changes, to deal with this problem of "too-big-to-fail."

The "too-big-to-fail" problem is one of the ones that most aggravates people in the country. The notion that, if incompetence gets large enough, it should be immunized from any kind of correction is, obviously, as unfortunate a concept as we can have. I believe we will be putting together a package of legislation that will substantially diminish that problem.

First of all—and this is, again, something that goes back to Secretary Paulson in April of 2008—we will be providing a mechanism for putting nonbank financial institutions out of everybody's misery. There will be death panels exacted by this Congress, but they will be for nonbank financial institutions that will not be considered "too-big-to-die."

And I say that because we have this euphemism that we are going to be resolving these institutions. It has not been my experience—and when someone says they are going to resolve something, they kill it. And we are talking about dissolution, not resolution. We are talking about making it unpleasant for the entities. This is not a fate people would want. We will do this in several ways.

But we will begin—last year, Secretary Paulson and Federal Reserve Chairman Bernanke and others in the Bush Administration told us that the problem was—and we had two major nonbank institutions to deal with in this situation: first, Lehman Brothers; and then AIG, in quick succession.

And the approach in Lehman Brothers was to pay none of the creditors. That led the Administration, the Bush Administration, to believe that the consequences of that were so negative that they could not allow it to happen again, so, with regard to AIG, they paid all the creditors.

The problem was, as they saw it, they had no option other than pay everybody or pay nobody, that the ability to step in and unwind this in a more orderly fashion was not available to them. When Wachovia failed, it did not have the same disruptive effect.

So we will give them the mechanism to do that and the mechanism to do that will protect the taxpayers and allow these institutions to be put out of business in the appropriate way.

We will also have powers given to a collection of Federal regulators to make it much less likely that we will reach that situation with the large institutions. Remember institutions fail frequently, and generally we have ways of dealing with them. We will be enacting legislation, I believe, to keep them from getting to the point where they are so large and so overleveraged that this will be happening.

Now, one proposal—I want to say, there had been some talk about a list being established by the Federal regulators of the institutions that were systemically important. I believe that would be a mistake. While those who proposed it in good faith thought it would be a kind of scarlet letter on them, in fact, others have seen it as a badge of honor.

So we are, I believe, going to empower the regulators to take action to stop this from happening, but we are not going to have a preordained list. I think we are likelier to get to the Potter Stewart principle. As lawyers will recollect, he said in the pornography case, "I know it when I see it." The regulators will know a systemic threat when they see it, because the systemic threat could be one large institution or a series of smaller institutions doing the same bad thing. Irresponsible subprime mortgages turned out to be a terrible systemic threat. No one institution was at that point.

When you get to that—and we are still working, and there will be disagreements, but I think ultimately an agreement, on who does it, what combination of existing Federal regulators will have the power to designate and then enact restrictions. Those institutions or those activities which are deemed to be risky will be restrained. There will be restrictions on excessive leverage, and there will be restrictions on activities. Such a regulator would, I believe, have told AIG to stop issuing credit default swaps and to begin to unwind that portfolio in an orderly fashion and to increase their capital.

So I do want to stress, yes, there is no one magic bullet that does away with "too-big-to-fail." But you will have an ability to resolve them in ways that protect taxpayers and give people a disincentive to get into that situation. And you have a power, before you reach

that, to restrict their activities, both quantitatively and qualitatively. That will be very much what we do.

The gentleman from Alabama is now recognized for 4 minutes.

Mr. BACHUS. I thank the chairman for holding this hearing.

And, Secretary Geithner, I thank you for returning to our committee to discuss the President's proposals for regulatory reform.

The Administration has presented to Congress a far-reaching regulatory reform proposal which, as of today, has failed to achieve anything approaching consensus, either on Capitol Hill or even among the Federal regulators who would be responsible for implementing it.

The lesson that we learned from the events that led to the financial crisis and subsequent government actions is that our 1930 regulatory system is not up to the task of monitoring the safety and soundness of complex financial institutions in the 21st Century. We do need smarter regulation, but not necessarily more regulation. We need enforcement of existing regulation, not another layer of regulation or more government bureaucracy.

And, finally, what we do not need and what we have had too often is government policies which encourage harmful business practices or incentivize those practices or, when they went terribly wrong, blessed them with bailouts.

The chairman used the term "liquidate and resolve." And I think that most of my colleagues welcome that, as opposed to what the Administration started by saying, and the chairman, using words like "rescue," because "rescue" implies that the taxpayers will be presented with the ultimate bill.

Unfortunately, the Administration's regulatory reform plan continues the pattern that we have seen with health care and energy of a big-government solution that replaces individual choices with bureaucratic mandates. Their plan establishes the Federal Reserve as the systemic risk regulator, despite the fact that the Fed has historically done a poor job of identifying and addressing systemic risk before they become crises.

It tasks the Fed with identifying a class of systemically significant firms that the market will view as "too-big-to-fail," as the chairman said, and then compounds this mistake by creating a so-called resolution authority that will promote continued taxpayer-funded bailouts of these institutions rather than actually unwinding and shutting down their operations.

And, finally, the Administration plan would establish a massive new government bureaucracy known as the Consumer Financial Protection Agency, which consumers will ultimately pay for on top of the numerous regulatory agencies and the regulatory legislation and patchwork that currently exists.

Mr. Chairman, my deep-seated reservations about the Administration's financial reform proposals, which, again, I point out are shared by Members on both sides of the aisle and many of the regulators themselves, should not be interpreted as a rejection of commonsense reform. Although Republicans have taken a different path than the Administration's, we are not saying "no" to reform. Republicans are saying "no" to more bailouts and "no" to more of the same approach of misguided government regulations and interventions which helped bring about the crisis in the first place.

Republicans have offered a clear alternative to the Administration's approach to reform and will continue to do so. The Republican plan promotes effective consumer protection by streamlining and consolidating the functions of the bank regulators, including consumer protection, into a unified agency.

End the bailouts. Our plan directs all failed nonbanks to an enhanced bankruptcy process that will force creditors and counterparties of those firms to bear the cost of failure rather than sticking the taxpayer with the tab. To promote sound monetary policy, our plan relieves the Fed of its current supervisory duties and prohibits the Fed from bailing out any specific financial institution.

Mr. Chairman and Mr. Secretary, I thank both of you. I look forward to working with you and my colleagues in the months ahead as we address regulatory reform. Thank you.

The CHAIRMAN. And we have an imbalance of speakers, although the same numbers. So I will go to Mr. Hensarling next for 2 minutes, if he is ready. Two minutes is what was on the sheet I was given.

Mr. HENSARLING. Thank you, Mr. Chairman.

And welcome, Mr. Secretary.

When it comes to the Administration's financial regulatory plan, not unlike their trillion-dollar health care plan, it will prove to be terribly expensive and lead to forms of rationing.

First, the Administration's proposal rewards regulators with sweeping new Draconian powers, like the CFPA, to regulate industries as diverse as car rental companies, advertising agencies, and neighborhood department stores, all of which will simply make credit more expensive and less available to struggling small businesses and American families throughout our Nation.

The Administration proposal also includes the designation of certain companies as Tier 1 financial holding companies. The Administration's proposal, I fear, will simply codify the policy of "too-big-to-fail" and enshrine us as a bailout nation.

Now, some maintain that bailouts have brought us to the verge of a recovery. I hope and pray we are on the verge of a recovery. But I remind all, Mr. Chairman, there is no such thing as a jobless recovery. No jobs, no recovery. Since the Administration has taken office and enacted their economic agenda, 3 million more of our countrymen have lost their jobs, and we currently suffer under the highest unemployment rate in a quarter of a century.

The Administration's continued bailouts of Fannie Mae, Freddie Mac, AIG, Chrysler, GM, and the list goes on, have hampered our economic recovery and helped our Nation pass a very important milestone: the first trillion-dollar deficit in our history, not to mention a budget which will triple the national debt over the next 10 years.

There is a huge difference between adding emergency liquidity to a panicked financial system and bailing out firms fortunate enough to be designated "too-big-to-fail." Under the latter policy, the big get bigger, the small get smaller, the taxpayer gets poorer, and our children get saddled with the mother of all debts.

Clearly, reforms are needed, but the best way to end taxpayer bailout of failed companies is to simply end taxpayer bailouts of failed companies. The best way to protect consumers is with com-

petitive markets, vigorous enforcement of antifraud laws, and effective disclosure that is easily understood.

Thank you, Mr. Chairman.

Thank you, Mr. Secretary.

The CHAIRMAN. The gentleman from Illinois, the chairman of the Subcommittee on Financial Institutions, Mr. Gutierrez, is recognized for 3 minutes.

Mr. GUTIERREZ. Mr. Secretary, first of all, thank you for appearing.

Exactly 1 year ago, we experienced the most agonizing week of the current financial crisis. And this committee began to address the root causes of the social and economic trauma that crippled our economy and caused millions of Americans—and we should remember this—to lose trillions of dollars of their hard-earned wealth. Let me repeat that: Trillions of dollars of hard-earned wealth were lost by the American people. Not so much the guys on Wall Street, they lost, but the people on Main Street lost.

Predatory mortgage lending, combined with risky investment practices and poor underwriting standards, financed by some of the largest financial institutions in this country, created the financial and economic debacle that we must now address.

Over a decade ago, the Federal Reserve was given the power by this committee—I was here; I got elected in 1993—to stop predatory mortgage practices through the Homeowners' Equity Protection Act. It took the Federal Reserve 12 years to implement the rules and regulations that could have prevented many, if not all, of the worst abuses by predatory lenders and originators, abuses that were a direct and immediate cause of our current crisis.

Why did it take so long? While there were many theories to explain this, I believe it took the Fed this ridiculously long time, including the FDIC, which did absolutely nothing either, because it was distracted by their other regulatory obligations and by a sense in Washington, D.C., of do less, do nothing, leave it alone, it is okay.

The default of these toxic mortgages and the securitized products based on them caused trillions of dollars in losses and caused the 2008 freeze in credit markets, which nearly destroyed not only our financial system but the entire international financial system.

The message to those of us who want to restore the stability to the financial system could be no clearer or louder. If we do not include a strong, effective Consumer Financial Protection Agency within our regulatory reform legislation, Congress will have failed to address the current and any future economic challenges facing our country.

We must also address the economic threat inherent in institutions known as "too-big-to-fail." I believe we must work to a comprehensive, risk-based pricing regime which eliminates the incentives for these financial firms to grow to the point of becoming "too-big-to-fail."

One of the ways we can prevent an institution from becoming "too-big-to-fail" is through a pricing regime which discourages banks from growing so large and interconnected. We must not only increase capital requirements, but we should also require decreased

leverage ratios and increased contributions to the Deposit Insurance Fund.

Let me ask that this be submitted for the record, my complete statement, because it is clear to me, Mr. Chairman, we are going to have, you know, our classical debate. Our colleagues on the other side have already thrown health care into this, big government. I hear "socialism" coming any second. They are going to say, "No, no, no. Global warming doesn't exist, no. We don't need to do anything about global warming. We really don't need to do anything about this."

We do need to do something, and Mr. Geithner knows it probably better than anybody else. We can never allow a Lehman Brothers again to have a 30:1 ratio. We can't allow that kind of leverage. And government is the only one that is going to stop it from happening again.

Thank you very much, Mr. Chairman.

The CHAIRMAN. The gentleman from New Jersey, Mr. Garrett.

Mr. GARRETT. Thank you, Mr. Chairman.

Thank you, Mr. Secretary.

Before I begin, I just want to say I don't believe anyone from either side of the aisle believes that everything was done right in the past and we can just continue going in that same direction. I believe from both sides of the aisle everyone agrees that reform is necessary. It is just the nature of that reform, to make sure that we do not limit growth nor do we provide for instability. We want just the opposite; we want economic growth and stability to come out of reform that we do. I think we can agree on that.

One point, the chairman raised the issue of timelines and moving forward and what he would like to do. When I think about that, you go back. In April, the Administration thought before the G–20 they wanted to have a reform proposal out on the table. That wasn't done. Then there was talk by that G–20, not a complete proposal. Then, by the end of Memorial Day, there was talk of doing a markup and having that done for resolution authority. And that wasn't done. And then there was talk of dealing with the systemic regulator and getting that through, and that was not done. And then, of course, in July, we were told that we were going to be dealing with the consumer agency. And that was kicked until September. And then that was eventually kicked to September when we came back from break. And, of course, now that is kicked now to mid-October.

So it seems that all those timelines have not really been met quite as they had wanted to meet them. And we really don't have, today, any legislative text from the legislative side of the aisle. I do appreciate that the Administration has provided us with legislative language, which is absolutely necessary for us to deliberate on these things. But it is appropriate, of course, for Congress to come up with their own legislation.

Now, in the Senate, of course, we have Senator Dodd, as some would say, throwing a wrench into the works, because he has come up now with an idea of a single regulator. And why I use the word "wrench" is because the chairman has said there will never be any prospect of merging the OCC and the OTS. So we are at different ends of that spectrum on that area.

So I guess what I would be curious hearing from you today is, is there a need to be able to deal with each of these issues deliberatively, to have time actually to have the legislation before us, and maybe move until 2010 before we actually have the completion of all this legislation?

I thank you, and I look forward to your testimony.

Mr. GUTIERREZ. [presiding] The time of the gentleman has expired.

And now we will hear from the person that we are all gathered to hear from and that we have many questions for, the Secretary of the Treasury, Mr. Geithner.

Please proceed.

STATEMENT OF THE HONORABLE TIMOTHY F. GEITHNER, SECRETARY, U.S. DEPARTMENT OF THE TREASURY

Secretary GEITHNER. Thank you, Mr. Chairman, Ranking Member Bachus, members of the committee. It is a pleasure to be back before you today and to talk about how best to reform the system. I am pleased to hear the enthusiasm for reform across both sides of the aisle. And, of course, we all recognize the task we face is how to do it right and how to get it right.

Our objective, of course, is to provide stronger protection for consumers and investors, to create a more stable financial system, and to reduce the risk that taxpayers have to pay for the consequences of future financial crises. We have outlined a broad set of proposals for achieving these. We provided detailed and extensive legislative language.

We welcome the time and effort you have already put into considering these proposals and the suggestions you have made, many of you individually and collectively, have made to improve them. As the President likes to say, we don't have a monopoly of wisdom on these things. Our test is, what is going to work? That is our test. What will work? What will create a more stable system, better protections, with less risk to the taxpayer?

I want to focus my remarks briefly on what I think are the two key challenges before us at the center of any debate on reform. The first is about how you achieve the right balance between consumer protection and choice and competition. And the other is how to deal with the moral-hazard risk people refer to as "too-big-to-fail."

So, first, on the consumer challenge, our system of rules and enforcement failed to protect consumers and investors. The failures were extensive and costly. They caused enormous damage not just to those who were the direct victims of predatory practice, fraud, and deception, but to millions of others who lost their jobs and their homes or their savings in the wake of the crisis.

And to fix this—and I will just say it simply—we need to have strong minimum national standards for protection. They need to apply not just to banks but to institutions that compete with banks in the business of providing credit. They need to be enforced effectively, consistently, and fairly. And there need to be consequences for firms that engage in unfair, ineffective practices, consequences that are strong enough to deter that behavior.

We believe we cannot achieve that within our current framework of diffused authority with the responsibility divided among a com-

plex mix of different supervisors and authorities who have different missions and many other priorities. We think it requires fundamental overhaul so that consumers can understand the risks of the products they are sold and have reasonable choices, and institutions have to live with some commonsense rules about financial credit.

Of course, the challenge is to do this without limiting consumer choice, without stifling competition that is necessary for innovation, and without creating undue burden and cost on the system.

Our proposal tries to achieve this balance by consolidating the fragmented, scattered authorities that are now spread across the Federal Government and State government. And it is designed to save institutions that are so important to our communities—credit unions, community banks, other institutions that provide credit—from making that untenable choice between losing revenue, losing market share, or stooping to match the competitive practices that less responsible competitors engage in, competitors that had no oversight, that were allowed to engage in systematic predatory practices without restraint.

Now, some have suggested that, to ensure no increase in regulatory burden, we should separate rule-writing authority from enforcement. But our judgment is this is a recipe for bad rules that are weakly enforced—a weaker agency. So we think we need one entity with a clear mission, the authority to write rules and enforce them.

Now, just briefly on this deeply important, consequential question of moral hazard and "too-big-to-fail," no financial system can function effectively if institutions are allowed to operate with the expectation they are going to be protected from losses. And we can't have a system in which taxpayers are called on to absorb the costs of failure. We can't achieve this with simple declarations of intent to let future financial crises burn themselves out.

We need to build a system that is strong enough to allow firms to fail without the risk of substantial collateral damage to the economy or to the taxpayer. And this requires that we have the tools and authority to unwind, dismantle, restructure, or close large institutions that are at the risk of failure without the taxpayers assuming the burden. It requires that banks pay for the costs incurred by the government in acting to contain the damage caused by bank failures. And this requires higher capital standards, tougher constraints on leverage across-the-board, with more rigorous standards applied to those who are the largest, most complicated, posing the biggest risks to the system.

Now, this package of measures is central to reform. You can't do each of these and expect it to work. You have to take a broad, comprehensive approach. And the central objective, again, is to make the system strong enough so we can allow failure to happen in a way that doesn't cause enormous collateral damage to the economy and to the taxpayer.

As the President said last week, taxpayers shouldered the burden of the bailout, and they are still bearing the burden of the fallout in lost jobs, lost homes, and lost opportunities. We look forward to working with this committee to help create a more stable sys-

tem. We can't let the momentum for reform fade as the memory of the crisis recedes.

Thank you, Mr. Chairman.

[The prepared statement of Secretary Geithner can be found on page 54 of the appendix.]

Mr. GUTIERREZ. You are very welcome.

Mr. Bachus, you are recognized for 5 minutes.

Mr. BACHUS. Thank you very much, Chairman Gutierrez.

Just last night, Chairman Frank released a memo—I am sure you have probably seen it—to his caucus where he suggested changes to the Consumer Financial Protection Agency. And, specifically, the chairman intends to drop, or seems to, the plain vanilla requirement, which has received so much attention.

The White Paper was where the Administration highlighted that. I know Elizabeth Warren, who first proposed a financial protection safety council, I think that was sort of the main emphasis—that plain vanilla. And it is in your draft legislation that the Administration sent to the Hill.

What is your position on leaving out plain vanilla? You didn't mention it this morning.

Secretary GEITHNER. Thank you.

I have read the note quickly. And, in general, we are very supportive of the changes proposed by the chairman, including the one you referenced.

But let me just explain the basic rationale for where we started. Our basic framework is designed to use disclosure to make sure consumers are less vulnerable to predation.

Mr. BACHUS. Of course, now, you know, Mr. Secretary, about 18 pages of the present disclosures are because of Federal requirements.

Secretary GEITHNER. No, I agree. But I think, as anybody realizes, how many of you read those disclosures and understand what they mean?

Mr. BACHUS. No, I agree with you.

Secretary GEITHNER. It is really a remarkable failure to provide the kind of ability to choose that is so central to any reasonable financial system.

So, in general, Mr. Bachus, we think it is a reasonable idea to try to make sure consumers have the ability to choose a simple product, not something they don't understand. And maybe the most effective way to do this to make sure you get disclosure right.

Mr. BACHUS. Okay. Although a lot of the disclosure is because of Federal regulation. So, I mean, that is the reason—

Secretary GEITHNER. But you said something that I often say and completely believe: that, in many ways, this is about smarter regulation. And, you know, what you cite in disclosure is an example that you can have a lot of requirements and not achieve the objective of clarity.

Mr. BACHUS. Sure. I agree. Okay.

In your testimony, on page 8, you spent a lot of time this morning on the systemically significant, the Tier 1. You say that the identification of a firm as a Tier 1 will not convey a government subsidy.

But isn't it a fact that a firm that has been identified as Tier 1, just that identification tends to imply government subsidy, given that creditors will know that the firm has been determined to be so important that it can't fail?

Secretary GEITHNER. We are deeply worried about that risk. And you are absolutely right, as is the chairman, to point out the risk in any regime that creates the expectation that the government will be there if you screw things up.

But let me just make clear what is important. It is very important that these institutions that matter, whose future could threaten the economy as a whole, are subject to higher constraints on leverage in the future, more conservative cushions of capital and liquidity so that they can absorb losses they face when they make big mistakes.

So what we are trying to do is to make it clear that, if you have this particular source of threat to the system, we are going to hold you and subject you to more conservative constraints on risk-taking.

Now, you can't do that without identifying who those institutions are. But you have to do it in a way that doesn't, as you said, create an expectation that the government will be in there if they fail.

But that is why you can't just do it with tighter capital requirements. You have to give them the tools for the government to intervene to save them, but to act in a way that allows them to be dismantled and restructured and—I won't use the chairman's language—again, without the taxpayers assuming that burden. That is the central imperative for reform.

And you are all right when you say that the key thing we have to do is not reinforce any expectation that the government is going to step in and protect people from losses in the future. Our job, though, is to make sure the system is less vulnerable to the collateral damage that can be caused when people make big mistakes.

Mr. BACHUS. But can you assure us that the government won't step in if they fail?

Secretary GEITHNER. You know, Mr. Bachus, as I said, we had a little natural experience as a country last fall in what happens when—

Mr. BACHUS. It wasn't so little.

Secretary GEITHNER. No, I would just say we had a test of the proposition that you can solve a crisis by hoping it is going to burn itself out. You saw how deeply damaging it was to the country as a whole.

So you can't fix this system, make it more stable in the future, by hoping and promising that you are going to—how should I say it—

Mr. BACHUS. Not have more bailouts.

Secretary GEITHNER. —abolish the fire station, lock the doors of the fire station when the crisis breaks out. It is not a strategy that works.

Mr. GUTIERREZ. The time of the gentleman has expired.

The Congresswoman from California, Maxine Waters, is recognized.

Ms. WATERS. Thank you very much.

