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FINANCIAL REGULATORY REFORM: PROTECTING TAXPAYERS AND THE ECONOMY

HEARING

BEFORE THE

JOINT ECONOMIC COMMITTEE
CONGRESS OF THE UNITED STATES

ONE HUNDRED ELEVENTH CONGRESS

FIRST SESSION

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FINANCIAL REGULATORY REFORM: PROTECTING TAXPAYERS AND THE ECONOMY

THURSDAY, NOVEMBER 19, 2009

CONGRESS OF THE UNITED STATES,
JOINT ECONOMIC COMMITTEE,
Washington, DC.

The committee met, pursuant to call, at 10:04 a.m., in Room 210, Cannon House Office Building, The Honorable Carolyn B. Maloney (Chair) presiding.

Representatives present: Maloney, Hinchey, Hill, Sanchez, Cummings, Snyder, Brady, Burgess, and Campbell.

Senators present: Schumer, Klobuchar, Casey, Brownback, and DeMint.

Staff present: Paul Chen, Gail Cohen, Colleen Healy, Michael Neal, Andrew Wilson, Rachel Greszler, Lydia Mashburn, Brian Robertson, Jeff Schlagenhauf, Ted Boll, and Robert O'Quinn.

OPENING STATEMENT OF THE HONORABLE CAROLYN B. MALONEY, CHAIR, A U.S. REPRESENTATIVE FROM NEW YORK

Chair Maloney. The meeting will come to order.

It is my pleasure to welcome Secretary Geithner.

In order to allow enough time for members to have all the questions they desire, I am limiting opening statements to the Chair and Ranking Member. I ask for unanimous consent to accept written statements into the record, and the Chair recognizes herself for 5 minutes.

First of all, I want to again thank Secretary Geithner for joining us today. The severe breakdown in our financial system under the watch of the previous Administration triggered a cascade of events, including a free fall in household wealth, paralysis in consumer spending, frozen credit markets, and a tailspin in the labor market. A recession grew into a near depression. By some measures, what happened to our economy was worse than what happened during the Great Depression.

During the first year of the recession, household wealth plunged by 17 percent, more than five times the decline seen from 1928 to '29. In addition, stock prices became even more volatile than they were at the heart of the Great Depression.

Yet recently we have seen some recovery. Treasury, the Federal Reserve, and the FDIC, along with Congress, took an extraordinary series of measures to preserve financial stability and restore the proper functioning of the credit markets. These initiatives included recapitalizing banks and creating a series of new lending facilities at the Fed. They have clearly contributed to the recovery of the financial system. Interbank lending rates are back to normal after having spiked during the crisis, and the S&P 500 is up by over 64 percent from its March, 2009, low.

However, Chairman Bernanke noted earlier this week constrained bank lending and a weak job market will prevent the recovery from being as robust as we would like.

Treasury has taken actions recently to help spur lending and create jobs. Treasury will provide low cost capital to community banks and submit a plan to increase small business lending and increase lending to small businesses in the hardest hit communities.

But more needs to be done, as Professor Stiglitz testified before this committee, and I quote: Where there are perverse incentives there are perverse outcomes unless we constrain behavior. End quote.

The regulatory reform that we are considering will do just that. It will eliminate the incentives for banks to engage in the same risky behavior that led to the financial crisis.

The House Financial Services Committee under Chairman Frank's leadership has recently passed or marked up a number of bills related to financial regulatory reform. First, a systemic risk regulator that will make sure that no firm is too-big-to-fail. Second, firms will not be bailed out. They will be taken over and shut down in an orderly way. Third, regulatory gaps will be plugged. Hedge funds and over-the-counter derivatives market will not be allowed to grow unchecked and threaten the viability of the financial system, and we will stop fraudulent and predatory lending or banking practices by creating a Consumer Financial Protection Agency. This agency will help spur the demand for credit to the many Americans who are now nervous about the financial products available to them. Like the Credit Cardholders Bill of Rights that I introduced and Treasury supported and Congress passed, it will stop the most abusive practices of lenders of credit.

Although much more needs to be done to help American workers and small businesses, reforming the financial system is a very crucial step in that process. Restoring trust in our financial system will help revive the job market and jump-start the flow of credit to the economy.

Secretary Geithner, again, we thank you for your testimony here today; and we look forward to hearing your thoughts on how financial regulatory reform will help impact the economy as a whole and help working Americans in particular. Thank you for being here.