Thank you very much for being with us today, Mr. Secretary.

I would like to quickly respond to some of your testimony. You outlined some critical objectives, and you said to achieve these objectives will require changes across the entire financial system. And you laid out some of the changes. I would like to add a little something to that.

On August 13th, Assistant Secretary Kim Wallace sent me some figures on Treasury's workforce diversity. I would like to thank you for those numbers. And I will enter them into our record today.

And I would like to ask you to provide a little bit more specific breakdown of workforce diversity within each division. I am especially interested to see what roles each class of minorities occupies. For example, how many are lawyers, how many are policy staff, how many are administrative assistants?

And I am not going to ask you to do that today; I am going to ask you to respond in writing. And I thank you very much.

Second, I would like to focus on the suggested language you sent over on over-the-counter derivatives. As you know, I am very concerned about credit default swaps, which are a type of derivative. We allowed the SEC to ban short-selling, as it did last fall. The SEC also created new rules to significantly limit naked short-selling.

The rationale behind this is that short-selling was used to improperly speculate in financial stocks. This caused what has been referred to as a crisis of confidence, which undermined each company's ability to operate. The same can be said about a company's credit default swap price. A naked credit default swap can be used to speculate on a company's creditworthiness and drive the value of the bonds lower.

The current derivatives proposal does not have any limits on naked credit default swaps. We already allow the SEC to ban short-selling. We know naked credit default swaps can be used for the same speculative purposes as short-selling. Why shouldn't we give the SEC the authority also to ban credit default swaps?

Secretary GEITHNER. An important issue and a thoughtful question. What we do in our proposal—and this is something you need to reflect on—is we propose to give the SEC and the CFTC the ability—they do not now have this authority today—to effectively deter and prevent manipulation in the derivatives markets. And, that is a very important thing to do. We didn't do that before. We have to fix that. We proposed a variety of ways of doing that.

We don't think that banning what you call naked credit default swaps is necessary or appropriate to that objective. But we do think it is critically important you give them enforcement authority and the tools necessary to address, prevent, and deter manipulation in the derivatives markets. And that should be a centerpiece of what your committee considers in reform of derivatives markets.

Ms. WATERS. Thank you very much.

Finally, I would like to ask a question about the Consumer Financial Protection Agency. I am extremely supportive of the Consumer Financial Protection Agency. I am a little bit worried about the concerns that have been identified by the FDIC and the Fed about their roles.

Are you guys working through this in the Administration, to help everybody get online, to determine what this Consumer Financial

Protection Agency will be and what will be taken from each and not taken from each? Can we all get together on that?

Secretary GEITHNER. Ultimately, the committee is going to have to make that choice. And, as I have said before, what you are hearing from the supervisors is just an understandable desire to protect authority they have today and make sure that people they have doing these jobs don't face uncertainty about their broad future. And I understand that wish.

But let me just say it starkly: Did that system work? How well of a job did it do? How did it work out for the country to have that authority spread out among those agencies?

So, again, I think it is understandable they are expressing reservations and concern. You can't expect them to do anything different. But our responsibility is to figure out what is right for the country, even if it is inconsistent with the individual institutional prerogatives of individual supervisors and even if it is going to be uncomfortable for the financial firms who are going to have to face tougher standards, better enforcement.

Ms. WATERS. I appreciate that. It would just make it a little easier for us if the Administration could just get its act together with all of—

Secretary GEITHNER. Again, one great virtue of our country is that these are independent agencies with independent authority, and they have independent traditions, and they have things that they want to defend and protect. And we all respect that. But our job, the committee's job, the Congress' job is to figure out what is right for the country. And I think, again, we had a test of whether that system works, and it didn't work.

Ms. WATERS. Okay. Well, finally, let me just ask you one question about the plain vanilla products. You support coming up with what is described as "plain vanilla" products. How important do you think that is to the Consumer Financial Protection Agency's work?

Secretary GEITHNER. Look, our judgment, in shaping these recommendations, was shaped by the, sort of, simple proposition that consumers should be given the choice of opting for a simple 30-year fixed-rate mortgage, for example. Now, they shouldn't be restricted from the ability to do something different that better meets their needs, but that should be one of the options they are able to choose. And we want to make sure the system as a whole does a good job of providing that choice.

But there has been a lot of concern that if you invest the government with the ability to decide what is appropriate here and what is there, that is going to lead you to the point where you actually have less competition and choice.

We have been open to many suggestions many people have raised that you find a way to have stronger standards without creating the risk that, over time, you are going to see a bunch of bureaucrats, frankly, narrow legitimate choice and restrict competition.

So, as I said earlier, I think the chairman's proposals that I have just had a chance to read very briefly are, I think, a pragmatic, helpful way to make sure that you have a better balance of choice with protection.

Ms. WATERS. Thank you very much.

Mr. GUTIERREZ. Mr. Hensarling, you are recognized for 5 minutes.

Mr. HENSARLING. Thank you, Mr. Chairman.

Mr. Secretary, I am hearing some things that are somewhat surprising to me, so I want to make sure my ears do not deceive me. I am sorry that Chairman Frank isn't here; I know he went to another hearing.

I thought I heard Chairman Frank say that, essentially, his vision of the resolution authority would constitute a death panel and end in dissolution. And then I thought I heard you say that you would not necessarily use the chairman's language.

So does that mean that—

Secretary GEITHNER. I only meant the phrase "death panel."

Mr. HENSARLING. Okay. So—

Secretary GEITHNER. But on the objective and strategy—

Mr. HENSARLING. But under the Administration's plan, then, a conservatorship versus a receivership would still be on the table. Is this correct?

Secretary GEITHNER. Oh, absolutely.

Mr. HENSARLING. Okay. It appeared that the chairman was going in a different direction.

Secretary GEITHNER. But let's make sure people understand what the choice is. Remember, what we are proposing to do is to take a regime that was set up, a process that was set up for small banks and thrifts that existed for more than 20 years, set up in the wake of the S&L crisis, to make sure the government has the ability to come in and act to help restructure—

Mr. HENSARLING. I think we understand—

Secretary GEITHNER. —without costing the taxpayer.

Mr. HENSARLING. We understand that, Mr. Secretary.

Secretary GEITHNER. No, but this is really what is important.

So what we want to do is take that model and apply it to the largest institutions in the country, so that the taxpayer is less exposed to risk in that context.

Now, without that authority—

Mr. HENSARLING. Wait, Mr. Secretary, I am sorry, I have a limited amount of time. I understand the point.

Something else that I thought I heard you say—I actually am somewhat confused after your answer to the gentlelady from California. Are mandatory, standardized products, also known as plain vanilla, are they on the table or are they off the table?

Secretary GEITHNER. Those are a part of what we proposed in both our broad recommendations and our detailed legislative language.

But, as I said, Congressman, we are very committed to trying to make sure that we find a balance that gets better protection for consumers without limiting choice and competition. And there are different ways to do that.

Mr. HENSARLING. I understand that, Mr. Secretary, but it is a fairly simple question. In the original language that the Administration submitted, it has mandatory standardized products. I am just trying to ask, is that off the table? Are you now indicating there are other approaches?

Secretary GEITHNER. Yes, absolutely.

Mr. HENSARLING. Okay—

Secretary GEITHNER. But hold on. I would say that, again, these are judgments the committee is going to have to work through. And, as I have said and we have always said, there are different ways to find this balance.

But what is important—and I think you can see a test of this in the credit card bill that this body passed a couple of months ago—of an approach that tries to find a balance, that does not limit choice, but gives better protection. The question is how best to do it.

Mr. HENSARLING. Let's speak about balance for a second, Mr. Secretary. In your statement earlier today, you said that the Administration's proposal addresses core regulatory failures and weaknesses that directly contributed to the crisis and the dangers that could lead to the next one.

As many of us look at your proposal for a CFPA, we see something that is very broad, very Draconian. As we read the legislative language, is it not true that ultimately Wal-Mart, Target, and Macy's could be subject to regulation by the CFPA?

Secretary GEITHNER. Let's do the simple objective and the simple imperative we share, okay? Which is, if you are in the business of providing financial credit, that is your business, and you are competing with banks and thrifts who do that, there should be a common set of basic standards and protections.

If you don't do that, then we will have again what this country went through over the last 5 years. Because what you will do is allow one set of institutions to be subject to these rules, and all risk and activity will migrate to where there is no protection.

Mr. HENSARLING. Okay, Mr. Secretary, I understand the rationale. But does that mean the answer is yes, that ultimately Wal-Mart, Target, and Macy's, if they offer credit, can come within the regulatory ambit of the CFPA?

Secretary GEITHNER. Well, one of the great virtues of our system is these are judgments the Congress of the United States has to make and this committee is going to have to work through.

Mr. HENSARLING. But the language—I am asking you, Mr. Secretary—the Administration's language—

Secretary GEITHNER. What we proposed is straightforward, black and white. We proposed it, and it is on the table. And, as I said from the beginning, we welcome the chance to work with you—

Mr. HENSARLING. So if these firms are engaged in the marketing of consumer financial products or services, then they could come within the regulatory ambit, not unlike Starbucks, Chili's, Applebee's, rental car companies, Avis, Budget, Enterprise—

Secretary GEITHNER. Congressman, I understand what you are doing. It is a reasonable proposition, the approach you are trying to take.

But let's do the basic imperative. If you allow institutions that are essentially doing what banks do to compete with banks with no adult supervision, no constraints, and are free to engage in unfair practices, then you will recreate again—

Mr. HENSARLING. Do CPAs compete with banks?

Mr. GUTIERREZ. The time of the gentleman has expired.

I recognize myself for 5 minutes.

Secretary Geithner, a year ago, you were—Mr. Paulson and Mr. Bernanke, Lehman Brothers was about to collapse and go into bankruptcy. How much did the 30:1 leverage have to do with Lehman Brothers and its collapse?

Secretary GEITHNER. Central to their vulnerability, AIG's, Bear Stearns's, broad swaths of the rest of the financial system, was excess leverage allowed to build up without constraint.

Mr. GUTIERREZ. And when the Securities and Exchange Commission was visited by the Wall Street heads from many of the same companies you just referred to, and I think it was in 2005, and they said, listen, we really like not to leverage 5:1 and 6:1, but 30:1, how significant was the decision by the Securities and Exchange Commission to allow that practice?

Secretary GEITHNER. Well, again, it was very significant. The biggest part of the failure of our system was to allow very large institutions to take on leverage without constraint. And that is what really causes crises, what makes them so powerful. And that is why a centerpiece of any reform effort has to be the establishment of more conservative constraints on leverage applied to institutions whose future could be critical to the economy as a whole.

Mr. GUTIERREZ. And I ask you that because that is what I thought, and I just wanted to see if we agree that this leveraging of 30:1, which was actually authorized by the Securities and Exchange Commission—you have never worked at an investment banking firm, though, right, on Wall Street?

Secretary GEITHNER. I have not had that privilege, no.

Mr. GUTIERREZ. Well, that is good. Because it was always interesting to me the kind of dynamics, as you were running through this, that Secretary Paulson headed up Goldman Sachs, and he was there trying to figure out how this leveraging was going to get unleveraged, the same leveraging that he went to the Securities and Exchange Commission. I want to make sure that never happens again, that we don't have people in this kind of situation.

So tell me exactly what we are going to do different that isn't—okay, you are the Secretary of the Treasury. How are we going to make sure that another part, the Securities and Exchange Commission or somebody else, doesn't go and do something like this that then corrupts your ability, undermines, corrupts your ability to keep the financial markets in check?

Secretary GEITHNER. You have to ensure that any institution that poses that kind of risk to the country is subject to conservative constraints on leverage. There is no other way to do it.

And, alongside that, you have to make sure you have the capacity, if they end up making mistakes that will threaten their viability in the future, that they bear the consequences of those mistakes without threatening the stability and the health of the rest of the economy, the rest of the innocent victims out there in the economy who were responsible—

Mr. GUTIERREZ. And I probably failed to ask, so how do we stop—as you see this, we are done. We are done with our work. The President signed the bill. It is going to happen, much to the chagrin of my friends on the other side. They will do everything—two of them already brought up that maybe you and Barney Frank

disagree about the vanilla envelope. That is the opening thing, divide and conquer. It is not going to work. The plain vanilla envelope, two of them have brought them up. That is the new thing. That is the headline, "They Disagree." Hopefully, it is also going to say, "Secretary Geithner Doesn't Bite," because I think that would be a mistake and lead us in the wrong direction.

So how do we make sure that you or someone has the power, the ability, the oversight, the capacity? You see that in the bill that is signed by the President?

Secretary GEITHNER. It is central. Without that, nothing will work.

Again, I think in many of the concerns you have expressed on this side of the aisle, but also on your side of the aisle, are concerns about the threat of moral hazard. The question is how best to prevent that. I think what we learned from this crisis is you can't expect the market to constrain excess leverage and you can't fix a problem by hoping it will burn itself out.

Mr. GUTIERREZ. Let me just ask, so how is it that we lost trillions of dollars, and how will it be different in the future? Because it is, like, mind-boggling to me, it really is, that trillions of dollars could be lost, that financial instruments could be sold on the markets. People bought these things, all right? And it is like nobody is going to jail. There hasn't been a grand jury investigation. You know, like, nobody is doing serious jail time. I can't believe that all this happened. And, I mean, for nickel-and-dime stuff in the neighborhood, they will call a grand jury. And this is stuff that has really caused a serious harm to our economy, and trillions of dollars have been lost, and there is no one going to jail.

I just want to make sure that, as we look at this, we put some police and we police this. Because, you know, I believe in cops on the beat. I think we need some cops on the beat around Wall Street, too, lots of good, smart cops who are going to help you and others enforce the law. Because I have a funny feeling the law is only as good as the number of policemen that you put on the beat to make sure the law is enforced and you put people in jail when they violate the law.

That is the end of my time. We will now recognize Mr. Garrett for 5 minutes.

Mr. GARRETT. Thank you, Mr. Chairman.

Thank you, Mr. Secretary.

You know, Mr. Secretary, I just heard you say something that actually harkens back to last time you were here, and that is talking about the goodness of having independent agencies and regulators out there on the one hand, but on the other hand that you sort of expect them to take the actions that they did. Because that was actually something that you said, and I remember what you said, that institutions have this authority to regulate, and they are not enthusiastic about giving up that authority. They would just defend their traditional prerogatives of their agencies.

And I think, frankly, all arguments need to be viewed through that basic prism. We will have a hearing later on, and I guess that is the prism where we will have to take their testimony at that point in time, that they are doing it just to represent their own turf

as opposed to what we are looking to you for, for the benefit of the country.

One of my opening comments was the timeline, and you heard that whole perspective. Very quickly, with the immensity of this issue, the complexity of the problems, is it realistic that we can resolve all this and all of our differences in the next 7 weeks and get it done and get it done right that would not have any negative consequences in the future?

Secretary GEITHNER. Again, that is a choice you are all going to have to make. I think it is realistic. But let me just say what the consequence of the alternative is. I am very confident that, if you decide that you are going to do this over a protracted period of time—

Mr. GARRETT. But "protracted" could just be into next quarter or something like that.

Secretary GEITHNER. Well, that is what people will say. But there is a huge risk that it will just make it harder, because people will say, "Gee, it seems kind of hard. Let's not take this on. It is difficult. The crisis receded. Things aren't going to be so bad." I think that is a huge risk.

Mr. GARRETT. I understand. I appreciate that.

Let me ask you about another issue, which obviously was happening during the heat of the moment, and that is back in the situation with the Bank of America situation and the SEC Bank of America case. Obviously, I would assume that if Bank of America was working with the Fed and the Treasury at that period of time, I would have assumed, but you can tell me if I am wrong, that you all would have been talking with Bank of America as to what they could and what they couldn't do with regard to the Merrill Lynch merger.

Do you remember anything about those conversations as to what they should or should not be doing and what they should or should not be disclosing at that period of time? Do you have any recollection of that?

Secretary GEITHNER. As you may recall, that happened at a time when I had been nominated by the President to be Secretary of the Treasury and I was pending confirmation. And so, throughout that period of time, I did what was the necessary and appropriate thing, which was to recuse myself from any engagement in any individual—on not just monetary policy, but any individual discussion with those firms.

And so, although both the Secretary and the chairman occasionally gave me a little update on where they were going, I was not party to those discussions.

Mr. GARRETT. Okay. So any information that they gave you, was any of the information that they gave you indicative of those issues that are now before the SEC, as far as what Bank of America should or should not be doing with regard to disclosure? I know you may not be sitting in at them, but as far as the information that was given to you?

Secretary GEITHNER. No. I would say that what they did is what I think was appropriate, given that I was being considered for this job, was to make sure I was aware of the broad choices they were facing in terms of whether and what it was going to take to make—

Mr. GARRETT. So is that a no?

Secretary GEITHNER. Well, again, I think that, as I said, what they did was, again, appropriate, which was to give me the occasional sense of what they thought they were going to be bequeathing me.

Mr. GARRETT. Was that a no?

Secretary GEITHNER. Well, again, I am trying to be fair to—

Mr. GARRETT. Well, either they talked to you about it or they didn't talk to you about it.

Secretary GEITHNER. Let me say it this way. The issues that you raised that are central to the discussion of the SEC were not part of my discussion with them.

Mr. GARRETT. Okay, so that is a no. Was not essential to the—so that is a no.

Secretary GEITHNER. No, that is what I said, Congressman, which is that the issues that you raised were not part of or not central to what they—

Mr. GARRETT. I don't really care whether they were central or tangential. Was that part of the discussion at all?

Secretary GEITHNER. I would really be happy to talk through this as long as you want.

Mr. GARRETT. I only have 5 minutes. So, yes or no? Was it brought up with you and discussed with you at any way, shape or form; yes or no?

Secretary GEITHNER. Not the questions of disclosure, no.

Mr. GARRETT. Thank you.

Now in the last 30 seconds to get into the meat of some of the derivative aspect. The derivative language that you have does not have exemptive authority in it, which raises some real concerns for some folks out in the industry in saying that your language has to be finite and clear enough and explicit enough in not giving the regulators that flexibility to use. Do you believe—are you with me open that? Do you know what I am saying?

Secretary GEITHNER. I agree that you want to make sure that you get, to use a phrase, the right balance and you don't have—you don't have sort of, how should I say, exploitable loopholes that allow the complicated risky stuff to shift where there is no oversight, and that is a challenge.

Mr. GARRETT. So you think it is flexible?

Mr. GUTIERREZ. The gentleman's time has expired.

The gentlelady from New York is recognized for 5 minutes.

Mrs. MALONEY. Thank you.

Welcome, Mr. Secretary. And we appreciate your coming to testify before us as we work to enact some of the most sweeping financial service reforms in decades.

First, I would like to publicly acknowledge and thank you for your leadership and efforts to help pass the credit card reform bill. It was very valuable and greatly appreciated.

I would like to join the chairman and my colleagues on both sides of the aisle who have raised questions about the "too-big-to-fail" designation, and by designating these tier-one financial holding companies, aren't we in essence saying that they are "too-big-to-fail?" And I am concerned that with this designation and the perception of a government automatic bailout, these firms will take

more risks. And even though we will be limiting their leverage and requiring larger capital requirements, it still is a huge taxpayer guarantee to have a "too-big-to-fail."

And my question is, aren't there some activities that are so risky and do not have any public benefit that should be not part of an institution that has a government guarantee? And I would say proprietary trading, which does not have a social benefit, it is basically making money for that particular firm, as opposed to—why should that have a government guarantee? It is often risk-taking and very profitable, but why should people be able to make a profit, and then when bad times come, get a bailout?

Former Treasury Secretary Volcker has also talked about the concept of having certain government guarantees that we have in the FDIC and for necessary parts of commerce, such as insurance and commercial banking, but not having the guarantee for risky behavior, such as credit default swaps and derivatives. Let them go off in the corner and take all the risks they want.

I would never want to hamper the free market system, but why should it have a government guarantee? And I use the example of one of the most successful companies in the country that was in my district; I was very proud to represent AIG, one of the greatest insurance companies in the world, probably the greatest one, brought down by risky behavior from another division in the bank. Wouldn't it have been better to let the risky behavior be off in the corner, not have the guarantee, not having it pull down a great company and not costing taxpayers now $185 billion?

But I do want to note that the TARP money is being paid back at a 17 percent interest rate, so the taxpayers are recouping their money. And I am proud that the private sector is bounding back. But my question is, why should we be giving a government guarantee for risky behavior that does not have a public benefit? Insurance has a public benefit. Commercial banking has a public benefit. Why should we be giving a guarantee to risky behavior? Shouldn't we separate it out? That is the proposal put forward by Mr. Volcker. I think it has sound sense.

Secretary GEITHNER. I think we agree with you. And we are not proposing, would not support, even if you wanted to, providing a guarantee to those institutions or to that kind of behavior. It would be irresponsible to do it. We would not consider it. We would not contemplate it.

Mrs. MALONEY. Even proprietary trading?

Secretary GEITHNER. Of course not. And nothing in our proposal would provide that kind of guarantee.

Mrs. MALONEY. Would that be separated out?

Secretary GEITHNER. But again, you are absolutely right; it would be a bad thing for the country.

Mrs. MALONEY. But if it is allowed to be part of the bank, that can pull it down. So it has to be separate.

Secretary GEITHNER. Well, that is a slightly different question. About the guarantee thing, again, it would be a mistake, and we would never support providing a guarantee for the institutions or for particular types of those activities, would not do it.

Mrs. MALONEY. Great. On the toxic assets, could you comment on how we are progressing? Are we being successful? Have investors

used the PPIP program to purchase these toxic assets? How much of a challenge is it? Is it moving away from our banks? Is it still there? Could you comment on the taxpayer assets?

Secretary GEITHNER. Absolutely. Toxic assets are a problem for any financial system if banks don't hold enough capital against those losses and if they are unable to raise capital because the market doesn't understand the risk in those banks. And if you measured against that, you have seen dramatic amounts of new capital coming into the financial system because of disclosure in some sense we force in the system. The markets for those kind of real-estate-related loans and securities are beginning to improve. The prices have increased. There is more liquidity in part because of the programs we have set in motion.

But we are just on the verge now of making the initial allocations of capital to the fund managers, and we have some authority to come in and buy those securities. But, again, the suite of these programs has already had a pretty important impact on liquidity and price in those markets, and things are starting to improve. But the best measure of this is, again, the amount of private capital that has come back into the financial system because of the disclosure we forced on the major institutions.

Mr. GUTIERREZ. The time of the gentlelady has expired.

Congressman Neugebauer, you are recognized for 5 minutes.

Mr. NEUGEBAUER. Thank you.

Mr. Secretary, good to have you again. I want to go back to something that is really bothering me and that is that I hear you have said on numerous occasions now that the Treasury—I mean, that some of these regulators, FDIC, the Federal Reserve, all of these various regulators that disagree with you on this Consumer Protection Agency, and you keep stating, well, the reason they disagree with me is they are just trying to protect their turf.

Secretary GEITHNER. I didn't say it quite that way. I was a little more delicate in how I said it. There are principled reasons for disagreeing with any proposal as you know.

Mr. NEUGEBAUER. Why don't you let me get to my question.

Secretary GEITHNER. I am sorry.

Mr. NEUGEBAUER. I think you were a little bit more clear in that meeting with them about how you felt about—I understand that you had some remarks to make to them. But I think the question here that—we have a number of people who are in regulatory positions here who are supposed to be smart people, supposed to be experienced people, supposed to know what they are doing. They are telling you that, for example, the FDIC says that these changes would be very disruptive in the agency's operations during a very critical time. The OCC says its exam is conducted in integrated exams, but the CFPA could not make supervisory recommendations to the banks to influence consumer compliance.

So, Mr. Secretary, I get concerned that either these people are incompetent or maybe you are not right. You are saying they are wrong, and you are right, but we have four people, and there are others who say they think this is not a good process. And so I think we have to be very careful about if we don't have competent people in place in these agencies and—because you think that they are not

looking after the best interest of the country; they are looking after their turf, then that is a very serious charge.

Secretary GEITHNER. Well, I think it is just a simple observation.

And let me just say, I have great respect and work very closely with all of those people, and they are doing an excellent job under very exacting circumstances.

But if you were in their shoes and if I was, I would be making the same basic arguments. And there is principle in those arguments. It is not an unreasonable point for them to make. But you have to view it for the basic imperatives that they are defending instead of traditions and authorities that they have lived with for some time that they are comfortable with.

But the basic—I cannot say it more strongly than this: How did it work in practice? Did it do what it was designed to do? And I think there is no basis for claiming that it worked. That is the only one way I can say it, which is a simple thing. We had a chance to see how it worked over decades, and it did not do what it was designed to do.

Now, it wasn't simply about how they exercised their authority because large parts of the system were outside their authority. And that made it harder for them in that context. But that is why I think you have to look back and step back and try to do something more fundamental.

Mr. NEUGEBAUER. I think the other question, too, you have to determine exactly what part of this of what happened in the past was actually attributed to the consumer part of it, and because you are making a very radical change when we really haven't really sat down I think and done the proper autopsy to determine how much of the activities happened because of inadequate or lack of consumer protection.

Secretary GEITHNER. I think it is actually kind of simple and stark, and if we understand one thing, I think we understand that. To say it simply, where there were rules, they were weak and enforced, but there were large parts of the system without rules. And that is not a tenable balance for any system.

Mr. NEUGEBAUER. I want to go back to the derivatives issue because we have had a number of companies come and testify or come and see I think individual Members of Congress and are very concerned about the proposals. These are companies that use these derivatives to hedge risks that they are not able to cover in other ways. And now that even though with the exemption, many of these are going to be—meet the eligibility requirements of the clearinghouses and so they are concerned they will not be able to use the exemption. And many of them say that with that factor and having to put up larger amounts of cash margins, they will not be able to actually hedge those risks. What are you proposing to make sure that we clarify this because this is a serious issue?

Secretary GEITHNER. I completely agree with you and I think you are right to point out and they are right to point out that there are companies that make things and sell things that people need, that need the capacity to manage their business that allows them to hedge risks, and not all those things will be met, needs to be met through a simple standardized product that is traded on the exchange.

So preserving that is important. But the challenge for us is to make sure that in preserving that, we don't create a large loophole that allows all that stuff that needs oversight to migrate to where there is none.

The CHAIRMAN. The gentleman from New York, Mr. Ackerman.

Mr. ACKERMAN. Thank you, Mr. Chairman.

Mr. Secretary, I have two issues I would like you to comment on this morning. The first, many of us place a very large share of the blame for what happened in the secondary mortgage market squarely on the shoulders of the credit rating agencies. Quite a few firms and many pension funds essentially outsourced their own due diligence responsibility to these credit rating agencies. The biggest of them are called nationally recognized statistical rating organizations; that approval bestowed upon them by the SEC. And there seems to be in reality no qualifications for that other than that they have a big share of the market.

Very often, these particular agencies got it wrong. In many instances, they have conflicts of interest. They got it wrong with complete immunity, and many investors, because they had this apparent government seal of approval—sort of was like the rabbi's seal of being kosher. I don't understand if some of them aren't really acting as honest brokers. What is the purpose of that title that they have? Is that counterproductive and misleading, and could you tell us something about the Administration's intentions when it comes to dealing with this issue?

Secretary GEITHNER. Thank you for raising that. You are right; it was central to the failures, and the failures this time around were much worse than you saw in the failures of ratings in the past, much more damaging.

The SEC I think released just—or is about to release or just released a set of broad recommendations for trying to address many of the problems you referred to, including reducing the risks that there are conflicts of interests or incentive problems that lead them to—or create greater risk of these ratings being wrong in the future.

But in addition, we have suggested that we try to eliminate what we call rating dependence in the regulatory capital regime and other parts of the regulatory system, so we are not creating greater incentives for institutions to rely on these ratings. And as the chairman has proposed and many others have considered, we think a critical part of the reform of securitization markets generally is to make sure that people who sell these securities retain some of the risk in them. And that will help get the incentives right. And, of course, as always, we are open to suggestions of how to make sure we strengthen these reforms over the rating agency process.

Mr. ACKERMAN. I will send you my suggestions.

The second issue that I would like you to address is SIPC. It has been over 9 months since Bernie Madoff discovered that he was a crook and turned himself in. There are 10,000 claims that people who have lost their dignity, their wealth, their security, their homes, their family and whatever is left. SIPC has contracted out a lot of their work. One of the contractors just lost a computer, or it was stolen or whatever, and 2,200 victims' files are now in the hands of we-don't-know-who.

The problem here is that, of the 10,000 claims that have been filed, only 543 as of July have been paid. That means 95 percent of the people are just hanging out there absolutely desperate in most cases. How are investors supposed to have confidence in what is going on if SIPC can't process the claims faster and make these people whole with this insurance policy that people believe they have?

Secretary GEITHNER. Congressman, you are right; it is tragic and unfair, and the scope of damage caused by that fraud is just extraordinary. And I would welcome a chance to come talk to you or your staff or have us, with the SEC, walk you through what we can do to make that process work better, not just in this case but—

Mr. ACKERMAN. I want to do that. But just tell me now there is a plan to speed this up somehow. When we couldn't get the checks out to the auto dealers quickly enough, we found a way of doing that. Can we speed this up?

Secretary GEITHNER. Again, I would be happy to work with the SEC and the other members of the board of SIPC to try to figure out how to do that.

Mr. ACKERMAN. I yield back the balance of my time.

The CHAIRMAN. In the 20 seconds the gentleman had remaining, if he would yield them to me, one of the items that I believe should be on the agenda of the committee next year, and of course the agenda of the committee is not something on which I have no influence, is looking at the degree of protection people get from the SIPC over and above Madoff. It is clearly inadequate to the expectations, to the role that it has played and I would hope in a bipartisan way we could look at expanding investor protection next year. And we will—that doesn't relieve the current issue, but it will be on our agenda for next year.

The gentleman from Delaware.

Mr. CASTLE. Thank you, Mr. Chairman.

Mr. Secretary, according to all the news this morning, yesterday there was a discussion draft of the Consumer Financial Protection Act distributed by the chairman of our committee to the Democratic members of the committee. My question to you is, were you or the White House in some way consulted about that, and are you familiar with it at this point?

Secretary GEITHNER. The only thing I have seen is a 2-page note that the chairman circulated, which as I said earlier, I had a chance to look through briefly. And we were not consulted in advance of the note itself, but we have been spending a lot of time, both sides of the aisle, walking through a range of concerns and questions people have raised with the legislative language we have proposed.

Mr. CASTLE. I hope it will be fair to ask if you could comment, perhaps in writing, at some point on that. Obviously there are some major, according to what we are reading, some major aspects of change there that we would be interested in your views on them. I would like to—

Secretary GEITHNER. I would be happy to do that. But as I said, I think the broad thrust of those proposals looks very encouraging and promising to us. And there is nothing in there at first glance that troubles me significantly in terms of its practical value.

Mr. CASTLE. Along the same lines, worrying about the CFPA, I am concerned about the whole mission creep aspect of this. There are clearly problems, and you are absolutely right; I think we all agree there are things we need to do. I am concerned about mortgages. That could have been spelled out better. We have already dealt with credit cards to a degree, and the Federal Reserve actually had a good plan on credit cards, which we pretty much emulated to a degree. And there are subjects like student loans, which may go by the wayside if the new legislation on direct lending goes through the Senate, etc. But there are many things that financial institutions, particularly banks, do that have not been questioned in terms of how they carried out—commercial lending, I don't think, has been questioned; the way they handled deposits, for example, even auto loans. And you could go through perhaps 10 or 12 subjects. And I am concerned that if we get a very activist agency, that the agency may go beyond where it belongs and all of a sudden be disruptive to normal banking procedures in the United States. I cannot tell you what percentage of customers were actually impacted negatively by problems that perhaps could have been prevented. My hunch is it is a relatively small percentage, versus those satisfied with their banking. But at agencies like this concerns me and the authority that we are giving them. Do you have any thoughts about how to restrict what they could do, other than, obviously, we could do it legislatively, or are taking that up with the Administration as you prepare—

Secretary GEITHNER. I agree. I think the legislation has to make sure that it is clear what authority they have and do not have. And one thing we proposed is to make sure they have a board as a check and balance against that risk that has on it representatives of the supervisors and others who have a stake in this. And I think you are right to point out the risks that we overdo it at this time. That was not the failure of the past.

The past was probably we under-did it, and that did cause a lot of damage and does put at risk potentially a lot of what was desirable, healthy productive economic activity by financial institutions. So I agree with your concern and I think there are lots of different ways to make sure that you don't create too much unbridled authority that would be damaging to what is an important part of our financial system.

Mr. CASTLE. You can take this as a comment. And I heard your comment earlier about the regulators who exist now and the question is, how good a job did they do? Did you know they were going to be testifying later this afternoon? And more than one of them, at least three of them have made comments about particularly the CFPA that are somewhat critical and negative.

And I heard your response, which was, well, they are protecting their jurisdiction in what they are doing to a degree. But in just reading their comments, and I haven't heard what they are going to say this afternoon yet. I haven't read the comments this afternoon. It seems to me there are some constructive points in there, and I would hope the Administration is listening to that, not necessarily in terms of doing everything that they are requesting, but listening to constructive comments that could help as far as consumption and the use of banking products is concerned.

Secretary GEITHNER. Absolutely. Again, as I said, our test is what is going to work.

Mr. CASTLE. Exactly. Very quickly on another subject that I think Congresswoman Maloney brought up which is the whole TARP business. We are at about the 1-year anniversary now of the enactment of the legislation on the TARP. As we know, it wasn't used quite as we expected it to be used. And some concerns remain, as expressed by the recent Congressional Oversight Panel report that these toxic assets still exist on the balance sheets of financial institutions. And you talked about this to a degree.

You indicated, with capital improvement, etc., prices are improving, and it is better at this point in time. But I am not sure where the public-private investment program currently stands on where we are in that area. I think I have run out of time. If you could submit that in writing, I would appreciate it.

Secretary GEITHNER. Absolutely.

Mr. CASTLE. Perhaps we can share it with everybody here.

Secretary GEITHNER. Absolutely.

Mr. CASTLE. I yield back, Mr. Chairman.

The CHAIRMAN. I thank the gentleman for that suggestion.

And if we haven't already said it, we will have general leave, without objection, for anybody to submit any documents they want. And the Secretary has always been very good about responding to questions. So any supplemental questions people have, we will get.

The gentleman from California, Mr. Sherman.

Mr. SHERMAN. Thank you, Mr. Chairman.

I know you can justify just about any transfer of power from Congress to the Administration by pointing out that you and your successors are patriotic, cautious, and no matter what power we give you, you would only use it in the best interest of Americans and only under emergency circumstances. That being said, I take a look at section 1204 of the legislation you have proposed and can only describe it as TARP on steroids. When we passed the TARP bill, we limited the Administration to $700 billion. Section 1204, unlimited, we limit it to a certain number of years. Section 1204 is there forever. In the TARP bill, we provided that if the taxpayers lose any money under certain vague provisions, you should go get that flown somebody in the financial services industry.

None of us think that is going to happen because—but in any case, it is in TARP and a similar provision is in the legislation you proposed.

In TARP, there are all kinds of special oversight, including Elizabeth Warren. In your proposal there is no special oversight. And in TARP, those institutions that benefit have all those—have at least some restrictions on executive compensation. In your proposal, there are no such restrictions. Now, section 1204 allows the FDIC to go spend an unlimited amount of money buying the debt obligations of, making loans to or assisting any systemically important institution in time of trouble? And that is in the first instance taxpayer money? Would great harm be done to this statute if we limited the Executive Branch's authority to a mere $1 trillion and said that if you want to commit more taxpayer money than that, notwithstanding the fact that you hope to get it back from someplace else, but if you need more than a trillion, perhaps you ought

to come to Congress? Or is there an assumption on Wall Street that Congress makes the wrong decisions, is a bunch of people who cannot be trusted and that Wall Street cannot be safe unless they have access to unlimited funds without further congressional action beyond that which you propose?

Secretary GEITHNER. Congressman, I don't recognize most of your concerns in the approach we recommend. But I understand the concerns. And I think you are right to point out, as are many of your colleagues across the aisle, that it would be a mistake for us as a country through the reform process to harden or create an expectation that if you get yourself in trouble, that the government is going to come in and save you—

Mr. SHERMAN. Mr. Secretary, I have such limited time. A trillion dollar limit, okay with you, not okay with you?

Secretary GEITHNER. Congressman, again, you are taking a—first of all, you are fundamentally mischaracterizing.

Mr. SHERMAN. Let us say I am fundamentally mischaracterizing. If I have an amendment to this section saying it is limited to a trillion dollars, is the Treasury going to oppose that, or are they going to support it?

Secretary GEITHNER. Congressman, it is important to make people understand and make sure people understand the following thing, this Congress put in law, after the S&L crisis, a very important authority to allow for resolution—not a great word.

Mr. SHERMAN. Mr. Secretary, I have asked you a simple question. I have very limited time. Would you support it or oppose it? And then let me move on.

Secretary GEITHNER. I would not support proposals that would put this country in the position we were in, in 2007 and 2008, where we did not have the ability to act to protect—

Mr. SHERMAN. The key thing then is that the Executive Branch have the power to commit, not just $700 billion, but a trillion or more without having to have Congress be involved at the time of the crisis.

Secretary GEITHNER. No. That is not—would not be a fair description of our strategy. And again, the critical test is, do you want to put this country in the position again where we come into the worst financial crisis in generations without the ability to protect the taxpayer—

Mr. SHERMAN. Reclaiming my time. The problem for Wall Street is that Congress had to be involved. It was embarrassing that they didn't get their money for a few days.

But let me focus on the one other question, and that is the only companies that are ever going to benefit from this are the systemically important institutions.

Secretary GEITHNER. No, that is not true.

Mr. SHERMAN. Well, it is limited to systemically support—

Secretary GEITHNER. Look, the only rationale, Congressman, and you think that the experience of last year would make this compelling to people, that if your strategy—

Mr. SHERMAN. In order for a company to benefit—do you want to look at Section 1203(b) 1 and 2 of the statute you presented?

Secretary GEITHNER. You are mischaracterizing the benefit.

The CHAIRMAN. The gentleman's time has expired. The gentleman has one last comment.

Mr. SHERMAN. I would say, you can claim that all Americans benefit from a provision that can only help about 20 institutions, but they will have a release of their moral—an elimination of moral hazard. They will have lower cost of capital, and either the taxpayer will pay or the medium-sized banks will pay if it is ever used. I realize—

Secretary GEITHNER. I hear your concern. But if we were proposing that, I would not support it. If you proposed that, I wouldn't support it. But you are right about the concern. The question is about how to get the balance right. Look what happened to the country when we allowed a system to build up where we had no choices in the event of failure between stepping in or letting it cause enormous damage.

The CHAIRMAN. The gentleman's time has expired.

The gentleman from Oklahoma, Mr. Lucas.

Mr. LUCAS. Thank you, Mr. Chairman.

And Mr. Secretary, let us come at this from a slightly different perspective but along the lines of my colleagues. You have used the phrase "in practice" several times, and I appreciate that tremendously because this is not just an academic exercise; there are practical consequences to everything we do.

My constituents, small financial institutions and what some would define as nontraditional institutions out in the countryside are very nervous about the Consumer Protection Agency bill, and their nervousness is not I think so much about protecting the consumer. They all support that.

But there is a fear out there in the countryside, and this comes before Chairman Frank's memo, there is a fear out in the countryside that the biggest institutions in this country with larger staffs, with greater budgets, with greater volumes of business will have the ability to meet these standards in a more cost-effective way than they will be, and that the ultimate net result, at least of the Consumer Financial Protection Agency, as envisioned by the Administration, will be to raise their cost disproportionately to the bigger institutions.

And they are very concerned about that out there. That is an issue I think we need to address as we move through this process.

And to touch on a slightly different subject and then whatever comments you might have, sir, on the derivative side of the equation, sitting on the Ag Committee, we have a little bit of involvement in those issues. I have a number of constituents and constituent industries back home in Oklahoma that use these kind of products to provide some sort of price stability for the commodities they sell over the period of time. Otherwise, they are a day-to-day—a day-to-day price, and that is a very difficult thing to do. They have expressed extreme concern to me, and I think there is some legitimacy to this, depending on how in the Administration's proposal we address these capital and margin requirements, they are concerned, and I think legitimately, that potentially they will be driven, because they still need the price stability—they have to have the product—if we dramatically increase capital margin requirements or place them in a fashion that is counterproductive,

they will be driven to the biggest financial institutions because they will have to have someone who can afford to not only engage in the contract with them, but who can finance all these other options. Once again, the fear being, Secretary, that they will wind up having fewer people to do business with, and it will be a small handful of the biggest, which runs contrary to I think what we have been saying on this side of the aisle, which is "too-big-to-fail" is unacceptable, untenable, and yet there are real concerns out in the countryside that these pieces of legislation as proposed will drive more business to the biggest, will put the biggest at an even greater advantage over everyone else. So let's visit for a moment about the practical consequences about these issues.

Secretary GEITHNER. I understand both concerns, and I agree with much of what you said about them. On the cost issue for community banks, we think we found a way, but I think the chairman's notice helped with clarification on this to give people reassurance that we can do this change in authority, reallocation of authority, without increasing costs.

I think that is an important thing to do. And I think that is achievable. Again, it is not that there are no people in the country who are doing this job now. It is just that they spread across a range of agencies, and we want to take that authority and consolidate in a place where it can be done with less distraction. But I understand the question. I think that is the concern.

I think we can achieve what is important to you and to those community banks. On the derivatives thing, you said well, again, we very much want to make sure we preserve the capacity of people in many different industries to use derivative markets, to hedge and protect themselves against the risks they confront. And we have tried to provide a way that gives them comfort for that. But we are obviously happy to work with you and your colleagues and with the FTC and the CFTC on how to provide the clarification and the assurance necessary, because again, we want to preserve that.

Of course, the challenge again, as I said, is to do that without creating just a huge loophole that allows people to evade the basic protections we think the country needs. But I think you framed the concern right, and we are very much willing to work with you on how to do that.

Mr. LUCAS. Because, after all, Secretary, in my region, we went through both an agricultural and energy property boom, bust, and bubble in the 1980's. We were slaughtered economically. We did not receive capital injections. Our industries were not propped up. It took us, 10, 15 years in some segments to recover from it. We do not wish that on anyone else, but by the same token, let us not make the matter worse because the feud back home is, it was the big boys that damn near killed us all, not the little players.

Secretary GEITHNER. And I think you are right. The people who provide that protection, write those commitments, whatever the form is, they need to hold margin and capital so it allows them to meet those commitments. And that was the big failure in the system.

Mr. LUCAS. Thank you, Mr. Secretary.

The CHAIRMAN. The gentleman from North Carolina has returned from passing a bill under this committee's jurisdiction on the Floor. And he is now recognized for 5 minutes.

Mr. WATT. Thank you, Mr. Chairman.

I hope my colleagues will support that bill when it comes to a vote. Actually, we passed it by voice vote, so you all are not even going to vote on it, the Defense Production Act Reauthorization.

Mr. Secretary, my good friend, Mr. Lucas, was talking about practical considerations, and I am kind of into practical considerations, too. And I have been looking at this Consumer Financial Protection Agency proposal and how we got to where we are on account of a practical basis. It seems to me that we gave the Fed and the FDIC and the other regulators substantial consumer protection authority. Each one of them had consumer protection authority. But we also gave them an expectation, a mandate, just like the consumer protection "mandate" that we gave them to assure the safety and soundness of financial institutions.