[The prepared statement of Representative Maloney appears in the Submissions for the Record on page 46.]

I recognize Ranking Member Brownback. We are hopeful that the Vice Chair, Mr. Schumer, will also be able to join us.

OPENING STATEMENT OF THE HONORABLE SAM BROWNBACK, RANKING MINORITY, A U.S. SENATOR FROM KANSAS

Senator Brownback. Thank you, Chair Maloney. I appreciate that.

Secretary Geithner, welcome, glad to have you here. You have had more experience in the last 2 years in tough situations than I think most people would want to have or wish on themselves in a lifetime. So you have a lot that you can share with us.

I mentioned to you in the foyer ahead of time the idea on the financial regulatory reform that Fed Chairman Hoenig is pushing out of Kansas City that we need to put in place too-big-to-fail policies, that if you are too big that there is a way to safely dismember if you are not—if you get there, and it is going to be harmful. And I am hopeful that you will look favorably on those sorts of proposals as you move this process forward, because I think we need some work in this area.

I am not sure I agree with all of the Administration plan, but this is a piece—I think there is broad bipartisan support that if a major financial institution gets of a certain size that we don't just assume the government is going to bail them out, that we tell the marketplace, look, there is a safe way and we will dismember this. So that we don't get in the moral hazard or them being able to get capital with the assumption that the government is going to bail them out. I am glad you are here to talk about that.

You asked when we were in the foyer about the mood in the country, and people are really deeply concerned. The debt just passed $12 trillion this week. That is getting close to the size of the economy in the country. People are really, really concerned about that.

The President just gets back from China, and it is like we are going to meet with our bankers, is what it looks like to a lot of people. And they don't like that. They don't like that setup.

And then we are looking at adding an entitlement program in health insurance, and I know there are different perspectives on that. But it is probably a multi-trillion-dollar obligation on the Federal Government's part at a time that we are $12 trillion in debt, and most people think this is fiscal insanity. We are hemorrhaging money at the Federal level.

And then to add that level of entitlement on top of it when we are hemorrhaging money and we are already $12 trillion in debt and we are going to the Chinese to give us some money, people don't think that makes any sense. And you are the guy at the top of the financial pyramid, you, with the President, to help us make sense of this.

Now, I think the bill coming out in the Senate scores financially neutral to a little favorable, which I am pleased to see. But it does that by taking more taxes from the people or money from Medicare, which we have proven unsuccessful in being able to do in the past. We did a doctor fix in—what—1997, and every year we fill the hole back up. As people come in and they lobby and they say, oh, you can't cut the providers this, you can't cut them; and every year it is filled back in.

So that the idea that you are going to save $400 billion out of Medicare, it has not proven doable in the past. And the idea that you would raise taxes on the American public when we are in this sort of financial condition in the country right now doesn't seem rational. It really does seem fiscally insane.

I know you didn't come up here to talk about that, but that is certainly what is on everyone's mind as they look at the situation.

One final thing I want to point to—and the President just got back from China. We have to get the Chinese to allow their currency to float. I want to show you one chart up here. And you know this one better than anybody. But the appreciation of other currencies versus the U.S. dollar, and you know that has taken place in major European, Japanese currency, the Euro.

You can see what it has done against the Chinese currency. No appreciation. None. They peg their currency to ours at a time when our currency has fallen, and you can see reasons for why it would fall, that the Chinese currency should clearly be going up against that, making our goods more competitive in China, theirs less competitive here.

One of my children is from China. I have a beautiful daughter that is in the sixth grade; and she asked me one time a couple of years ago, dad, why is everything here made in China? And I said, well, it is a long answer. But a big part of it is this currency issue, and I think we just have to hammer them for us and take aggressive action.

And this is not just important to the United States. Other Asian currencies are hurt by the Chinese pegging their currency to ours, and they are hurt big time on this. I know you are aware of this. I just think it is time to get the stick out and say, okay, we have to do something about this. This is going to the wrong direction. And I really hope you can speak to some of that as well.

Thank you very much, Chairwoman.

Chair Maloney. Thank you for your statement.

And I would now like to introduce the Secretary——

Representative Burgess. Madam Chair, just a question, if you don't mind. Many of us over here on the minority side, our only opportunity, our only opportunity, to talk to one of the most important individuals in the Administration is this morning. Secretary Geithner, this is his first trip here. We appreciate him being here.