And I guess my question to you is, you have been in one of these agencies. You came out of one of these agencies. You were with the Federal Reserve. If I look at you and tell you that your obligation is to assure the safety and soundness of the institutions that you have responsibility to regulate and I look at you and I say, okay, I am also going to give you the authority to do consumer protection, tell me, just as a practical consideration, practical consideration, which one of those things are you going to do come crunch time?

Secretary GEITHNER. Well, I think you say it right. The risk is if you have a range of different priorities, not one, than you are going to do less of a good job at focusing on the consumer side.

Mr. WATT. But what is your highest priority if you are the ultimate regulator for the safety and soundness of financial institutions? Isn't that far and away disproportionately a higher priority for you as a regulator in that scenario I just painted for you?

Secretary GEITHNER. That is the risk in combining those responsibilities in a bank supervisory—

Mr. WATT. You are being very kind when you say it is the risk. Actually, the Federal Reserve in a hearing had a witness up here that said that they really never thought of that as being on an equal plain with the mandate that they were given. It was kind of a second class authority that they had, but they never really thought about it until we got to this crisis. That is in testimony that we took before my subcommittee.

Secretary GEITHNER. I don't quite think that. I don't know who made—I wouldn't quite agree with that, because there are a lot of people who are good at this, who spent a lot of time looking at it, and it occupied an enormous amount of time.

Mr. WATT. I am sure that is true.

Secretary GEITHNER. But I think that the really important thing to recognize—I agree with what you are saying, but it was partly that. But a large part of it was the fact that there were all these other institutions that were allowed to compete with banks in providing credit that had no effective supervision, constraints, and oversight.

Mr. WATT. I am not minimizing the people who were outside any regulatory framework, but folks who were inside the regulatory

framework got involved in these things with regulators that had responsibility first and foremost for their safety and soundness which they didn't do a real good job of either, as it turned out, because of these bad consumer products. But even when they turned their attention to it, their primary focus was getting out of the ditch on safety and soundness and getting the economy back on an even keel. Even then, it really wasn't about consumers.

And it seems to me that if we are going to talk about practical considerations, the only way you are going to solve that practical consideration is to create an agency that goes to work every morning saying, my primary responsibility is to protect consumers. And if I run into a conflict between that and the safety and soundness regulator, then there is a mechanism for resolving that conflict, but there is no question what responsibility I have every day of the week when I go to work. Do you agree with that?

Secretary GEITHNER. I completely agree with you. I believe in accountability. You want people waking up every day, figuring out how they are going to do a better job in preventing this from happening in the consumer area.

Mr. WATT. Thank you, Mr. Chairman. I yield back.

The CHAIRMAN. The gentleman from Illinois, Mr. Manzullo.

Mr. MANZULLO. Thank you, Mr. Chairman.

Thank you, Mr. Secretary. Mr. Secretary, would you agree that the root cause of the financial collapse of this country was the fact that subprimes were not regulated too closely?

Secretary GEITHNER. No, I would say that it was one of a number of factors, but it was not the most important.

Mr. MANZULLO. But if people had not been allowed to buy homes they could not afford, that was the bad product in the first place; isn't that correct?

Secretary GEITHNER. I agree that is what—the basic—what happened to housing prices was partly facilitated by what happened to subprime mortgages made everything more perilous and worse. There were other things happening than simply the subprime.

Mr. MANZULLO. A lot of people believe that if the Fed had done its role, statutory role, which is to govern instruments and underwriting standards with regard to those mortgages, that we wouldn't have had this meltdown. In other words, the basic product that gave rise to the derivatives and the CDOs would have been sound.

Secretary GEITHNER. I don't think I would say it quite that way. Remember, as we just said, a lot of what happened in the system was that we allowed institutions to underwrite a bunch of stuff, sell a bunch of stuff to people who couldn't afford it. They were outside any scope of authority provided by the Congress with no effective deterrence. You can't look it quite through the prism of the authority that Congress gave the Fed and the other supervisors because of the absence of any authority over—

Mr. MANZULLO. No, I understand. But the Fed had the authority, did it not, to require, as it will beginning October 1st of this year, that there be written proof of a person's income when applying for a mortgage?

Secretary GEITHNER. Again, for the system to work—

Mr. MANZULLO. I understand it. But did I make the correct statement or not?

Secretary GEITHNER. Well, again—I don't think we are disagreeing. As I said many times before, I think the failure not just of the Fed—

Mr. MANZULLO. If we are not disagreeing, why don't you just say what I just said was correct?

Secretary GEITHNER. I believe that the system would have—this crisis would have been less damaging, there would have been less damage to the economy as a whole if authority had been stronger, used more effectively, used earlier by a bunch of other authorities.

Mr. MANZULLO. I understand. The point I am trying to make is the authority was there from the beginning with the Fed to stop the mischief.

Secretary GEITHNER. I don't think that is quite right. I think that you are right to say that if that authority had been used more effectively earlier, things would not have been as damaging.

Mr. MANZULLO. Well, call it not as damaging or whatever it was. Okay? The point I am trying to make is that the Fed had the authority—and actually, this was pre-Chairman Bernanke. By the time he got appointed, it was too late. But the Fed had the authority to come in and say, we are going to stop the practice of giving people mortgages when they can't even make the first monthly payment. They could have done that in two ways: getting rid of teaser mortgages, which is the instrument; and also saying that you have to have written proof of your earnings. That is where it started.

And I guess the problem that we are having is the very agency that had the authority to stop it, you want to give them more power. And—well, you do. You want to make the Fed the super regulator of all of this which you are proposing, going from a plain vanilla to what I believe is Rocky Road at this point.

Secretary GEITHNER. Let me say it starkly, what we are proposing is the clearest thing. We are proposing to take that authority away from the Fed and put it in an entity that we think we can do a better job of doing it in the future.

Mr. MANZULLO. I am talking about the super regulator.

Secretary GEITHNER. Again, that is not a fair description of what we are proposing.

Mr. MANZULLO. Call it—you can characterize it the way you want. It is giving the Federal Government more authority.

The CHAIRMAN. Would the gentleman yield?

I think there is a confusion. I believe my colleague is talking about the systemic risk function, and you are talking about the consumer protection function. And I think that is where the—

Secretary GEITHNER. Even on the systemic risk, the stability's function, which is so important, what we are proposing to give the Fed is the authority to make sure they can actually supervise and apply conservative capital requirements on these large complex institutions; they can make sure that the payment system, which is what spreads crisis, runs with tighter capital margin requirements. Those are important authorities that are not as clearly established in the law as we think is necessary. That would be a good thing for the country.

Mr. MANZULLO. I guess the point I want to make is, when you take a look at the 600 pages of legislation that you have proposed, if you take a look at Chairman Frank's memo today talking about

exempting different groups from this new Consumer Financial Protection Agency, to me it is going to be almost chilling for groups to know who is, in fact, regulating them. Banks right now are being chilled to give money because of oppressive tactics by the regulators. Good loans in the past have now become bad loans, because of the mixed messages coming from the regulators. And now there will be exemptions as to who is exempt from this new Consumer Protection Agency. I am glad lawyers are, auto dealers. It says accountants and other businesses that perform tax preparation services, but accountants that do business planning evidently would not.

So what you are proposing here are whole new sets of regulations, and the people, first of all, won't even know whether or not they are regulated and, second of all, what laws would apply under the regulations.

The CHAIRMAN. The gentleman's time has expired. We have some time for my intervention. So the gentleman's time has expired and—

Mr. MANZULLO. Thank you.

The CHAIRMAN. The gentleman from New York is now recognized for 5 minutes.

Mr. MEEKS. Thank you, Mr. Chairman.

Mr. Secretary, good morning. Let me just go slightly with some questions I have that has an international tinge to it. And the first question is dealing with the risk of regulatory flight. It seems as though and it seems pretty clear, I think, that it is a myth that firms are going to pick up and move away from the jurisdictions. Everything that I have looked at shows that is not going to happen. But there is a lingering question about whether financial firms with existing operations in multiple countries may relocate resources internally among these regional headquarters, potentially to the detriment of the United States. I was wondering if you could address this issue, you know, about that?

Secretary GEITHNER. It is a real concern. You are right to point it out. That is why we made it clear to the Congress and to the world that as we, as the Congress considers putting in place stronger rules, we need to make sure that the world outside of the United States does so, too, so that we have a level playing field that can be enforced more evenly, and so that risk can't just migrate to where it is going to face less strict supervision and oversight.

So we have proposed that the major economies come together and agree to a new international accord on capital, a range of other agreements to put in place stronger standards across all the major financial institutions so there is a level playing field. It is an important thing to do, and I think, actually, there is a lot of consensus on that basic strategy.

Mr. MEEKS. But likewise, I don't know if you know—you may or may not know. Last week, for example, I dropped a Sense of Congress Resolution dealing with the Lehman bankruptcy in the U.K., and I know that part of that number of investors thought that their money was being invested in the United States, and it ended up in the U.K., and it is caught up in this bankruptcy process. And a number of these are foundations and universities that I have

been talking to that are very concerned because it is going to have an effect on them.

I don't know what is going on with it, but—in my resolution, I was asking for the U.K. and the United States to work more closely to try to make sure that we do this in a more timely manner. But likewise, then, when you talk about international—is there any talk about an international resolution authority so that this problem does not occur again? And can you also tell me or give me an update as to where we are with the Lehman bankruptcy?

Secretary GEITHNER. I would be happy again to talk to the SEC and the U.K. authorities and help—and to the courts involved to help make sure that process is moving quickly.

On the basic question you raised about the future, what you need—what Lehman illustrated is we did not have here and was not in London an adequate mechanism for managing that failure in a way that caused less damage. And to fix that, you need to change the law here. You need to change it in the U.K. and make sure that it is done in a consistent way so these globally active firms can be handled—

Mr. MEEKS. Is that dialogue going on now?

Secretary GEITHNER. The dialogue is going on now. But, as many of your colleagues have observed, it is a very complicated difficult thing. You are not going to be able to do it just by sitting around a table and talking with the other supervisors. It requires changes in the laws and regulations in each of our countries. So we are trying to make progress on that.

Mr. MEEKS. Would that be subject at all to the conversation at the G–20 that is coming up in Pittsburgh?

Secretary GEITHNER. It will. And you will see in the broader recommendations and reforms that are laid out there an update on progress in that area and a reference to where we are trying to go.

Mr. MEEKS. Also, the role of the IMF, and I know that President Obama and other leaders are calling for a more stable and sustainable global trade system. For example, with countries like China and Germany are recess dependent on export-driven growth, and the United States is dependent on cheap international capital to finance deficit-driven consumption. There is talk, from what I understand, of the IMF playing a greater role. Can you share your thoughts on how this would actually work and how we could make it enforceable on an international basis?

Secretary GEITHNER. Very hard to make it enforceable. I think probably not achievable. But what we want to make sure the world understands, that as we save more as a country, which we are already doing and we are going to have to do going forward, they are going to have to find future growth more from domestic consumption in those countries, and if they learn anything from this crisis, it is that basic imperative. So that—the strategy we are suggesting is that we try to get countries to commit to reforms that will help produce that and that the IMF plays its natural role as an independent assessor of whether countries are doing things at all that contribute to a more balanced pattern of growth globally. But you can't expect in a world of sovereign states, and I would never recommend that this country, cede basic responsibility over basic economic policy to a committee of other nations or to the IMF.

The CHAIRMAN. The gentleman from Georgia.

Mr. PRICE. Thank you, Mr. Chairman.

Welcome, Mr. Secretary.

My background is health care. So I know that as a physician, if you don't make the right diagnosis, you can't treat the patient correctly. And if the patient gets well, it is by luck.

To the point of diagnosis, there are some individuals who believe we are in our current situation, in the current boat we are in, because—they will say this—because of a failure of capitalism and a failure of deregulation.

My sense in talking with folks is that simply isn't the case. I think that is very concerning because if we conclude as a society that the reason we are here is because of a failure of capitalism and a failure of deregulation, then I suggest that the solutions that we will come up with will not, in fact, correct the problem. Would you comment on those two matters? Do you believe we are where we are because of a failure of capitalism?

Secretary GEITHNER. No, I would not use that phrase.

Mr. PRICE. Do you believe we are where we are because of a failure of deregulation?

Secretary GEITHNER. To some extent, we are. I think we screwed up regulation is a simple way to say it.

Mr. PRICE. By having a system that wasn't flexible or nimble and wasn't minding the store?

Secretary GEITHNER. Partly that. But partly we had a system where parts of the system and people were crawling over these institutions yet didn't prevent excessive risk-taking; parts of the system, where there was nobody looking at it. It is not a sensible way to run a system. So I would—it is not as elegant as the phrase they used. I would say we just screwed up the regulatory system.

Mr. PRICE. So you have folks who are crawling all over people, not doing their right regulatory job, and some products out there in the marketplace that aren't being watched?

Secretary GEITHNER. Well, it is institutions and markets where there were no effective constraints on risks that could threaten the economy as a whole.

Mr. PRICE. And I would agree with you, I think.

If one believes that, then why wouldn't one have as a solution to simply charge the regulators that we currently have with the job of regulating the different products and institutions that are out there as opposed to creating a new bureaucratic institution that will take all of the time that it takes to get up and running, usurpation of authority from other individuals, who—I suspect we are marching down the road again of, who is minding the store?

Secretary GEITHNER. I think, actually, we are trying to fix that. Because right now, it is hard to know who is responsible, who is principally responsible. One of the virtues of accountability is nobody will be confused if we do what we are proposing about who is responsible. And that is a good place to start. If you give that responsibility to a bunch of different people, better responsibilities, then you can't hold them accountable for performance on that.

Mr. PRICE. Have you read our proposal, the proposal from the Republican side of the aisle?

Secretary GEITHNER. I have, although I read it when it first came out, and I haven't read it again recently, but I would be happy to go through it again.

Mr. PRICE. Do you have any—the way that we addressed that was to take the current regulators and say, you all have to do your job, one, and if there are new products or financial institutions that are out there that aren't being watched, somebody has to watch them, and you are charged with determining who is going to watch them. Is there something wrong that?

Secretary GEITHNER. I just don't think it goes far enough. Again, just due to practical reality, I think that would leave the current system basically intact, and we would be at too much risk of repeating this down the road. And I think that, again, a basic failure in our system was we left a bunch of institutions doing the same thing. Mortgages, credit cards, a bunch of credit-type products competing alongside banks where there was no effective deterrence enforcement. And I don't think you can fix the system without fixing that problem. And I don't think you can—I will say this more starkly than we need. But I don't think you are going to fix it by creating a committee.

Mr. PRICE. Well, I would suggest that the last thing that this government needs is another regulatory agency that may, in fact, repeat the same ills of the last.

Secretary GEITHNER. If we did that, that would be a mistake. But again, what we are proposing is to take authority that is diffused around a bunch of people and other things and move it to a central place. It is not fair to characterize it—although I understand the risk—that is some new bureaucracy we are imposing on top of the system. It is more like more accountability and clarity so people know where to go to; you know where you go to when you see systematic failures.

Mr. PRICE. I would encourage you to take a look at our proposal once again. I would love to have your feedback on that.

Secretary GEITHNER. Absolutely.

Mr. PRICE. Before my time expires, I want to address the issue of TARP. And I am sorry I wasn't here for an earlier comment, but my understanding is that your sense and the Fed Chair's sense is that we have moved on from this remarkable threat that we had to our Nation a year or so ago and that TARP's timeline was to be temporary and finite and hopefully end at the end of this year.

Are you planning on ending TARP at the end of this year?

Secretary GEITHNER. Can I say it slightly differently? Because of the force of the actions that the Congress authorized we took, we did pull the system back from the edge of the abyss, and we are able to wind down some of the emergency authorities necessary to rescue the system.

But we still have a very damaged system. There is a lot of challenge ahead for the economy. As many of you observed, we are only just now seeing the economy start to grow again. And it is too early for anyone to declare victory, say this is behind us. And I think anybody who lives in this world would say that there is still a lot of pressure the system is going through.

So, it is important that we not declare victory too soon, walk this stuff back prematurely.

Mr. PRICE. Thank you.

The CHAIRMAN. The gentleman from Kansas.

Mr. MOORE OF KANSAS. Thank you, Mr. Chairman.

Mr. Secretary, how do we end "too-big-to-fail?"

I don't know if you have seen the recent proposal by Chairman Tom Hoenig from the Kansas City Federal Reserve. The proposal on resolution authority lays out explicit rules of how a large financial institution like Lehman Brothers or AIG could be resolved so that debt holders, shareholders, and management would be accountable and responsible before taxpayers step in.

If you haven't seen the proposal, I would be happy to get you a copy, and would appreciate your comments in writing.

Others suggest we require the largest financial firms to undergo a regular stress test that would have aggregate information publicly released even in good times.

I know some have argued the list of these firms should remain confidential, but doesn't the market already know who these firms are based on the last round of stress tests? How do we create the right incentives for firms to maintain reasonable leverage ratios and strongly discourage "too-big-to-fail?"

Secretary GEITHNER. I have a lot of respect for Tom Hoenig. I haven't looked at his proposal, but I would be happy to do so and react to it. Anything that meets the objectives that you described I would be very supportive of.

I think, again, to say it simply, to prevent the moral hazard that is inherent in any financial system, you can't leave the market to do it. You have to put in place constraints on leverage in the form of capital requirements that help the institutions make sure they hold enough resources to cover losses.

And you have to make it clear that the government has the ability, if you screw it up, to wind you down, restructure you, in effect put you out of existence without imperilling the health of the rest of the system. That is the basic, simple way to describe what you need in this approach.

And, of course, we have also proposed that institutions have to pay for any losses the government absorbs in this context over time. That is helpful, too.

But those are the two core pieces of any effective strategy.

Mr. MOORE OF KANSAS. Thank you.

Mr. Secretary, would you support creating a financial watchdog council where financial inspectors general would meet on a quarterly basis and be required to provide an annual high-risk report on the greatest risks and gaps in our financial regulatory system that need to be addressed?

Secretary GEITHNER. Again, I would be happy to consider that.

And I do think that one thing that is important to do is to make sure that you have a group of people looking at the whole system, trying to look over the horizon to identify early things that are happening that could threaten the system in the future.

But I would be happy to look at that specific proposal.

Mr. MOORE OF KANSAS. Thank you, Mr. Chairman. I yield back the balance of my time.

The CHAIRMAN. The gentleman from California has now returned to claim his time.

Mr. ROYCE. Thank you, sir. I had a couple of bills on the Floor, Mr. Chairman.

Let me ask you, if I could, Mr. Secretary, to what degree did bank regulators contribute to the drafting of your regulatory reform proposal? Were they involved in that?

And let me just finish my thought, and then maybe you can explain. The reason I am asking that is because, as we look toward creating a more stable financial system and one that is focused on benefitting consumers, some regulators have expressed serious concern about the creation of a Consumer Financial Protection Agency and the separation of safety and soundness regulation from that consumer protection regulation authority.

I was just going to read a quote from Sheila Bair of the FDIC. She said, "Separating consumer protection regulation and supervision into different organizations would reduce information that is necessary for both entities to effectively perform their functions. Separating consumer protection from safety and soundness would result in similar problems. Placing consumer protection policy-setting activities in a separate organization, apart from existing expertise and examination infrastructure, could ultimately result in less effective protections for consumers."

So Ms. Bair is expressing what appears to be a common sentiment among regulators. Bifurcating these two regulatory objectives will actually weaken protection for consumers, from the standpoint of a number of people who have looked at this.

And I know the argument that they are simply trying to protect their regulatory turf. But when you listen to some of the economists and others that look at the past experience with bifurcating these two functions, there seems to be a point here. And I wanted to ask you about that.

Secretary GEITHNER. Again, I want to do this carefully. I think that they are right to raise that potential concern, and I think I share that concern. And we would not be enthusiastic about a proposal for reform that would create that risk.

But, again, we have had a lot of experience, as a country, with combining those authorities together. And we have been able to watch what happens when you put them together. And I think what you saw is a system that didn't work. And I think it is absolutely within our capacity and the committee's to find a way to separate those without having us undermine the capacity of bank supervisors to do safety and soundness.

Remember, bank supervisors have on-site supervision. They can live in those institutions. There is no risk if you take the consumer authority away from them that they are going to have a more difficult job doing safety and soundness. And there is no reason to believe that consumer protection would not, frankly, be done better if you have clear accountability for people whose job it is to worry about that.

Now, you can protect against the risk that you raise by making sure, as we proposed, there is a board with some checks and balances where supervisors are present. So if there is conflict—and the chairman in his note proposes some other things that I think are very helpful—that can be resolved.

Mr. ROYCE. I just look at the way in which—when we look at the GSEs, Fannie Mae and Freddie Mac, I just look at the way in which that bifurcation between the mission over at HUD and then OFHEO, with safety and soundness, I just look at the goals that were stressed at one end obviously in conflict with safety and soundness, and all of the overleveraging that went on and the, sort of, the mandates for the portfolio that half of it had to be subprime in the portfolio or Alt-A loans. I look at that and I see why the regulators are nervous. And that, also, is a chapter that we have experience with.

But let me ask you another question, because I was going to ask if you believe the perceived government safety net under our financial system distorted market incentives and contributed to the financial collapse, especially in the housing boom and bust. Can the moral hazard from the perceived safety net itself, in other words, have something to do with the ballooning of the housing market?

I am thinking of Fannie and Freddie there. That could be a contributor.

Secretary GEITHNER. Absolutely. And that is the central risk in any system, in any reform proposal. And that is why we need to make sure you can't ever again have institutions that are allowed to operate with the expectation of government support with no effective constraint on risk taking. That is the lesson, in some ways, of the GSEs, but also of other parts of the financial system.

Mr. ROYCE. Well, in 1999, about 27 percent of all of the liabilities of firms in the U.S. financial sector were explicitly guaranteed by the Federal Government. Another 18 percent enjoyed at least some implicit support. That is an estimate of 45 percent back then. It is increasing today; the moral hazard is increasing.

The CHAIRMAN. I am going to recognize myself and take my 5 minutes. I want to pick up on a couple of things here.

First of all, with regard to the regulators, I must say I am struck by their newfound interest in consumer protection. I have been on this committee since 1981. I have been the ranking member or the chairman since 2003. I do not remember the FDIC, the Federal Reserve, the Comptroller of the Currency, the OTS ever, ever volunteering anything about consumer protection. I guess it was the threat of absence made the heart grow fonder. But their record of consumer protection is abysmal.

There was on the law books a requirement or an authorization to the Comptroller of the Currency to prevent unfair and deceptive practices, the UDAP. The Comptroller of the Currency in 2002, 2003 was a Bill Clinton holdover—Comptroller, not partisan. He promulgated a very sweeping preemption that killed a lot of consumer laws. The former Chair of the Oversight Subcommittee, the Republican, Sue Kelly from New York, was appalled by this. We asked him what he would put in its place. Nothing. Because they hadn't used their authority to promulgate the unfair and deceptive practices code.

The Federal Reserve—the gentleman from Illinois mentioned it—they were given in 1994 authority to regulate mortgages. It wasn't until after this committee acted that Mr. Bernanke began to use the authority. Yes, the Federal Reserve has taken some consumer actions—in every single case, after this committee acted. They had

the authority to promulgate that UDAP code. Only after this committee passed a bill taking it away from them and got it through the House, because they had never used it, did they use it. It is simply not the case that they have paid much attention to it.

It is also the case, I believe, that the GSE example does not hold. The problem there was that the OFHEO was given too little authority. I was skeptical of that argument at first. By 2005, I joined the Republican chairman of the committee, Mr. Oxley, in trying to give them more authority.

I agree it was a mistake when there was, first in the Clinton Administration and then in the Bush Administration, the serious ratcheting up of the mandate to sell houses to people who shouldn't have bought them. And I objected to it at the time.

But let's get back to the regulators. It is turf. They never cared about consumer affairs. And I will now ask—and I will follow this up—I am going to ask every one of those regulators to give me the list of their consumer affairs activity.

We had an Assistant General Counsel, the Deputy General Counsel of the Fed testify—the Minority asked that he testify—against transferring their consumer authority. I asked him—he said he had gone to the Board, it was under his jurisdiction—how much discussion there had been at those meetings. He said none.

There was one Fed Governor, Ned Gramlich, who cared about consumer affairs. He was roundly ignored, as he acknowledged, and they wouldn't do anything about it. So let's be clear.

Now, it is not that they are bad people. It is, in fact, safety and soundness is their main concern. They regard consumer affairs as a kind of a nuisance.

And I do not think that there is anything inherently wrong with the consumer statutes, but we also, as the Secretary said, will have mechanisms so that if the regulators think safety and soundness is being interfered with, if they think that not jacking up people's credit card rates unfairly is somehow going to keep the bank from failing—maybe if that is the only way a bank can stay in business, it ought to fail—but that will be where we are.

So I want to be very clear that this—I am now going to be asking the regulators, I will follow this up, I would like them to submit to me their record in consumer protection. It is not very impressive.

Now, Mr. Secretary, I will ask you one question. Internationally, you mentioned, with regard to the question from Mr. Meeks, the IMF issue. One of the legitimate concerns we have had from the businesses here is that they will be at a competitive disadvantage if we are tough and others are not.

I do know, when I became the chairman-in-waiting of this committee in 2006, I was told that we had to repeal Sarbanes-Oxley or there would never be an IPO ever again in America, and they would all flee to the light-touch regulation of the Financial Services Authority, the head of which has subsequently said the era of light-touch regulation is over.

What are the assurances we can give American financial institutions they will not be put at competitive disadvantages if we were to adopt our rules?

Secretary GEITHNER. We are going to negotiate an international agreement on a set of standards that apply a level playing field,

that people can understand, that can be enforced. And we are going to do that so that U.S. firms are not put in the position where their competitors will be able to profit from being able to operate with lower standards. That is a—

The CHAIRMAN. Will we be able to take some action if we find others trying somehow to undercut us?

Secretary GEITHNER. I think that is an important thing to do. But I think the important thing—my basic feeling is the strategy is, you get them to commit to this standard; you ask them to put it in regulation and enforce it for their firms. And it is pretty black and white if they are meeting it or not. That is the basic strategy to do it.

And we have laid out a very detailed proposal with a timeframe for putting it in place so that we can all move together.

The CHAIRMAN. Thank you.

Mr. Secretary, we are going to try and wrap this up to get you out of here by noon.

Mr. Marchant?

Mr. MARCHANT. Thank you, Mr. Chairman.

Mr. Secretary, I would like to go and talk about Lehman Brothers for a minute. In the Lehman Brothers case, it was not the amount of leverage that they had, but it was the fact that they were funding that leverage with overnight funds. I think it probably was the case with Bear Stearns, as well.

As a result of that, you had the money market accounts went bust. And while a decision was made that there was no systemic risk—I guess that decision was made—and there would be no intervention on the part of Lehman Brothers, there was subsequently an intervention to guarantee the buck, basically, on money market accounts. And since that, basically, money market accounts have not been the preferred vehicle of investment by Americans.

Is there anything in this regulation that would have regulated, not the percentage of leverage with Lehman, but the fact that Lehman and most of these guys were keeping major parts of their portfolio in their capital portfolio, these mortgage-backed securities, and then holding 30-year maturity instruments and funding them with overnight funds? Is there something that will regulate that? Who would be the regulator? And do you see that as—I mean, to me, that was the systemic risk involved.

Secretary GEITHNER. I think you are exactly right, that it is not just the scale of leverage but the extent to which we are reliant on very short-term funding that can flee in a heartbeat. And that is what brought the system crashing down.

And so, when we use the word "capital," more conservative capital requirements, we are using it as a shorthand for longer funding requirements, more stable funding requirements, stronger liquidity cushions against losses to reduce that basic maturity mismatch, which is what creates the vulnerability to a run.

So you are absolutely right about the diagnosis. And we are just using a shorthand when we say more conservative capital requirements.

Mr. MARCHANT. So who will be the regulator?

Secretary GEITHNER. Oh, I am sorry. We are proposing, again, for the large, complex institutions that those requirements are set and

enforced by the Federal Reserve, which is quite close to the system today, now that investment banks are bank holding companies. But we want to make sure that is absolutely clear, so there is more accountability. But the rules need to be more conservative and better designed to reduce that run risk.

Mr. MARCHANT. So that there will be consideration given to—in all financial institutions, the consideration given to the source of the leverage?

Secretary GEITHNER. Exactly. How you are funded is as important to how much risk you take. In fact, they are totally and completely related. And it is this mismatch between very short-term liabilities that can run and long-term assets that are liquid that allow the risk in them that creates the inherent vulnerability to crisis.

So you need to both constrain leverage and make sure there is more conservative funding.

Mr. MARCHANT. In the future, do you see—well, do you see in the system now—there is this continual mismatch. Has this corrected itself?

Secretary GEITHNER. Well, again, banks operate with that mismatch. What they do is they take deposits and they lend them to people who need to buy a home or a business who wants to finance investment. That is inherent in any well-functioning financial system. But what you need do is to make sure that, again, you constrain leverage so that there is enough capital against risk and that there is as stable a funding base as you can achieve.

And what we did not do well as a country is that there were large institutions, very important, very complicated, very risky, that didn't have effective constraints on leverage and, as you said quite correctly, were allowed to fund themselves overnight with very, very high vulnerability to a run in a panic.

And so, you need to make sure that both the capital requirements and the liquidity requirements, margin, etc., are applied to that set of institutions who present those kind of risks. If you don't do that, we will be in this mess again.

Mr. MARCHANT. And my last question will be, if you require in this new regulation that there be a retained portion of the portfolio retained by the institution, if you do not put rules with that retained asset, then you will end up forcing them to have this mismatch.

The CHAIRMAN. The gentleman's time has expired. If he can respond in writing to the gentleman's question.

And next, the gentlewoman from New York, I believe. Oh, no, I am sorry, you got flipped, so it is the gentleman from Texas.

Mr. HINOJOSA. Thank you, Mr. Chairman.

Thank you, Mr. Secretary, for coming to visit with our committee.

Assistant Secretary Barr requested a meeting with me to discuss some of the concerns that I had on this legislation we are discussing, and we recently met in my office. During that conversation, I expressed my concern about the negative impact the CFPA, as recommended by the Department of the Treasury, could have on the local economies across the country. In particular, I said, we were concerned about the impact that this was going to have on

the community banks, credit banks, and regional banks that played no role in the global financial meltdown.

According to him—or, rather, according to the Secretary for Financial Institutions, the Treasury wants a level playing field. He wants all financial institutions to be examined and enforced by the CFPA.

And I disagree. I think that the community banks and credit unions and regional banks should be exempted from that CFPA umbrella. They didn't cause the problem; they did not create the financial crisis. In fact, as I and many of my colleagues here on this committee believe, community banks and credit unions provided some liquidity to local markets at a time when the large banks and the nonbanks had frozen the market liquidity.

Thus, Mr. Secretary, why should they be punished for actions of others?

Secretary GEITHNER. They shouldn't be. And I agree with you that one of the great strengths of our country is we have a system with 9,000 banks, including thousands and thousands of community banks that, as you said, were not part of the problem and are playing a very important role in providing credit. We need to preserve that.

But we have to make sure that, again, we are protecting them from the risk that competitors who are not subject to any regulation can take business away from them, and they are forced to try to compete with them by lowering standards, engaging in the same practices. That is why you need a more level playing field more broadly applied.

But you are raising, of course, understandable concerns about this. We are very sensitive to those, too. And we would be happy to work with you and your colleagues to figure out how to get that balance right.

Mr. HINOJOSA. I appreciate that.

Also, I have worked in conjunction with Congresswoman Judy Biggert on financial literacy over the years and hope a provision on financial literacy will be incorporated into the bill.

Mr. Secretary, will you support our literacy provisions being included?

Secretary GEITHNER. Can I take and make sure that I talk to my colleagues to take a careful look at them before I commit? I would be happy to get back to you.

Mr. HINOJOSA. Absolutely. And we will be glad to work with you to make sure that it is in a way that is going to help our consumers. Because I represent an area in deep south Texas that, had they had that financial literacy education, I think they would have refrained from signing so many predatory contracts and loans.

Secretary GEITHNER. I could not agree with you more. We need to make sure that public education in this country does a better job of equipping people, as they go through school, with some basic understanding of finance and economics. And I completely agree with the emphasis you are giving to us doing a better job of financial education and financial literacy.

Mr. HINOJOSA. We are trying to do the same on the Education Committee by requiring it for families wanting student loans to be

able to better understand their choices and make better choices, thus saving the family a big cost.

With that, Mr. Chairman, I yield back.

The CHAIRMAN. The gentleman from Minnesota.

Mr. PAULSEN. Thank you, Mr. Chairman.

Thank you, Mr. Secretary.

An area of fertile discussion has been the area of risk management. And most firms understand the risks that they run, but they don't often have the strength or the will or the foresight to say no. The competitive dynamic among firms creates the situation. And this is where a regulator with an eye towards aggregate risk in the system would be most beneficial, I think we could agree.

How do you intend to have the regulator calibrate that aggregate risk so that the benefits of competition that accrue to society will be able to go forward, as opposed to creating another disaster or go too much in the opposite direction where it is going to really burden innovation?

Secretary GEITHNER. I think it is a very difficult, complicated task. And I do think it is important to recognize that we can't have a system that relies on the wise exercise of discretionary judgment by supervisors, because they will never be able to fully understand soon enough where those sources of risks are coming from. And that is why we put so much emphasis on trying to make sure that firms run with bigger cushions against the uncertainty we all live with.

I think that is the only effective defense against this. And it is why—well, you can look at this in highway safety, all sorts of other examples of regulation where you need to have at the underpinning of stability some basic protections that are easily enforceable. Again, basically force firms to hold more cushion, resources, rainy-day funds against the losses they might face in an uncertain future.

But that future will be uncertain. You don't know where the source of risk is going to come from. And you can have risk management, all sorts of fancy, sophisticated risk management, but if you get that basic judgment wrong about how much and you are left with inadequate resources against losses, then you will have a more risky system.

Mr. PAULSEN. Okay.

Mr. Secretary, I will switch gears a little bit. What is the nature of the guarantee right now that the Federal Government is providing for toxic assets? We have had discussion about that. Are there any private-sector solutions that are less costly? Is your office receptive to having private-sector solutions from parties outside of the government come forward? And which ones might have the most merit?

Secretary GEITHNER. Of course. Of course. And, again, we have been very transparent about the detailed financial terms of these funds we proposed to use to bring private capital in alongside the government so people can look at the economics of that. But, of course, we are open to any suggestions on this stuff.

And, ultimately, of course, this only works if you get the private market to come back. And you need investors to start to take risk

on their own if you are going to see these markets start to heal and improve again.

Mr. PAULSEN. And let me ask this, Mr. Secretary. The Federal Reserve, in particular, has made so many dollars available right now that we have seen the devaluation of the dollar. And you have talked about our relationship with China and with foreign countries in the past.

But the market is kind of telling us right now, at least with the trade-weighted dollar that is out there right now, that there is concern about the Fed creating too much money in the system and the Treasury overspending. You know, the dollar is telling us we are not providing that much restraint.

I mean, shouldn't that be part of the feedback loop that we have right now, kind of watching that? Do you have concerns about that? The Fed kind of being the parent and the Treasury Department overspending? In other words, do you think there is a chance that we might be stimulating the economy too much in the short term?

Secretary GEITHNER. We can't take that risk. And I don't think that is a risk now we face. I mean, we have an independent Federal Reserve whose job is to make sure that we keep prices low and stable over time, growth sustainable. And they are committed to doing that. They have an exceptionally good record of doing that over time because they are independent.

But, as a country, on the fiscal side, we are going to have to go back to living within our means to bring these deficits down. But our big risk still at the moment is that we make sure we have a recovery under way that is led by private demand. And we want that to be strong enough and sustainable before we step on the brakes.

Again, you know, the big lesson of the United States in the 1930's and Japan in the 1990's, countries throughout history, was to move too quickly out of the hope it was all going to be okay, and put on the brakes in a way that deepened the recession, raised the ultimate costs of recovery. We need to make sure we avoid that risk.

But you are absolutely right to emphasize the importance, and no one feels more strongly about it than I do, about the importance that we go back to living within our means and that we walk back these exceptional measures necessary to fix the crisis as quickly as possible.

And if you look at what we have done, you are already seeing dramatic reduction in the amount of support the government is providing to the financial system as we, you know, see things starting to improve.

Mr. PAULSEN. Thank you, Mr. Chairman. I yield back.

The CHAIRMAN. The gentleman from Missouri.

Mr. CLAY. Thank you, Mr. Chairman.

Very quickly, Mr. Secretary, welcome back. And perhaps the most interesting aspect of the economic data pointing to a modest recovery is that it ignores the fact that foreclosures, the problem that imploded the financial markets and the economy in the first place, continue to rise.

Already, this year, more than 1.5 million families experienced foreclosure in the first 6 months. Just in the month of August, a

total of 358,000 properties went into default or foreclosure. Although the pace of new foreclosures slowed between July and August, this rate is up 18 percent year over year.

Does Treasury adequately address the entire issue of foreclosure and what started our financial crisis in your proposals?

Secretary GEITHNER. Congressman, we do not have the ability to prevent all foreclosures. It is just not a realistic objective for us.

But we are making a lot of progress and bringing more stability to the housing market and making sure that people are allowed to take advantage of a loan-modification program that reduces their monthly payments to a more affordable level. And we expect, within the next several weeks, to be in a position where half a million households are benefitting from modifications that substantially reduce their monthly payments.

You are already seeing, of course, interest rates of mortgages at historic lows. Housing is more affordable today. There is a little bit more stability in housing values now. And people are able to refinance their mortgages even if they are underwater. And those things are helping together.

But you are right to emphasize the fact that there are still a lot of people in this country who are facing the risk of foreclosure. And we are going to reduce that risk, but it is still with us. It is one of the reasons why we don't want to leave people any illusion that we are through the worst of this crisis and it is time now to dial back and wind down those programs.

Mr. CLAY. Would Treasury have an interest in private investors creating market instruments, for example like real estate trust investments, to which the government attaches a Federal guarantee, in order to encourage banks to remove toxic assets off their balance sheets?

Secretary GEITHNER. Well, again, we are pragmatic people. We are open to anything that we think will work. And I would be happy to look at any proposal. We look at a range of proposals all the time. But I think I would be very reluctant to—well, let me say it differently.

We want to make sure we are not exposing the taxpayer to losses they shouldn't have to bear by subsidizing a bunch of new activity in this area. And we need to figure out ways to do these things at the least cost to the taxpayer and that are going to have the most impact on credit flows.

But I would be happy to look at any proposal, though.

Mr. CLAY. And I do understand the reason for caution here.

And I will yield back.

The CHAIRMAN. Thank you. We will just finish with Mr. Lance. And Mr. Baca has one request he will make.

So, Mr. Lance, you will be the last questioner.

Mr. LANCE. Thank you very much, Mr. Chairman.

Good morning, Mr. Secretary.

The books close a week from today on the fiscal year. As I understand it, the deficit will be this year $1.6 trillion. What is your current estimate, Mr. Secretary, regarding next year?

Secretary GEITHNER. Congressman, in the mid-session review that OMB put out in August, there are revised assessments of the

Executive Branch about the deficit. I don't have those numbers before me, but I would be happy to make sure you get that.

But the government, of course, the way the system works, will provide another estimate of that in the President's budget submission for the 2011 fiscal year in, I believe, January or February.

Mr. LANCE. I certainly hope that we are we moving in the direction of trying to lower that, since, as I understand it, this is the highest annual deficit as a percentage of GDP since 1945.

Secretary GEITHNER. And we agree with you, we are going to have to bring that down over time.

Mr. LANCE. Yes. Well, thank you.

As I understand it, the GAO said last week that if AIG misses its fourth equity dividend payment due on November 1st, you have the authority to appoint directly at least two members of the AIG board of directors.

Have you begun examining that possibility yet?

Secretary GEITHNER. The AIG board—we have seen a substantial transformation and, I think, strengthening of the board of AIG already. And, as you know, there is a new management team now in place helping to get this institution back in a position where we get our money back.

Mr. LANCE. Thank you. But, as I understand it, you will have the ability to appoint new board members if the payment is not made. So I would hope that you would examine that situation by the 1st of November.

Number three, regarding the tariff situation on Chinese tires, your opinion, sir?

Secretary GEITHNER. My opinion?

Mr. LANCE. Yes.

Secretary GEITHNER. Oh. Well, the President acted to enforce the basic rules established not just by the United States but internationally, as part of Chinese accession to the WTO. And, you know, for our system to work, people have to have confidence that the rules that are there will be enforced.

Now, of course, we are completely committed to making sure that we preserve an open trading system. As a country, we have a huge stake in making sure that markets overseas are open to U.S. exports and products. And we are working very hard to find ways to expand those opportunities for American exporters.

Mr. LANCE. And, finally, and I know you have addressed this before, but I am still concerned regarding how the Tier 1 companies will work. And if they are not announced publicly and yet there are higher capital standards, then that will obviously be recognized by the market. It seems to me that you are sort of between a rock and a hard place if you don't announce what companies are in Tier 1, and yet you have the higher capital standards.

If you could elucidate us further on that. It is a very complicated topic. I know you have addressed it this morning, but any further comments you might have on it, Mr. Secretary.

Secretary GEITHNER. You can't have a fixed list. It is going to have to evolve over time. It is going to require a careful judgment of who poses the most risk to the system. But the most important thing, I think, as you said, is they need to live under appropriately

conservative constraints on leverage. And they are going to have to know what those constraints are.

Mr. LANCE. Thank you, Mr. Secretary.

I yield back the balance of my time, Mr. Chairman.

The CHAIRMAN. Mr. Secretary, thank you for the time. But the gentleman from California had an important point. I recognize him for a minute.

Mr. BACA. Thank you very much, Mr. Chairman.

Mr. Secretary, the regulatory plan proposes moving all standardized derivatives to some sort of clearing process to help bring more transparency and understanding to the market. When Chairman Gensler came before us in July, he said that initially he would envision it being four to five clearinghouses competing with one another.

My question concerns this competition. Wouldn't this situation create the same conflict of interest that exists with credit-rating agencies, in that they would be funded by the same institutions whose products they would be reviewing?

And my question is, are you concerned about the potential problem? And what kind of oversight do you envision in working to prevent against this?

As the chairman indicated before, it wasn't until 2003 that we began to have the oversight and accountability, especially as it pertains to capitalism and deregulation.

The CHAIRMAN. If we could, let's get to the answer. I think the question has been well put.

Mr. Secretary?

Secretary GEITHNER. Again, it is very important that the SEC and the CFTC have the authority to make sure that central counterparties operate with enough resources to protect themselves against the risk in central clearing. And there needs to be a level playing field evenly enforced. That is the only protection against the risk that competition erodes those standards, leaving with us a more risky system.

The CHAIRMAN. Thank you, Mr. Secretary. I think if you could elaborate on that in writing, it would be—and I guess the concern would be, would they compete by offering, sort of, lower margin requirements? And is there some way to prevent that from happening?

I thank the Secretary.

We will reconvene at 2:00 p.m. I will say for people on the Democratic side, we will begin in the questioning at the seniority level where we left off. On the Republican side, I am told because everyone who was here was able to question, they will start again. But we will begin in the middle of our second row.

The hearing is adjourned.

[Whereupon, at 12:04 p.m., the hearing was adjourned.]

A P P E N D I X

September 23, 2009

Statement by Rep. Michele Bachmann
House Financial Services Committee Hearing
The Administration's Proposals for Financial Regulatory Reform

September 23, 2009

Thank you, Mr. Chairman.

And thank you, Secretary Geithner, for being here today.