But just as Senator Brownback conveyed the concerns of his constituents, we need to have the courtesy of conveying the concerns of our constituents. Mine aren't mad—I mean, aren't anxious. They are mad. They are mad as hell. We need to be able to convey that to——

Chair Maloney [continuing]. Congressman, the usual procedure in prior Congresses was just the Ranking Member, the Chair and the Vice Chair were given opening statements. Each of us will have as many times as we want to stay for questions to give your opinions about—for your constituents or ask questions to the Secretary.

His time is limited, and I feel the American people would want to hear what he has to say, and he is the Secretary of the Treasury, and to respond to the questions that we have. No objection was given to me from your side.

And I now would like to hear from the Secretary of the Treasury. I will not even introduce his very impressive background so that we can just hear his words and hear where we are moving in the right way for this country and the challenges that are before us.

Mr. Secretary, you are recognized for as much time as you would like to consume.

STATEMENT OF THE HONORABLE TIMOTHY F. GEITHNER, SECRETARY OF THE TREASURY, UNITED STATES DEPARTMENT OF THE TREASURY

Secretary Geithner. Thank you, Chairwoman Maloney; and thanks to all of you for giving me a chance to come speak to you today.

You asked me to come and talk about financial reform, but I am happy to answer questions on any of the broad range of economic questions we see facing the country.

My microphone says it is on.

I just thank you for having me up here and you asked me to talk about financial reform, but I am happy to talk about any of the broader concerns on your mind that affect our economic future.

We are in the process now of recovering from the worst financial crisis—worst economic crisis in generations. The pace of job loss has slowed sharply, but unemployment is still unacceptably high and, unfortunately, is still rising. We have restored confidence in the stability of the financial system. The cost of credit has fallen dramatically and value of American savings has risen substantially. The ability of people to borrow a mortgage at low interest rates has improved dramatically.

But, as we discussed yesterday at the Forum on Small Business Financing, you see the classic credit crunch risk for small businesses across the country. Small businesses are having a hard time getting the credit they need, the access to credit and capital they need to expand and to hire more workers.

Now, I welcome the attention of the committee to this important cause of financial reform. Getting this right is critically important to the health and performance of the American economy. The economic costs of financial crises are devastating.

One of the great strengths of our financial system in the past has been the ease with which we are able to fund the ideas and ambitions of millions of entrepreneurs. There is no growth, no economic growth and no innovation without access to capital and credit. But if you let the financial system become too fragile and too unstable, if you allow risk to evade the safeguards we establish in the system, if you allow firms to escape protections for consumers and investors, if you create incentives for excessive investments, excessive risk taking, excessive investments in real estate, if you allow moral hazard to spread, the consequences will be brutal and the damage indiscriminate and long lasting.

This is an enormously complicated endeavor, and we have to be very careful to get this right. We need to make sure we enact reforms that are strong enough not just to correct the deep flaws in our present system but are strong enough to prevent severe crisis in the future.

Now, the comprehensive reforms that are being shaped in the House and the Senate now offer the best chance in generations to create a more stable system with stronger protections for consumers and investors and less risk to the taxpayer. I want to outline very briefly the four key elements, four key principles for reform that are critical to a strong package of legislation. There are different ways to achieve these reforms and different views on how best to balance the tradeoffs involved, but these basic elements are essential to any strong final bill.

First, financial firms must not be allowed to escape or avoid safeguards designed to make sure the system is stable and protections for consumers and investors. We can't let firms choose their regulator, shift risk where protections are weakest, structure their business with a form of financial instruments they sell to maximize short-term returns at the cost of greater risks to the economy as a whole.

Firms that provide credit help companies raise capital, provide the basic economic functions we call banking, need to be overseen as banks and operate on the same strong protections we have long put in place for banks.

We can't allow large institutions, whether investment banks like Bear Stearns or Lehman, firms like AIG, large finance companies that play critically important roles in our economy, from escaping consolidated oversight. We can't allow entities to compete with banks in providing mortgages, credit cards, other forms of consumer credit to evade protections we put in place for consumers.

From now on, firms that are engaged in the same kind of business, performing the same essential economic functions, must be subjected fundamentally to the same regulation and supervision.

The second principle of reform is there has to be clear accountability with a responsibility matched with clearly defined authority. We need to put in place a council for coordination, a council that is charged with making sure we have a level playing field with strong standards and no devastating gaps in coverage.