Holman Jenkins, Jr. noted in the Wall Street Journal last week, "The time to worry about moral hazard is now, between crises, when we have an opportunity to change the incentives of the system to make future crises less likely." This is good advice. But instead of addressing the issue of moral hazard, and thereby putting us on a path away from the likelihood of future bailouts, your regulatory overhaul plan actually codifies a path toward more such action.

I don't believe that anyone wants to relive the events of the past two years – probably few want to relive it as little as you, but future taxpayer bailouts are a centerpiece of your plan. Labeling large financial institutions as "systemically risky" and creating a "resolution authority" to wind them down are just code words for a planned and permanent system of taxpayer bailouts. And, thus moral hazard remains unaddressed. Until the federal government makes a commitment to end the cycle of bailouts, the marketplace will continue to respond with risky behavior, knowing that it will continue to be rewarded.

On the other hand, the Republican alternative to your proposal (H.R. 3310) both addresses the core problems in our financial system and promises American taxpayers that they will not be on the hook for Wall Street behavior in the future. Three key principles guide our proposal: ending government bailouts of "too big to fail" financial institutions; getting the government out of picking winners and losers; and restoring market discipline by removing moral hazards that exist today.

Our plan uses the bankruptcy code to direct the timely and orderly resolution of non-bank corporations and financial institutions – no matter how large or small. We make it clear that bankruptcy is the end-game for those that make mistakes or make risky bets. Our plan would strengthen market discipline by making it clear that a failing institution's creditors and counterparts will bear the cost of financial mistakes – not American taxpayers.

The Republican plan also takes on Fannie Mae and Freddie Mac – two of the most significant contributors to the financial crisis – and ends their taxpayer subsidies within a set time frame. This would remove a flaw inherent in government sponsored enterprises –they will no longer be considered government sponsored! The marketplace will no longer view them as backed by a bottomless taxpayer ATM. Unfortunately, your proposal avoids this critical issue.

Our bill also creates a Market Stability and Capital Adequacy Board that would monitor all sectors of the financial system, how they are interconnected and whether their size and scope could jeopardize the safety and soundness of our system. Rather than creating a government behemoth, as you propose in the Consumer Financial Protection Agency, our proposal would enhance consumer protection without restricting access to credit and individual choice.

Our plan would consolidate regulatory and enforcement authority into a single regulator with both consumer protection and safety and soundness duties. This should clearly be a guiding principle in any reform. Many of the regulators who will be testifying later today have made that very point. Comptroller of the Currency, John Dugan, has stated, "[T]here are critical issues in bank supervision for which consumer protection and safety and soundness cannot be separated." And Sheila Bair, Chairman of the FDIC has stated, "Separating the examination and supervision of insured depository institution consumer protection compliance from that of safety and soundness could undermine the effectiveness of both."

Thank you for being here today, Secretary Geithner, and I look forward to today's hearing.

Thank you, Mr. Chairman, and I yield back the balance of my time.

September 23, 2009, morning hearing
Statement by the Honorable Kenny Marchant
House Committee on Financial Services
Hearing on "The Administration's Proposals for Financial Regulatory Reform"

Out of the many moving parts of the Administration's regulatory reform proposal, the Consumer Financial Protection Agency concerns me the most. This proposed agency is a classic government overreach. The scope of the CFPA's proposed powers is immense, yet the most worrisome aspect is that its limits are truly unclear.

I was pleased to hear that the Chairman considers the agency's powers, as drafted, an overreach as well. It seems not a day goes by without another group coming into my office to tell me that the draft bill would give the CFPA the power to oversee (and selectively bar) their products. Whether it's mortgages, car loans, business loans, pay day loans, credit cards, title insurance and the list goes on and on. Probably the most worrisome aspect to me is that, if this agency is created, judging from history, the scope of its power will only grow.

In addition, I am interested in digging into the logistics of the creation of the CFPA. I'm interested to see exactly how this will all end up being paid for.

The burden of paying for the creation a massive new layer of bureaucracy must come from somewhere, and no matter where the money comes from – the government or private sources-- the timing could not be worse. Economically, we're not out of the woods yet. Also I am curious as to how long it would take for the CFPA to organize, gather staff, put together research, and eventually promulgate rules. My contention is that it would take years. In the mean time, what rules will financial entities abide by?

To me this boils down to a fundamental struggle between the individual and the government for the power to make decisions. Who knows best when it comes to personal decisions—the individual or the government? The answer is very clear to me. On average an informed consumer with all the possible choices the free market can create will always be more efficient.

By no means are these all the concerns I have with the CFPA. However they represent a serviceable cross section. I'd like to close by stating that the creation of this agency will, without a doubt, increase the cost of credit of every kind for consumers. Limiting choice and choking off availability of credit are not the answers we're looking for. I look forward to working together on these and other issues moving forward.

Secretary Timothy F. Geithner
Written Testimony on Financial Regulatory Reform
House Financial Services Committee
September 23, 2009

Chairman Frank, Ranking Member Bachus, members of the House Financial Services Committee, I am pleased to be back before you today as our Administration and this Congress work toward comprehensive reform of our financial regulatory system.

The Chairman has set an ambitious schedule of hearings that will lead to your markup of legislation and facilitate enactment this year. We have now provided more than 600 pages of legislative language, and I am aware and appreciative of the long hours you have spent working through the critical details of reform. My staff has been in constant contact with members of this committee and with your staff, and will continue to be as we work through key issues.

As you prepare to put this legislation together and we prepare to help, it might be useful to remind ourselves why we have a financial system in the first place and why we have reached this moment of decision.

Stripped of its complexities, the purpose of a financial system is to let those who want to save—whether for vacation, retirement or a rainy day—save. It is to let those who want to borrow—whether to buy a house or build a business--borrow. And it is to use our banks and other financial institutions to bring savers' funds and borrowers' needs together and carefully manage the risks involved in transfers between them.

The job of a financial system, in other words, is to efficiently allocate savings and risk.

Last fall, our financial system failed to do its job, and came precariously close to failing altogether.

In September alone, Fannie Mae and Freddie Mac were put into government conservatorship. Lehman Brothers collapsed. Merrill Lynch, Wachovia and Washington Mutual were acquired in distress. A $62 billion dollar money market fund "broke the buck." The world's largest insurer avoided bankruptcy only with the help of $85 billion in emergency aid. Goldman Sachs and Morgan Stanley announced they would protect themselves by becoming bank holding companies. When Congress' first attempt to pass the Emergency Economic Stabilization Act (EESA) failed, the stock market took a historic plunge.

In a matter of just three months, five trillion dollars of Americans' household wealth evaporated. Economic activity and trade around the world ground toward a halt.

The failure was so sudden and far-reaching that the government was forced to step in to restore the flow of funds between savers and borrowers. Congress courageously passed EESA. Upon taking office, President Obama moved quickly on all fronts, working with Congress to win

approval for a recovery act to help the economy and launching a stability plan to help repair the financial system and restart lending.

A year has passed since the crisis peaked. There is little doubt that we have moved back from the financial brink and toward economic recovery. Important parts of the financial system are back to functioning on their own. Some of the damage to people's savings has been repaired. We have taken the first steps towards reducing the government's direct involvement in the system and the risks that taxpayers are bearing.

But make no mistake: The flaws in our financial system and regulatory framework that allowed this crisis to occur, and in many ways helped cause it, are still in place. We may disagree over details of how to best fix those flaws, but that cannot mean we do not act.

We simply cannot walk away from the worst financial crisis since the Great Depression and not do everything in our power to reform the system that contributed to this breakdown.

At a minimum, reform must achieve these critical objectives:

- It must provide substantial new protections for consumers and investors.
- It must create a more stable, safer financial system, one less prone to crisis.
- And it must safeguard American taxpayers from having to bear the costs of battling future crises.

To achieve these objectives will require changes across the entire financial system. Let me lay out some of the changes, and briefly explain how the Administration reform plan will make them.

Reform requires a fundamental overhaul of consumer and investor protections so that Americans are told about the risks of financial products and services in ways they can understand, and providers live by commonsense rules in delivering those products and services.

The Administration proposal will effect this overhaul. It will strengthen standards for investment advisors and brokers while expanding Securities and Exchange Commission (SEC) authority over disclosure and enforcement. And for the first time, it will provide consumers with a dedicated agency to set and enforce clear rules for both banks and non-banks in credit cards, mortgages and savings accounts.

Reform requires comprehensive oversight of the financial system to eliminate dangerous gaps and loopholes.

Our proposal is comprehensive. It will address the core regulatory failures and weaknesses that directly contributed to the crisis, and the dangers that could lead to the next one.

It will close gaps and loopholes that encouraged games-playing and enabled firms to evade strong government oversight. It will do so by, among other things, merging the Office of

the Comptroller of the Currency (OCC) and the Office of Thrift Supervision (OTS) into a new National Bank Supervisor.

It will eliminate competing regimes for holding company supervision and correct inconsistencies that allow firms to own banks, but still avoid supervision and regulation as bank holding companies. It will bring unregulated firms and markets into the system by requiring registration of hedge funds, and setting clear rules for all derivatives markets. Perhaps most importantly, it will require regulators to take the broad view – regulating firms and markets with an eye to the safety of the entire financial system, and not just that of individual institutions.

Reform requires tighter constraints on leverage so that institutions arrive at the eve of future periods of financial stress less indebted and better able to bear their own risks.

Our proposal will tighten constraints by requiring that all financial firms hold higher capital and liquidity buffers. It will establish a higher baseline for all firms, and then go beyond that baseline to impose still higher standards on the largest, most leveraged and most interconnected firms that pose the greatest risk to the system as a whole.

To protect the system in moments of crisis, reform requires better preparation and better tools to respond. Our proposal will require the largest, most interconnected firms to prepare plans for how they should be dismantled in case of failure, and will provide for the orderly unwinding of these firms in a way that protects taxpayers and the broader economy while ensuring that losses are borne by creditors and other stakeholders.

Finally, reform requires that as we in the United States strengthen our system, other nations take similar steps to strengthen their own systems, protect against cross-border gamesmanship, and ensure that the global financial system is safer and more stable. I will accompany President Obama to Pittsburgh later this week to advance the work that we have already done in this regard with our G-20 partners.

Today, I want to focus on two key challenges that are at the center of the debate over regulatory reform. The first is how to strike the right balance between protecting the stability of the system and American families' finances while still fostering innovation, growth and prosperity. The second is how to address the challenge of firms whose failure, absent reform, could threaten the stability of the financial system – the challenge of so-called "too big to fail" firms.

Concerns have been raised about whether, in seeking to restore stability and fairness to our financial system, our plan will impose excessive burdens on the financial industry or stifle critically important innovation. These questions have been raised especially in connection with our consumer protection proposal.

The need for a dedicated, consolidated consumer protection agency is clear. The current consumer protection system failed to protect consumers, responsible providers, or market efficiency and innovation.

It failed to protect consumers from unexpected risks. Instead, it led them into a housing and consumer debt crisis.

It failed to maintain a level playing field for responsible providers; instead, it let a large unregulated sector drag down standards.

And it failed to set clear rules of the road for sustainable innovation to thrive. Instead, it left a vacuum in which institutions, including many subject to extensive federal oversight, followed their competitors down the easy path of tricks and traps for short-term gain.

These failures were structural. That is because there is no home in today's regulatory system for the mission of protecting consumers and providing the market clear rules for sustainable innovation. There is no authority in federal regulations for watching over the parts of the consumer market that are operated by non-bank institutions. And the authority for watching over banks in that market is so fragmented among regulators that it encourages them to drag feet and point fingers instead of acting, and invites corrosive competition in regulatory laxity.

Consumer protection cannot be reformed without addressing these structural problems. Our proposal will address them directly. It will consolidate fragmented consumer authorities into one agency, the Consumer Financial Protection Agency (CFPA), which will write rules, oversee compliance, and address violations by non-bank providers, as well as banking institutions.

Effective protection requires consolidated authority to both write rules and conduct oversight and enforcement.

Combining these authorities will ensure that the agency has a wide range of tools to address any problem within its domain, and can choose those that are most effective and impose the least burden.

Rule-writing authority without supervisory authority – including reporting and examinations – and enforcement authority would risk creating an agency that is weak and ill-informed, and dominated by agencies with enforcement authority. If enforcement and supervisory authorities remain divided among the agencies as they are today, we will continue to see regulatory inertia and arbitrage, uneven protection, and eroding standards. Just as importantly, a rule-writing agency that does not receive information from and examine institutions and address their violations will not understand how institutions operate and the burdens that regulations put on them. Such an agency will likely underestimate the costs of regulation and fail to get the balance between costs and benefits right.

Our proposal will not create new bureaucracy for banks. It will take consumer authorities spread across many agencies and combine them in one place.

Our proposal will not increase the regulatory burdens on community banks. Most community banks do not pay assessments for federal supervision today, and our plan will preserve that arrangement. Examination schedules will be coordinated between agencies, which will exchange examination reports to promote consistency. Clear delineation of agencies' roles will keep conflicts to a minimum, and the rare conflict will be resolved with a reasonable dispute resolution mechanism. In the case of mortgages, institutions making them will see a cost savings

when the agency integrates federal mortgage disclosures now implemented separately by two different regulators.

The CFPA will save firms from having to face a choice between losing revenues or stooping to the questionable practices of less-responsible competitors. This will be of particular benefit to community and regional banks that lost revenues when they refused to compete on terms set by unregulated mortgage lenders and brokers. These banks' competitors in the non-bank sector will face federal oversight for the first time.

Moreover, the CFPA will allocate its oversight resources on the basis of risk to consumers. Firms that pose less risk to consumers will face proportionally less burdensome oversight. Risk-based oversight will help banks that have the strongest incentives to treat their customers fairly because they serve a relatively fixed customer base in a limited geographic area and have deep ties to their communities. These are most frequently community banks.

Our proposal will also meet the challenge of preserving innovation. It will do so by giving the agency a focused and balanced mission to protect consumers from abuse while simultaneously ensuring that markets are efficient and that innovation can thrive.

Innovation is essential to the growth of our financial system and the prosperity of our country. We especially value innovation in consumer financial products because it better matches products to consumer preferences. But without clear rules, firms can innovate in ways that erode standards and threaten stability.

Without adequate regulation, American families were enticed to switch credit cards with balance transfer offers at low interest rates of which they could not take advantage if they put gas and groceries on the card. They got mortgages with interest rates that shot up painfully in two years or sometimes less, and which often had increasing loan balances. They got hidden late fees, penalty rates, and prepayment penalties. These risks were disclosed, if at all, in fine print that no reasonable consumer could be expected to see and understand.

When developments such as these were introduced, they were frequently hailed as innovations. And in fact, features that can harm some consumers but provide more benefit to others have a place in a well-functioning market. We firmly believe that consumers should have the ability to choose those offerings that they believe best meet their needs if they can make well-informed choices.

Consumers can not be assured the opportunity to make informed choices about the risks without clear rules of the road. Innovation without regulation leads to a race to the bottom based on exploiting consumer confusion. Without rules, the firm that makes its product appear more attractive by hiding the real cost to the consumer wins. Perhaps a firm does not want to take that route, but competition forces it to. Without a strong framework of regulation, banks and other providers compete to take advantage of consumer confusion rather than to better serve consumer preferences. This must end.

Let me turn to the challenge of "too big to fail" firms.

The sudden collapses of Bear Stearns, Lehman Brothers, and AIG demonstrated that our framework for supervision and regulation of large, highly leveraged and substantially interconnected financial firms – and the government's toolkit for managing their failure – is profoundly inadequate.

There were many causes for the growth of these large, leveraged, and interconnected financial firms over the past few decades, but important among them was the assumption on the part of investors and others that these firms would receive government assistance if they ran into trouble.

The assumption undermined market discipline and contributed to excessive risk-taking by the firms. And the actions of the federal government over the past 18 months to support our major financial firms, while necessary to prevent an implosion of our financial system and deeper damage to our economy, have solidified the market perception that Washington will always be there to help these firms.

Addressing the threats to financial stability posed by large, leveraged, and interconnected financial firms is central to the Administration's financial regulatory reforms. Here is how our plan will accomplish this goal.

First, we cannot allow firms to reap the benefits of explicit or implicit government subsidies without very strong government oversight. We must substantially reduce the moral hazard created by the perception that these subsidies exist; address their corrosive effects on market discipline; and minimize their encouragement of risk-taking. So, for example, we cannot permit weak regulation of government-sponsored enterprises like Fannie Mae and Freddie Mac that accumulate trillions of dollars of exposure that is implicitly backed by the taxpayer. We cannot again permit our largest investment banks or other firms to operate without real consolidated supervision, yet obtain government assistance when they collapse.

We will provide the federal government with the authority and responsibility to oversee every financial firm that poses a threat to financial stability. Most of these firms already are organized as bank holding companies and therefore already are subject to supervision and regulation by the Federal Reserve. But our current laws do not ensure that the government will have oversight over all major financial firms. Going forward, the government must have the authority to extend a common framework of supervision and regulation over all financial firms that present outsized systemic risks.

Second, we will impose tough rules on our largest, most leveraged, and most interconnected firms. We will require these firms to hold more capital to protect the system in the event of the firm's failure. And we will make the financial markets more resilient.

We will require bigger buffers in the financial system to make it strong enough to withstand the failure of individual firms, and will reduce the threat of contagion caused by interconnections among major firms. This will include raising capital and liquidity requirements

for all banking firms, and raising capital charges on exposures between financial firms. It will include comprehensively regulating over-the-counter (OTC) derivative markets, including by substantially increasing the use of well-regulated central clearing platforms. And it will include strengthening supervision and regulation of critical payment, clearing, and settlement systems

We will supervise our major financial firms more intensively and, after the financial system has had time to emerge from the recent crisis, we will hold these firms to tougher safety and soundness standards than other firms, including tougher capital and liquidity requirements. We will.require that supervision of these firms include effective oversight of the parent company and all of its subsidiaries. And we will require a new kind of supervision of these firms – one designed to protect overall financial stability and not just the solvency of individual companies.

Our plan for stricter supervision and regulation of the major financial firms will have several powerful effects. It will force these firms to pay an appropriate regulatory price for the risks that their failure or distress could impose on the broader financial system. It will offset the perceived government support enjoyed by these firms, which should substantially reduce any competitive advantage they have due to the market's assumption that they would receive assistance in the event of failure. In sum, our proposals will provide positive incentives for these firms to shrink and to reduce their leverage, complexity, and interconnectedness. In addition, more conservative supervision and regulation of our major financial firms should reduce the probability that they will fail and therefore the likelihood that they will pose a threat to the financial system.

Third, we must reduce moral hazard, improve market discipline, and limit the risk that the taxpayer has to bear in the next crisis and the costs they shoulder. Our plan will do this in a number of ways.

We will require our major financial firms to prepare and regularly update a credible plan for their rapid resolution in the event of severe financial distress. We will require supervisors to carefully evaluate the plan on an ongoing basis. This requirement will create incentives for a firm to better monitor and simplify its organizational structure and would better prepare the government – as well as the firm's investors, creditors, and counterparties – in the event the firm collapsed.

In addition, as Lehman's collapse showed, existing bankruptcy arrangements are often ill-suited for dealing with the insolvency of large financial institutions. We will give the government the capacity, as it has now for banks and thrifts, to dismember or unwind major financial firms in an orderly fashion with less collateral damage to the system. Simultaneously, we will enhance market discipline by enabling the government to manage the resolution of troubled firms in a manner that imposes losses on firms' stakeholders.

It is imperative that we minimize the risks that taxpayers pay the price of a future rescue of the financial sector. Therefore, any losses that might be incurred by the government in its efforts to resolve failing financial firms will be recouped through assessments on other large financial firms.

Crucially under our proposals, there will be no fixed list of Tier 1 FHCs, and identification of a firm as a Tier 1 FHC will not convey a government subsidy – it will be no guarantee of extraordinary governmental assistance in the event of financial distress. To the contrary; it will be a guarantee of substantially stricter supervision and regulation by the government – an intensity of government oversight that will serve as a strong disincentive for firms to become too big, complex, leveraged, and interconnected.

We understand the need to coordinate regulation of major financial firms internationally to prevent geographic regulatory arbitrage. Financial firms, markets, and transactions have never been more globally mobile. The G-20 Leaders have acknowledged that we must raise safety and soundness standards for all major financial firms to consistently high levels, and we look forward to working with our colleagues around the world to do just that.

No private economic system can function effectively if firms are insulated from the full consequences of their bad decisions. History suggests that periods of financial stress will happen again in the future. Therefore, it is critical to limit the systemic footprint of individual firms and to reduce the likelihood of, and the potential damage to the financial system from, the failure of our major financial firms. Accomplishing these goals and reducing the need for government support of financial institutions in the future is a fundamental issue of fairness, and it is essential to making the financial system more stable, efficient, and robust.

Mr. Chairman, in the coming weeks, your Committee and we in the Administration will have to work through difficult details on all of the issues I have discussed today and others as well in order for you to enact the historic legislation that you are now preparing to move. And we appreciate that you have joined the President in committing to enact this legislation by year's end.

But as we do this, we must remember the President's admonition on Wall Street last week. Time is the enemy of reform. As some normalcy returns to our financial system and our economy, we cannot let it be cause for complacency.

We must act to correct the regulatory problems that have left our financial system so fragile and prone to further trouble that Americans come to distrust it as a reliable repository for their savings and a stable source of the credit they need to conduct their lives and build their businesses.

Thank you.

DEPARTMENT OF THE TREASURY
WASHINGTON, D C. 20220

ASSISTANT SECRETARY

August 13, 2009

The Honorable Maxine Waters
U.S. House of Representatives
Washington, DC 20515

Dear ~~Ms.~~ Chairwoman Waters.

The Department of the Treasury is committed to ensuring that small businesses of all types are provided opportunities to do business with the Federal Government As a follow-up to your meeting with Deputy Secretary Neal Wolin on July 21, 2009, I am pleased to provide the following information regarding the participation of minority-owned and women-owned businesses in support of the Department of the Treasury's contracting needs or programs:

1. **The number of minorities, by division, that work at Treasury.**
   Please see Attachment 1.

2. **The roles that each minority-owned and women-owned business partner is playing in the PPIP (managing funds, providing valuation, assisting with underwriting, etc.).**
   While the Treasury Department has encouraged the participation of small-, veteran-, minority-, and women-owned businesses in the Legacy Securities PPIP, the Department has not been involved in selecting or vetting partners for the pre-qualified Legacy Securities PPIP fund managers. These nine fund managers have established meaningful partnerships with small, veteran, minority, and women-owned businesses. We anticipate that these roles will include, among others, asset management, capital raising, broker-dealer, investment sourcing, research, advisory, cash management and fund administration services However, since the definitive closing documents have yet to be finalized with respect to any of the Public-Private Investment Funds, it is premature at this time to speculate on the precise role that each small business partner will ultimately play We would be happy to provide additional information as soon as we move further along the process. In the interim, please find below the current list of the minority-owned and women-owned businesses partnership participants:

SMALL BUSINESS FIRM	M/W	PRE-QUALIFIED FUND MANAGER PARTNER
Altura Capital Group, LLC	M	Alliance Bernstein, LP
Castle Oak Securities	M	Angelo, Gordon, and Co. LLP / GE Capital Real Estate
Park Madison Partners, LLR	W	Angelo, Gordon, and Co. LLP / GE Capital Real Estate
Utendahl Capital Management	M,W	Blackrock, Inc

Jackson Securities LLC (subsidiary of Atlanta Life Financial Group)	M	Invesco Ltd.
Muriel Siebert & Co. Inc.	W	Invesco Ltd
The Williams Capital Group, LP	M	Invesco Ltd.
Arctic Slope Regional Corporation	M	Oaktree Capital Management, LP
Blaylock Robert Van, LLC	M	Marathon Asset Management, LP
The RLJ Companies, LLC	M	Western Asset Management, LP
Advent Capital Management, LLC	M	Wellington Management Company, LLP
The Williams Capital Group, LP	M	Wellington Management Company, LLP

3. ***(Requested information as clarified in our conversation with Mr. Matt Janiga on July 27)*** **Minority-owned and women-owned businesses supporting Treasury as higher level financial services providers; participating in the Capital Purchase Program (CPP) and/or the Troubled Asset Relief Program (TARP) or providing support for any other Treasury financial programs.**

   Please See Attachment 2, which includes the following:
   - Minority-Owned and Women-Owned Businesses Providing Financial Services
   - Minority-Owned Capital Purchase Program Community Development Financial Institutions

We appreciate your strong commitment and support of small and disadvantaged businesses, and we look forward to a continuing partnership to strengthen and enhance this program at the Treasury Department.

I hope the information provided is responsive to your request. Please let me know if I can be of further assistance in this matter.

Sincerely,

Kim N. Wallace

Kim N. Wallace
Assistant Secretary for Legislative Affairs

Attachments

Legend For Treasury Department Workforce Chart

(Submitted by Congresswoman Maxine Waters on 9/23/09)

BEP = Bureau of Engraving and Printing

BPD = Bureau of the Public Debt

DO = Department of Treasury

FINCEN = Financial Crimes Enforcement Network

FMS = Financial Management Service

IRS = Internal Revenue Service

MINT = United States Mint

OCC = Office of the Comptroller of the Currency

OIG = Office of the Inspector General

OTS = Office of Thrift Supervision

SIGT = Special Inspector General for the Troubled Asset Relief Program

TIGTA = U.S. Treasury Inspector General for Tax Administration

TTB = Alcohol and Tobacco Tax and Trade Bureau

Department of the Treasury *Total Workforce by ERI and Gender

ATTACHMENT 1

	Total Employees			Hispanic or Latino		Non-Hispanic or Latino											
						White		Black or African American		Asian		Native Hawaiian or Other Pacific		American Indian or Alaska Native		Two or More Races	
Bureau	All	male	female	male	female	male	female	male	female	male	female	male	female	male	female	male	female
BEP	1979	1471	508	86	15	786	135	557	330	27	17	0	0	6	5	9	6
%	100.00%	74.33%	25.67%	4.35%	0.76%	39.72%	6.82%	28.15%	16.68%	1.36%	0.86%	0.00%	0.00%	0.30%	0.25%	0.45%	0.30%
BPD	1973	730	1243	8	8	678	1187	34	32	3	7	1	0	3	3	3	6
%	100.00%	37.00%	63.00%	0.41%	0.41%	34.36%	60.16%	1.72%	1.62%	0.15%	0.35%	0.05%	0.00%	0.15%	0.15%	0.15%	0.30%
DO	1662	886	776	29	31	686	445	124	259	42	31	0	0	1	2	4	8
%	100.00%	53.31%	46.69%	1.74%	1.87%	41.28%	26.77%	7.46%	15.58%	2.53%	1.87%	0.00%	0.00%	0.06%	0.12%	0.24%	0.48%
FINCEN	334	170	164	7	10	134	97	18	42	9	13	0	1	0	1	2	0
%	100.00%	50.90%	49.10%	2.10%	2.99%	40.12%	29.04%	5.39%	12.57%	2.69%	3.89%	0.00%	0.30%	0.00%	0.30%	0.60%	0.00%
FMS	1936	782	1154	48	57	392	343	256	675	75	63	3	2	6	5	2	9
%	100.00%	40.39%	59.61%	2.48%	2.94%	20.25%	17.72%	13.22%	34.87%	3.87%	3.25%	0.15%	0.10%	0.31%	0.26%	0.10%	0.46%
IRS	106276	35037	71239	3195	8182	24399	37656	5226	21495	1803	2916	49	125	241	631	124	234
%	100.00%	32.97%	67.03%	3.01%	7.70%	22.96%	35.43%	4.92%	20.23%	1.70%	2.74%	0.05%	0.12%	0.23%	0.59%	0.12%	0.22%
MINT	1839	1293	546	124	66	780	204	267	211	104	60	1	1	10	1	7	3
%	100.00%	70.31%	29.69%	6.74%	3.59%	42.41%	11.09%	14.52%	11.47%	5.66%	3.26%	0.05%	0.05%	0.54%	0.05%	0.38%	0.16%
OCC	3231	1677	1554	88	100	1276	967	185	372	95	90	2	1	16	11	15	13
%	100.00%	51.90%	48.10%	2.72%	3.10%	39.49%	29.93%	5.73%	11.51%	2.94%	2.79%	0.06%	0.03%	0.50%	0.34%	0.46%	0.40%
OIG	113	58	55	4	2	42	23	9	22	2	7	0	0	0	0	1	1
%	100.00%	51.33%	48.67%	3.54%	1.77%	37.17%	20.35%	7.96%	19.47%	1.77%	6.19%	0.00%	0.00%	0.00%	0.00%	0.88%	0.88%
OTS	1064	665	399	30	31	526	225	56	99	42	33	1	2	5	4	5	5
%	100.00%	62.50%	37.50%	2.82%	2.91%	49.44%	21.15%	5.26%	9.30%	3.95%	3.10%	0.09%	0.19%	0.47%	0.38%	0.47%	0.47%
SIGT	53	29	24	1	1	25	13	0	5	3	5	0	0	0	0	0	0
%	100.00%	54.72%	45.28%	1.89%	1.89%	47.17%	24.53%	0.00%	9.43%	5.66%	9.43%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
TIGTA	815	461	354	26	22	363	216	55	86	12	24	0	1	4	1	1	4
%	100.00%	56.56%	43.44%	3.19%	2.70%	44.54%	26.50%	6.75%	10.55%	1.47%	2.94%	0.00%	0.12%	0.49%	0.12%	0.12%	0.49%
TTB	534	211	323	10	16	173	227	17	63	11	10	0	1	0	2	0	4
%	100.00%	39.51%	60.49%	1.87%	3.00%	32.40%	42.51%	3.18%	11.80%	2.06%	1.87%	0.00%	0.19%	0.00%	0.37%	0.00%	0.75%
Treasury	121809	43470	78339	3656	8541	30260	41738	6804	23691	2228	3276	57	134	292	666	173	293
%	100.00%	35.69%	64.31%	3.00%	7.01%	24.84%	34.27%	5.59%	19.45%	1.83%	2.69%	0.05%	0.11%	0.24%	0.55%	0.14%	0.24%

* Total workforce includes data for both permanent and temporary employees currently at the Department of the Treasury.

As of PP12 ending on 6/20/2009 12:00:00 AM

Report Generated: 7/6/2009 11:49:08 AM

Generated by HR Connect Workforce Analytics

Report ID: 1111 - Workforce by ERI and Gender.rdl

DEPARTMENT OF THE TREASURY

MINORITY-OWNED (MO) AND WOMEN-OWNED (WO) SMALL BUSINESSES PROVIDING HIGHER LEVEL FINANCIAL SERVICES

BUSINESS ENTITY	TYPE	SCOPE OF SERVICES PROVIDED/ROLE
GARDNER, KANYA AND ASSOCIATES, P.C.	MO	ACCOUNTING AND AUDITS OCC FINANCIAL STATEMENTS AUDITS SERVICES
BROWN AND COMPANY CPAs, PLLC	MO	AUDIT SERVICES (GRANT AUDITS/HIDTA AUDITS)
CONFERENCE CONSULTING GROUP, INC.	MO/WO	AUDIT SUPPORT SERVICES
LANDRO AND COMPANY CPAs, PLLC	MO	FINANCIAL AUDITS
REGIS AND ASSOCIATES, INC.	MO	FEMA PROPERTY MANAGEMENT AUDITS
PROFESSIONAL SERVICES OF AMERICA, INC.	MO/WO	ACCOUNTING SERVICES
WILLIAMS, ADLEY AND COMPANY, LLP	MO	• FEMA NATIONAL PROCESSING SERVICE CENTER AUDIT • FIRST RESPONDER AUDIT - UTAH • MISSOURI STATE HOMELAND SECURITY GRANT PROGRAM AUDIT • STATE HOMELAND SECURITY GRANT AUDITS (SC, WV)
FTI CONSULTING	MO	CREDIT REFORM MODELING AND ANALYSIS FINANCIAL ADVISORY (TARP)
ONE UNITED BANK	MO	CPP/CDFI
CARVER BANCORP, INC. (CARVER FSB)	MO	CPP/CDFI
LEGACY BANCORP, INC.	MO	CPP/CDFI
PCB HOLDINGS, INC.	MO	CPP/CDFI
LIBERTY FINANCIAL SERVICES	MO	CPP/CDFI
CITIZENS BANCSHARES CORPORATION	MO	CPP/CDFI
FIRST AMERICAN INTERNATIONAL CORP. (FIRST AMERICAN INTERNATIONAL BANK)	MO	CPP/CDFI
UNITED STATE BANK OF MEMPHIS	MO	CPP/CDFI
CITY NATIONAL BANCSHARES CORPORATION	MO	CPP/CDFI
PREMIER BANCORP, INC.	MO	CPP/CDFI
ISB BANCORP, INC.	MO	CPP/CDFI
FIRST BANCORP, INC. (MERCHANTS AND FARMERS BANK)	MO	CPP/CDFI
PIONEER BANCSHARES CORPORATION	MO	CPP/CDFI

QUESTIONS FOR THE RECORD

FOR US DEPARTMENT OF THE TREASURY

SECRETARY TIMOTHY GEITHNER

HOUSE FINANCIAL SERVICES COMMITTEE

Hearing on the "Administration's Proposal on Regulatory Reform"

September 23, 2009

Questions for the Record from Representative Kanjorski

Rating Agencies

1) Mr. Secretary, as you know when you last appeared before the Financial Services Committee, I raised concerns that the Administration's package on regulatory reforms for credit rating agencies did not go far enough. You agreed that we should work together to strengthen the regulation of these gatekeepers. In this regard, I want to ask you about two matters:

First, in the world of broker-dealers, supervisors can be held accountable for the actions of their employees. Should we work to import a similar regime in the world of credit rating agencies so that supervisors carefully manage their workers to ensure the production of high-quality ratings?

We have put forward a comprehensive legislative package to address conflicts of interest, regulatory oversight, competition, and transparency in credit rating agencies. We look forward to working with you, as you develop additional ideas to add to this reform package, including ways to improve accountability among rating agencies for providing unbiased, transparent assessments. In considering importing a regime from a broker-dealer framework, it is important to be cognizant that broker-dealers are individually licensed and therefore a regime that allows for individual and supervisory accountability may be necessary. In a rating agency framework, the staff is not individually licensed and the ratings are generally a product of a team, rather than an individual. For this reason, the corporate managers are already the natural place for accountability.

Second, I remain very concerned about the conflicts of interest caused by the issuer-pays model for credit rating agencies. Last time you indicated that there probably was no practical alternative to the issuer-pays model. I accept that conclusion, but still want to address the underlying problem, and I want to do more than just requiring disclosure of what issuers pay a rating agency. Accordingly, we could create a self-policing mechanism building on the Administration's proposed requirement that issuers make available data and due diligence reports to all certified rating agencies. Specifically, I would propose that we create a shared-responsibility system whereby the other issuer-paid NRSROs would be subject to certain burdens to investors if the NRSROs conducting the initial rating did so inaccurately and then lacked the resources to compensate investors after a trial. We have a similar joint-and-several liability system already in place for the Federal Home Loan Banks. What are your thoughts about this idea?

We do not believe that issuer-paid rating agencies are the only possible business model that could succeed. In fact a number of investor-paid rating agencies exist in the market today, and our proposals would strengthen their ability to compete – for instance by requiring that all information given to one rating agency be made available to others. Therefore, rather than the government prescribing a particular business model, we would make it easier for any business model – issuer-paid, investor-paid, or even non-profit to compete in the market place on the basis of the quality of their ratings.

When considering ideas for joint-and-several liability among credit rating agencies, we think that we should be careful to consider potential unintended consequences. Individual differences in NRSRO practices could vary more widely. Requiring rating agencies to be liable for the actions of each other could stifle competition by encouraging collective action by rating agencies.

Investor Protection

2) Mr. Secretary, the Administration's plan has many desirable reforms for protecting investors, especially the creation of a whistleblower reward program to put more cops on the beat. I, however, would like to do more, much more. I would also like to improve upon some of your proposals. As such, I have several questions:

First, the Madoff scandal revealed a number of deficiencies with respect to the Securities Investor Protection Corporation. I have already identified several sensible reforms that we could easily write into legislation. Would you support incorporation into the regulatory reform package to update and improve the Securities Investor Protection Act in order to better protect investors from fraud? We have also recently learned that the captive insurer behind this excess insurance may lack the resources needed to compensate investors. Should Congress work to address problems related to excess insurance provided by some broker-dealers? Moreover, should we consider revising the law to allow all investors in a pension fund to collect coverage from SIPC?

The Investor Protection Act approved by the Committee (H.R. 3817) includes significant reforms relating to the Securities Investor Protection Corporation (SIPC) and the bankruptcy of Bernard Madoff LLC (Madoff). These reforms will go a long way toward strengthening investor protection, rebuilding investor confidence, and preventing Madoff frauds in the future. Strengthening SEC enforcement and enhancing SIPA protections complement each other by, on the one hand, avoiding the need for SIPA proceedings if possible, and facilitating SIPA protections if needed.

The bill shepherded through the House Financial Services Committee by Mr. Kanjorski strengthens SIPA customer protections by increasing the cash limit to $250,000; increasing the Treasury line of credit and other SIPC resources to pay customer claims; enhancing the efficiency of customer protection proceedings; increasing the penalties for prohibited acts; and protecting futures held in a portfolio margining securities account. These reforms provide additional protection to customers in SIPC proceedings.

In particular, three sections of the bill are particularly noteworthy regarding the Madoff fraud. First, the bill directs the Government Accountability Office to study and report to Congress within one year on the feasibility of risk-based assessments for SIPC members. The Madoff fraud illustrated a number of deficiencies in broker-dealer risk management, including the audit function that a risk-based assessment structure could address.

Second, Section 414 (the Foster amendment) requires the Securities and Exchange Commission (SEC) to adopt a rule preventing registered investment advisers having

custody of more than $10 million of client funds and securities to hold the client's funds and securities in an independent custodian. In Madoff, the adviser and the broker-dealer custodian were the same entity, which facilitated the fraud and helped to trigger the need for SIPA protections.

Third, Section 305 (the McCarthy amendment) requires the SEC within six months to report to Congress on the SEC's implementation of "Post-Madoff Reforms" as outlined by the SEC. The SEC's outline includes several SIPA-related proposals to strengthen the broker-dealer custody function, such as safeguarding investors' assets, conducting risk-based examinations, integrating broker-dealer and investment adviser examinations, and enhancing the licensing, education and oversight regime for "back-office personnel."

Second, I am generally supportive of the goal of creating a fiduciary duty standard for broker-dealers and investment advisers when they offer investment advice. But, the proposed language has caused concerns for many. Would you accept modifications to that language designed to address the legitimate concerns being raised?

We would be glad to work with you on the specific ideas to address legitimate concerns with the legislative proposals we have submitted.

Additionally, the enforcement regimes for broker-dealers and investment advisers are very different in structure and have very different sets of resources. For example, FINRA examines more than 50 percent of broker-dealers each year, while the SEC gets to less than 10 percent of investment advisers. I therefore think that in this legislation we ought to ensure the consistent enforcement of the fiduciary duty rules to be developed by the Commission. We should also ensure that we maintain a common standard across regulators over time. Do you agree?

We would be glad to work with you on specific ideas to make sure that similar activities are regulated and supervised in a consistent manner across broker-dealers and investment advisers. Our proposals have focused on harmonizing the regulatory standards for investment advisers and broker-dealers when offering investment advice. The SEC has already taken action in 2009 to improve enforcement across the securities markets.

Third, the recent report by SEC Inspector General David Kotz on the agency's failures to act to stop the Madoff fraud despite repeated external warnings over nearly two decades was shocking. If we are to truly improve the performance of the Securities and Exchange Commission, I believe that as part of this legislation we need to look at the resources available to the SEC, the methods for allocating this funding, and the agency's organizational structure. What are your thoughts on these matters?

We agree that considering the resources and effectiveness of all the regulatory agencies is a critical part of reform. The process of reform at the SEC is already underway in many respects. For instance, our legislative proposal requires a dedicated office for credit rating agencies within the SEC to focus on that critical aspect of financial market regulation. Our legislation would create a permanent Investor Advisory Committee to give investors a

permanent and statutory voice at the SEC. Already this year, the SEC has undertaken a series of significant reforms to improve performance – and in particular to improve enforcement. For instance, the SEC has expanded training programs, set in place procedures to bring expertise from the outside and put experienced investigators on the front lines, streamlined enforcement and examination procedures, better shared information and better used knowledge from third parties, and improved risk assessment so that resources are better targeted and allocated. There are significant and important reforms already under way, and we would be glad to work with you and with the SEC to consider additional ideas in this area.

Fourth, as you know, securities lending is one of the two key issues that led to the downfall of AIG, the other being its faulty credit default swaps. As part of this reform package, why shouldn't we give the SEC more power to regulate this market in order to enhance market transparency, limit collateral exposure and risk, and limit potential conflicts of interest?

Through the payments and settlements authorities, our proposal would provide the government with appropriate authority to create regulatory requirements that would support the orderly function of the securities lending market. The Administration's regulatory reform proposals also have provided a potential mechanism for addressing threats to financial stability arising from the tri-party repo market. Title VIII of our regulatory reform bill, among other things, confers upon the Federal Reserve Board authority to impose risk management standards (including capital and margin requirements) with respect to any systemically important payment, clearing, or settlement activity of financial institutions. We believe that it would authorize the government to regulate how the key banking organizations that are instrumental in the clearing and settlement process provided those services in the tri-party repo market. We further believe that it would give the government authority to impose minimum initial and/or variation margin requirements (or other prudential requirements) for all lenders in the tri-party repo market.

International Coordination

3) As you know, Mr. Secretary, I recently spent an extensive amount of time meeting with European legislators and regulators regarding financial regulatory reform. I am very much of the belief that we need to work to achieve high-level, strong, common standards across international borders in order to prevent regulatory arbitrage whereby sophisticated wizards seek capital advantages by conducting their businesses in countries with lower standards. This problem is an inevitable outgrowth of capitalism. I know that you have been meeting with the leaders in other countries on these matters, and this is helpful. However, because lawmakers will ultimately need to enact laws to put in place the reforms you will be proposing, lawmakers need to be part of the discussion process. The failure to include lawmakers in discussions about the Kyoto accord ultimately led to that agreement's downfall. What steps will you take going forward to better involve lawmakers in international discussions on financial services regulatory reform?

The Administration is committed to working with Congress to meet the objective of strengthening international regulatory standards. The reforms that we are asking

Congress to enact will strengthen the U.S. financial system and allow the U.S. to continue its strong global leadership in the international forum.

I absolutely share your view that lawmakers need to be part of the discussion process on this important issue. We have testified before Congress and addressed issues related to the G-20 and international coordination on regulatory reform six times in the last five months. In addition, senior Treasury staff has briefed Congressional staff on these issues and stands ready to continue to do so. We will continue our efforts to proactively work with members of Congress on issues of international concern, and engage with you and your staff as we coordinate our international efforts to make sure that the high standards in the U.S. are matched by our international counterparts.

Insurance Reform

4) As you know, Mr. Secretary, I am very pleased with your proposed refinements to my legislation to establish a national office focused on insurance matters. This has long been a glaring shortcoming of our present regulatory system, and the near collapse of AIG demonstrates the need for such an information resource within the federal government. That said, there are many of us who are very interested in pursuing federal regulation of some or all parts of the insurance industry. I am especially interested in putting in place federal insurance regulation for financial guarantee products like reinsurance, bond insurance, and mortgage insurance. Does the Administration have a view on these complex matters? Should we pursue them now, or would we be better advised to wait until next year?