But we can't have supervision enforcement or rule writing by council or committee. The American people and the Congress should know who is responsible for consumer protection, for market integrity and investor protection, for traditional bank supervision, for the stability of the system as a whole, for operating the emergency room when firms fail.

These are complex, specialized, and very different functions. No one entity can do all of them well. We have too many agencies, though, doing them now and yet still have large gaps in the system without anyone in charge or accountable. This is a mess, and we have to clean it up.

The third principle is that the financial system as a whole has to be more capable of absorbing shocks and coping with failure. This requires much stronger, more carefully designed shock absorbers for financial institutions and for the markets where firms come together; and it requires tough constraints on risk taking. These shock absorbers in the form of capital, liquidity, margin requirements are critical not just to reduce the risk of failure by our large institution but to make sure that we prevent failures of large firms from spreading like wildfire across the economy and around the world, as we saw last fall. These constraints have to be applied across the institutions that play critical roles in our markets as well as to the clearinghouses and markets like derivatives where firms come together where risk can concentrate and cause the most damage.

Fourth and final principle, no institution should be considered too big to fail. As we saw in Lehman's collapse and AIG's failure, the U.S. government came into this crisis, worst crisis in generations, without adequate tools to respond effectively when the failure of large institutions truly threatened the stability of the financial system.

Now, that is why we have proposed that the government have the authority, as we have today for banks and thrifts, to break apart or unwind major large, complex financial institutions in an orderly way, imposing pain on shareholders, creditors and managers but limiting collateral damage to the system and sparing the taxpayer.

This emergency authority, what we call resolution authority, has to be designed to facilitate the orderly demise of a failing firm, not ensure its survival. And to protect the taxpayer from bearing the cost of financial failure by private firms, any risk of loss must be recouped from the largest institutions in proportion to their size. The financial industry, not the taxpayers, need to be on the hook.

Now, in addition, to further reduce the risk of moral hazard, we have proposed to substantially limit the emergency authorities of the FDIC and the Fed so that they are only available to protect the financial system as a whole, not individual failing financial institutions.

Just let me conclude, Madam Chairwoman, by complimenting the leadership role that Chairman Dodd and Chairman Frank are playing in crafting strong and comprehensive reform. This is a just cause. They are facing enormous resistance, and they deserve our strong support.

We have suffered a devastating loss of confidence in what has been a great strategic economic asset of the United States. Financial reform is essential to restoring confidence. We have to lead the world and enact reform or we are going to lose our leadership role.

Thank you very much.

[The prepared statement of Timothy F. Geithner appears in the Submissions for the Record on page 46.]

Chair Maloney. I want to thank you for your testimony.

As you noted, Senator Dodd and Chairman Frank are deeply involved in financial reform. Just this week, Chairman Frank has been leading markups on financial reform in the Financial Services Committee.

Mr. Secretary, what would you say are the three most potent economic indicators, the three things that you can point to to the American people to assure them that our economy is on the right track?

Secretary Geithner. Madam Chairwoman, the best broad measure of health of our economy is the rate at which we grow. And at the end of last year, beginning of this year, the economy was shrinking at a rate of about 6 percent of GDP, the most rapid rate we have seen in decades. And you saw last quarter the economy start to grow again. It grew roughly at the rate of 3 percent, the first time we have seen signs of growth in more than a year.

Beginning of this year, we were losing almost three-quarters of a million of jobs a month; and the pace of loss of jobs has slowed dramatically. You have seen the value of American savings rise very dramatically, credit markets start to open up, the basic pipes of the financial system start to open up again.

But this is a very tough economy still. You see that, of course, in this devastatingly high unemployment rate. And it is going to take us a while to work through these problems.

Again, we started with just the worst financial crisis we have seen in a long period of time, and it already caused huge dramatic damage to confidence. It takes a while for that confidence to be restored, but I think you are seeing positive signs of stability now and the early signs of growth. You need growth to create jobs. You won't have an economy generating jobs again until you see growth start to broaden and spread. And I think you are seeing the underlying pace of growth in the economy, although it is modest, it still is gradually strengthening.

Chair Maloney. Thank you.