I share your belief that regulation of the insurance industry needs to be modernized. Our current insurance regulatory system is highly fragmented, inconsistent, and inefficient. While some steps have been taken to increase uniformity, they have been insufficient. The Treasury's Financial Regulatory Reform White Paper calls for increased national uniformity in insurance regulation through either the creation of a federal insurance charter or through significant changes in the state-based insurance system.

Our white paper laid out six principles for modernizing our system of insurance regulation. We would evaluate any proposal along these principles and are willing to support proposals consistent with this approach, which as we stated could include a federal charter. We want to work with you and colleagues in the Congress on timing.

Investment Adviser Registration

5) Mr. Secretary, I applaud the Administration for its proposal to require the registration of virtually all investment advisers. I have for some time been saying that everyone needs to get an annual pass in order to swim in the pools of our capital markets. That said, a number of parties are suggesting that we ought to create some exceptions to this new registration requirement. For example, some advisers who solely work to assist wealthy families in the management of their portfolios -- generally known as single family offices -- have suggested that they should remain exempted from registration requirements. What are your thoughts about creating such carve outs?

Our reforms are focused on gaining increased understanding of potential risks in the actions of hedge funds and private pools of capital, and to close gaps in regulation so that risky activities cannot migrate into regulatory gaps and that risks cannot build up completely outside regulatory monitoring or awareness.

That is why our reforms in this area are guided by a simple principle: all advisers with more than $30 million in assets under management must be brought into the system, at least through registration. This will help ensure that risky activities cannot migrate into regulatory gaps and that risks cannot build up completely outside regulatory monitoring or awareness.

We do not believe that our proposals place heavy regulatory burdens on investment advisers. We would simply require that such firms register with and report regularly to the SEC. This process will allow the SEC and other federal regulators to monitor trends and evaluate areas where risks might build.

Questions for the Record from Representative Bean

1) Following up on Chairman Kanjorski's question regarding insurance regulatory modernization, would you support Congress going beyond the administration's proposed Office of National Insurance to modernize and improve our insurance system if they met the administration's six principles for insurance regulation?

I share your belief that regulation of the insurance industry needs to be modernized. Our current insurance regulatory system is highly fragmented, inconsistent, and inefficient. While some steps have been taken to increase uniformity, they have been insufficient. The Treasury's Financial Regulatory Reform White Paper calls for increased national uniformity in insurance regulation through either the creation of a federal insurance charter or through significant changes in the state based insurance system.

Our white paper laid out six principles for modernizing our system of insurance regulation. We would evaluate any proposal along these principles and are willing to support proposals consistent with this approach, which as we stated could include a federal charter.

2) One of the central reasons cited for creating the CFPA focuses on the lack of action by the current agencies to promulgate consumer protection rules. Clearly, until recently, there was a lack of attention by the Federal Reserve to update consumer protections-especially in mortgage lending and credit cards. So the administration's proposal to put rule-making authority in the CFPA with meaningful input from the bank regulators is understandable.

However, our next panel consists of the federal bank regulators who are responsible for enforcing the rules on the book.

Have you found that it was their lacking enforcement of the consumer protection rules that existed at the time contributed to our economic downturn or was it lacking rule-making authority?

We believe that both a lack of rule-making authority and a lack of enforcement of consumer protection laws for financial products and services contributed to certain aspects of our economic downturn. Moreover, we believe that the problems that emerged in rule-making and enforcement of laws relating to mortgage and credit card products were closely related because the fragmented authorities among agencies—some charged with enforcing requirements, while others charged with rule-making authority—contributed towards making each hesitant to act to curb practices that proved to be harmful to consumers. In light of these experiences, we believe that consolidating rule-making and enforcement authorities with the Consumer Financial Protection Agency ("CFPA") will eliminate one of the key weaknesses in our system for regulating the provision of consumer financial products and services.

For example, the fragmented authorities among the agencies resulted in weakening the consumer protections for credit card products. The Federal Reserve Board had the authority under the FTC Act to prescribe rules to prohibit banks from engaging in unfair

credit card practices; the OTS had similar rule-making authority for thrifts; and the OCC and OTS had enforcement authority over the major card issuers and could have brought cases under the FTC Act. The Federal Reserve Board maintained that the other agencies should bring enforcement actions; the OCC maintained that the Federal Reserve Board should establish rules and, as a result, neither agency acted until it was too late for millions of consumers.

A similar dynamic led to weak consumer protections for mortgage products. The Federal Reserve Board had power under the Home Ownership and Equity Protection Act to prohibit by regulation unfair and deceptive practices in the mortgage market and each of the Federal banking agencies had authority under the FTC Act to bring enforcement actions against banks and thrifts originating mortgages unfairly or deceptively. The Federal Reserve Board did not adopt regulations, and the other agencies did not bring enforcement actions.

The agencies ultimately adopted supervisory guidance, but the fragmentation of authority made it impossible for them to act in time. In June 2007, the Federal banking agencies finally reached consensus on supervisory guidance imposing the most basic standards on the sale and underwriting of subprime mortgages—two years after evidence of declining underwriting standards emerged publicly in the OCC's survey of loan officers. By that time, the subprime explosion was nearly over. And it took a third year—until 2008—for the Federal banking agencies to agree on the simplest model disclosure of subprime mortgages, by which point the subprime market had long ago imploded.

There are two closely related lessons to be taken from these experiences. First, *rule-making and enforcement should not be separated.* Separation of rule-making authority from enforcement authority leads to inertia, unevenness, and erosion of standards. In addition, a rule-making agency that lacks the benefit of hands-on supervisory experience will be far less effective because the agency will lack critical information about market activity and emerging problems.

Just as importantly, the agency may not fully appreciate the burden its rules might impose —making it very hard to weigh the costs and benefits of additional regulation. A rule-making agency that does not examine and receive information from financial institutions will not understand how institutions operate and the burdens that regulations put on them. Such an agency will likely underestimate the costs of regulation and fail to get the balance between costs and benefits right.

Second, but closely related to the first, *supervisory authority should not be split among various regulators.* If we leave banks to be supervised by one agency or set of agencies and non-bank institutions by another, the standards for consumer protection will ultimately diverge, and market activity will migrate towards the lower standards. There must be a level playing field in supervising all of these financial institutions which offer comparable financial products and services to consumers.

3) One of the key goals of the administration's consumer protection agency is to establish consistent regulation of financial products. However, the CFPA proposal permits states to add additional consumer protection standards. Does this not undercut the goal of consistent regulation so all consumers have the same protection regardless of where they reside?

Congress repeatedly has enacted laws regulating consumer financial products and services that, with limited exceptions, explicitly allow the states to adopt standards that afford greater protection to consumers. Federal law in this area thus establishes a floor, not a ceiling, for strong consumer protections. We propose to preserve that standard which reflects a decades-long judgment of Congress, which we share, that states should retain authority to protect the welfare of their citizens with respect to consumer financial services. Federal law ensures all citizens a minimum standard of protection wherever they reside. Citizens of a state, however, should be able to provide themselves—through their legislators and governors—more protection.

The continued ability of citizens to protect themselves through their states is crucial to ensuring a strong federal standard. State initiatives can be an important signal to Congress and federal regulators of a need for action at the federal level. It is impossible to simply mandate that federal laws or rules remain updated, since practices change so quickly. States are much closer to abuses as they develop, and are able to move much more quickly when necessary. For example, the states were far ahead of the federal government in regulating subprime mortgages. If states were not permitted to take the initiative to enact laws providing greater protection for consumers, the federal government would lose a critical source of information and an incentive to adjust standards over time to address emerging issues.

If the CFPA is created and endowed with the authorities we have proposed, we expect the standards adopted by the Agency will promote regulatory consistency, even while it respects the role of the states. We believe a strong and independent CFPA, that is assigned a clear mission to keep consumer protections for financial products and services up-to-date with changes in the marketplace, will reduce the incentives for a state to act on its own. If financial services providers in a state are already subject to a strong national standard, the state is less likely to conclude that the benefits of passing a stricter state standard outweigh the costs

Follow up - Consumer groups have argued that if the standards are high enough states will not have an incentive to act. However, as long as states are given the ability to do so, state actions can be expected. Would it not be better to simply set high federal standards and avoid the potential for additional state action?

We believe that actions of the states will focus the attention of the federal regulators, leading to more effective Federal standards. State initiatives bring the attention of the federal government to consumer protection problems the federal government might otherwise not fully appreciate. State initiatives encourage the federal government to keep federal standards up to date. If states were not permitted to take the initiative to enact laws providing greater protection for consumers, the federal government would lose a

critical source of information and an incentive to adjust standards over time to address emerging issues.

4) A lot of the problems with subprime mortgages happened in non-bank lenders and brokers regulated by the states. Will CFPA have the bandwidth to supervise non-bank lenders and brokers while taking on supervisory powers over already regulated banks?

We will work with Congress to create and fund an agency that has the capacity to protect consumers across the marketplace, regardless of the charter or corporate form of the entity providing the consumer financial product or service. It is critical that we do so. Of course, the CFPA's resources, like those of any agency, will be finite, but our proposal would establish a mandate for the Agency to allocate its resources on the basis of risks to consumers. Firms that pose more risk to consumers—because, for example, they are not supervised by other regulators—will receive proportionally more oversight from the CFPA. Firms that pose less risk to consumers—for example, because they have compliance systems in place and have been closely supervised at the federal level—will receive proportionally less oversight. By establishing risk-based standards and procedures for administering its supervisory authorities, we believe that the CFPA should be able to effectively supervise non-bank lenders and brokers.

5) The proposal of having the fed being the consolidated regulator of tier 1 holding companies calls for the fed to supersede the regulatory authority of the functional regulator which is different from the relationship between the fed and functional regulators for bank holding companies (fed defers to functional regulator in most cases).

If ABC Bank Holding Company is determined to be a Tier 1 holding company, do you envision the Federal Reserve conducting on-site examinations instead of the National Bank Supervisor?

What if XYZ holding company that owns an insurance subsidiary is determined to be a Tier 1 holding company, do you envision the Federal Reserve conducting day to day supervision over the current state insurance regulators?

With respect to both scenarios, the answer is no, the Treasury does not envision that the Federal Reserve Board would replace the National Bank Supervisor or state insurance regulator in the exercise of their statutory supervisory responsibilities.

The Treasury proposes that the Federal Reserve Board should have the authority to require reports from and conduct examinations of Tier 1 FHCs and all of their subsidiaries but, to the extent possible, should continue to gather information from reports required or exams conducted by the primary supervisors. The Treasury also proposes that the Federal Reserve Board should have the authority to impose higher prudential requirements or more stringent activity restrictions, if such action is necessary to address systemic concerns, but, again, only after consulting with the primary supervisor. In other words, the Federal Reserve Board will be the consolidated supervisor and will continue to depend in most cases on the functional regulator, whether that is a federal bank regulator or a state insurance regulator.

6) Some have proposed banning naked credit default swaps with the exception of market makers. Do you believe naked CDS should be banned?

We do not believe that there should be a ban on "naked" credit default swaps (CDS). A naked CDS usually refers to the purchase of protection by an investor on an underlying bond that the investor does not hold. Implementing a ban on such products would be very difficult. Many firms hedge their risks on a portfolio basis and do not use exact hedges to manage their risks. In addition, determining the extent to which a particular derivative trade hedges another position of a dealer is very hard to determine.

Moreover, CDS – used and regulated properly – serve a number of valuable economic functions. For example, CDS enable financial institutions to hedge the credit risks in their loan books – making the institutions safer and enabling them to increase credit availability in the economy. CDS markets also provide a valuable amount of transparency for the debt markets. CDS markets tend to be substantially more liquid than the corporate bond and ABS markets, and hence provide a much greater amount of more timely information about the credit quality of debt issuers and instruments. Accordingly, CDS are an important source of market discipline for firms.

Our plan approaches the risk of manipulation and fraud directly by providing regulators with complete transparency into the OTC derivative markets and thus will give regulators substantially more information to support their efforts to police fraud and market manipulation in the securities markets. In addition, all derivatives dealers and major market participants will be subject to prudential regulation so that firms cannot take risks without holding reserves. These firms will be subject to capital and margin requirements, and the capital requirements for customized derivatives will be higher than standardized and cleared contracts – lowering the risk to the system and creating incentives for the market to move towards standardized contracts.

7) The Treasury proposal creates a Financial Services Oversight Council. How would the Council mitigate or make final decisions on regulatory disputes, such as those that may emerge in the harmonization of the SEC and CFTC's regulatory regimes?

Under our proposal, the Council would facilitate interagency discussion and analysis of financial regulatory policy issues to support a consistent well-informed response to emerging trends, potential regulatory gaps, and issues that cut across jurisdictions. The Council would facilitate information sharing and coordination among the principal federal financial regulatory agencies regarding policy development, rule-makings, examinations, reporting requirements, and enforcement actions and provide a forum for discussion of cross-cutting issues among the principal federal financial regulatory agencies. Under the proposal that is being debated by the House Financial Services Committee, the Council would be able to make decisions of this sort based on a majority vote of its members.

Questions for the Record from Representative Foster

1) Do you have an opinion on the merits of conducting periodic stress tests on potentially systemically important financial institutions banks and publishing the results?

The SCAP stress test earlier this year served a vital purpose during extraordinary market conditions, providing the market with rigorous estimates of large firms' capital needs using scenario assumptions determined by supervisors.

On an ongoing basis, enhanced public disclosure of risk exposures on a comparable basis could be a valuable tool to help the market assess firms' relative exposures to low-probability, high-risk events and thereby promote market discipline. Such disclosures could be based on common stress scenario assumptions provided by supervisors. The Treasury is currently sponsoring a working group on banking supervision and regulation, in cooperation with the federal banking supervisors, which will address the topic of enhanced public disclosure of firms' risk-taking. Treasury plans to release these recommendations in the near future.

2) In your prepared testimony you indicate the Administration's proposal, "...will establish a higher baseline for all firms, and then go beyond that baseline to impose still higher standards on the largest, most leveraged and most interconnected firms that pose the greatest risk to the system as a whole." How do you impose higher standards on the largest firms without effectively creating a list of systemically important institutions? Is there a way to accomplish this objective without, in fact, creating such a list?

We do not intend to create a public list of financial firms whose failure could pose a threat to financial stability. We do, however, expect the Federal Reserve Board to impose heightened prudential standards on the largest, most interconnected financial firms. The Federal Reserve Board effectively does this today in the context of its risk-focused supervision of bank holding companies and in its approach toward the Basel 2 capital requirements. We also note that identification by regulators of a firm as in need of stricter prudential standards would not be accompanied by any promise of government support if the firm became troubled. All that such identification would cause is more intensive government supervision and regulation – supervision and regulation that would force the firm to internalize externalities, offset any implicit government subsidy from its size, leverage, complexity and interconnectedness, and provide incentives to shrink and reduce leverage, complexity, and interconnections.

3) Your testimony describes the Consumer Financial Protection Agency (CFPA) as a consolidation of consumer protection functions, an action that would potentially reduce the size of the consumer protection bureaucracy. However, increasing its scope to include currently unregulated entities and activities would certainly increase its size. Could you provide a rough estimate of the net effect of your proposed changes to the overall manpower devoted to consumer financial protection?

While we propose to consolidate the consumer financial protection functions of seven Federal agencies under the CFPA, as you note, the Agency will also need staff and resources to effectively regulate non-bank entities that previously were not supervised by a Federal agency. Nevertheless, consolidating the authorities of the Federal agencies that currently regulate consumer financial products and services should lead to efficiencies that will help offset the new costs of regulating non-bank entities. For example, each of the Federal agencies now issues regulatory compliance guidance and consumer financial education materials on substantially similar topics. Where there is currently considerable overlap between the different functions for rule-making, enforcement and supervision, consumer education, and research, there will likely be efficiencies by consolidating these functions with the CFPA. As the CFPA coordinates these functions to regulate banks, the CFPA should be in a position to effectively allocate resources to regulate non-bank entities. In addition, even though the CFPA will need resources to build the registration, reporting and examination functions to effectively oversee non-bank entities, the Agency will develop risk-based standards and procedures to supervise these entities. We are working to formulate an estimate on what resources will be needed to perform these important functions so that consumers nationwide are better protected in the marketplace for consumer financial products and services, regardless of whether those products and services are provided by banks or non-bank entities.

4) There are recurrent suggestions of limiting the size of financial institutions, either explicitly or implicitly via nonlinear capital requirements and other disincentives. What is known about the reduction in efficiency of our economy as a function of the maximum allowable size of banks? To what extent is the economic success of large financial institutions due to efficiencies of scale as opposed to lower cost of capital arising from the assumption of a federal backstop for large firms?

We believe that setting a hard, binding cap on the maximum size of financial institutions could negatively affect our economy by hindering America's ability to compete globally. Moreover, given the scale and complexity of our economy, that is not a realistic or desirable option. While size may be an indicator of the risk that a firm might pose to the financial system, not every firm that threatened financial stability over the past two years was large. An undiversified institution can present a risk profile that is more pronounced than a well run, larger institution. Therefore, in determining new capital and liquidity requirements, we also look at how interconnected a firm is, and how important it is as a source of credit to American households and businesses. Under our plan, we look at all these things – and firms that present unusual risks will be subject to much higher standards, so that the risk of failure is lower.

The Administration has laid out core principles for reform on capital and liquidity standards, to strengthen the financial system's ability to withstand periods of financial distress.

- **Capital requirements should be designed to protect the stability of the financial system, not just the solvency of individual banking firms, including banks, bank holding companies, financial holding companies and large, interconnected firms.**

- **Capital requirements for all banking firms should be increased, and capital requirements for financial firms that could pose a threat to overall financial stability should be higher than those for other banking firms.**
- **The regulatory capital framework should put greater emphasis on higher quality forms of capital that enable banking firms to absorb losses and continue operating as going concerns.**
- **The rules used to measure risks embedded in banks' portfolios and the capital required to protect against them must be improved. Risk-based capital requirements should be a function of the relative risk, including systemic risk, of a banking firm's exposures, and risk-based capital rules should better reflect a banking firm's current financial condition.**
- **The pro-cyclicality of the regulatory capital and accounting regimes should be reduced and consideration should be given to introducing countercyclical elements into the regulatory capital regime.**
- **Banking firms should be subject to a simple, non-risk-based leverage constraint.**
- **Banking firms should be subject to a conservative, explicit liquidity standard.**

Stricter capital and liquidity requirements for the banking system should not be allowed to result in the re-emergence of an under-regulated non-bank financial sector that poses a threat to financial stability. Moreover, these higher capital and liquidity standards should provide positive incentives for the largest, most interconnected firms to reduce their size, complexity and interconnectedness.

In addition to higher capital and liquidity standards, the Administration's plan would close loopholes and impose tougher standards, especially for those firms that pose the most risk, to make the system more stable. The Administration's plan subjects all companies that control insured depository institutions to robust, consolidated supervision and regulation under the Bank Holding Company Act. It would also raise prudential standards for all financial holding companies.

In periods of financial distress, our plan creates better tools to respond to crisis than those that are currently available to protect American taxpayers and the economy from the failure of large, interconnected institutions. The resolution authority we have proposed gives us another alternative: it allows the government to impose losses on shareholders and creditors without exposing the system to a sudden, disorderly failure that puts everyone else at risk.

In addition to being subject to strong, consolidated supervision, the largest, most interconnected firms must be subject to tougher standards. Prudential requirements should be set with a view to eliminating any perception that size alone carries implicit benefits or subsidies. Capital and liquidity requirements must be higher for major firms, and they should be set at levels that compel firms to internalize the cost of the risks they impose on the financial system.

Regulators should have the authority to break up or constrain the growth and activity of these firms, when their size or activities would pose a risk to the financial system. Firewalls

between insured depository institutions and their affiliates should be strengthened. Risky activities – including in particular proprietary trading and sponsorship of off-balance sheet vehicles – should be subject to higher capital requirements.

Through tougher prudential regulation, we aim to give these firms a positive incentive to shrink, to reduce their leverage, their complexity, and their interconnectedness. And we aim to ensure that they have a far greater capacity to absorb losses when they make mistakes.

Question from Representative Wilson

Mr. Secretary, I have a close to home question to pose to you about GM/Delphi salaried retirees. You were a great help in making sure that most of the employees were able to receive the pay and benefits that they had worked so hard for. Now, the only employees of this company that have not been "made whole" are the salaried retirees. What can we do to rectify this?

The situation regarding the salaried Delphi employees is challenging and we do not have a lot of options to address some of the reductions that have occurred. As you know, Delphi has been in bankruptcy for over three and a half years and during that time Delphi has experienced a dramatic diminution in value that has hurt all of its stakeholders. Prior to the involvement of the Auto Task Force and the GM restructuring, Delphi was in a precarious and uncertain negotiation with those stakeholders for desperately needed liquidity; however, with no new cash investment to Delphi from its existing creditors forthcoming, the company was on the verge of complete liquidation.

Through tremendous efforts and shared sacrifice, Delphi was finally able to file an amended Plan of Reorganization on June 1. At the end of July, the Bankruptcy Court did approve a Plan of Reorganization paving the way for Delphi's ultimate emergence from Chapter 11, preserving thousands of jobs for its employees. Nevertheless, Delphi's Plan encompassed a number of painful concessions in order to create some reasonable likelihood of success.

Under the Plan, secured creditors are taking substantial haircuts and unsecured creditors are expected to receive little or no recovery. Unfortunately, there simply is no realistic alternative to the termination of the existing Delphi salaried pension plans and the transition of their stewardship to the Pension Benefit Guaranty Corporation (PBGC). Delphi's pensioners will receive distributions under their plans in accordance with applicable law.

We recognize these reductions will be difficult. On June 23, the President signed an Executive Order establishing the White House Council on Auto Communities and Workers, of which I am a member, to help coordinate the Federal response to the communities that have been hardest hit by the auto industry's decline. I am committed to working with the Council, my staff at Treasury, and people such as yourself to find lasting solutions that will provide long-term economic stability to those communities.

○