There was a report that came out this week that was rather critical of Treasury's actions with AIG counterparty payments and the Federal Reserve's actions. And I would like to ask, if resolution authority had been in place at that time, do you think that there would have been a different outcome than paying AIG counterparties par value? And could you walk us through the various scenarios that were available to you at that time? What would have happened on Main Street in America if we had allowed bankruptcy of AIG? Can you paint a picture of what it would mean or what the other scenarios that were out there and how the actions that the reform legislation that is being put in place will make that different in the future?

Secretary Geithner. I think the best way to point out what would have happened if AIG had been allowed to default is to look at exactly what happened when Lehman failed. What you saw is economic activity around the world come to a stop. For the first time in generations, you saw trade stop. You saw financial activity stop. You saw the basic savings of Americans plummet. You faced for the first time again since the Great Depression a generalized run on our financial system. Americans across the country were starting to take their money out of banks.

AIG presented exactly the same kind of risk Lehman did. But, in some ways, they were greater—because AIG as an insurance company, one of the largest in the world, was providing a range of insurance products to households across the country. And if AIG had defaulted, you would have seen a downgrade leading to the liquidation and failure of a set of insurance contracts that touched Americans across this country and, of course, savers around the world. And the judgment made at the time by my predecessor and by the chairman of the Federal Reserve Board and by myself was that we had the ability to prevent that and that was the necessary and prudent thing to do; and in acting that way we were going to save the economy from even greater devastation than we saw in the wake of Lehman's collapse and, ultimately, that would be more effective in containing damage at less ultimate cost to the economy and the taxpayer.

You were right to say we came into this crisis—and this is a tragic failure of this country. The United States of America, the largest financial system in the world, the reserve asset of the entire financial system came into this crisis without anything like the basic tools countries need to contain financial panics and manage failure.

Coming into AIG, we had basically duct tape and string. The Federal Reserve had already used its basic powers wisely and courageously to try to contain the damage of the panic, but those tools were not designed to carry the full burden of solving financial crises.

In the AIG context, we did not have what the U.S. put in place, the will the Congress enacted a long time ago to make sure that when banks and thrifts fail we can manage that failure in an orderly way. We had no such ability and no such tools for the institutions that dominate our financial system.

Now, what we have proposed in this reform package are a set of tools like we have for banks and thrifts that allow us, as you said very well, to manage their failures safely so you don't have the taxpayers exposed, the taxpayers at risk, and you don't see a huge amount of indiscriminate damage to a bunch of firms that were prudently run and prudently managed, businesses that didn't borrow too much, families that didn't borrow too much. That is a just and necessary thing.

And a critical part of reform is just to make sure we come out of this with that basic authority. If we had that authority in place, we would have had much better choices in the AIG context.

We have had a range of other tools to make sure that we managed through that crisis without leaving the taxpayer as exposed as we were. But, at that time, the choice was to prevent default or allow default. Default would have been devastating. Preventing default meant that AIG was able to meet its obligations, its contractual obligations. Again, not just to the financial system as a whole, but to the millions of Americans and savers around the world that had bought a basic set of insurance products, protections from that company.

Now, nobody in my job should ever be in the position again of having to come into a crisis like this without those basic authorities.

Chair Maloney. Thank you.

Senator Brownback.

Senator Brownback. I am going to pass to Congressman Brady.

Representative Brady. Thank you, Senator Brownback.

It has been a year since the President was elected. It is appropriate for the American people to assess how well this Administration's economic policies are working. They are not. They have failed.

Unemployment skyrockets far past White House projections and promises. America continues to shed jobs, more than 2.8 million since the stimulus was enacted. We have had a series of embarrassing investigations about all the wild stimulus claims, the latest fake jobs from fake congressional districts; and, today, the General Accounting Office revealed yet more scandals within the stimulus claims in the case of which thousands of recipients claimed jobs and they have not yet received money.

The U.S. has the worst performance in terms of unemployment rate among the major developed economies since the stimulus bill was enacted, worse than Australia, worse than Canada, worse than the European Union, Japan, South Korea, not to mention China. The industries that the White House and, Secretary, you, promised would have the most job creation, manufacturing and construction, have seen by a percentage the greatest job losses.

The deficit is becoming frightening and threatens our economic recovery. The budget challenges we face with Medicare and Social Security, Fannie and Freddie Mac have been left unaddressed. We are reduced to begging China to buy our debt and getting lectures from other nations on our financial disarray while they discuss replacing the dollar with a more stable reserve currency.

Much of the TARP money is still hidden from taxpayers' eyes. Why, in the public's view, Wall Street is still getting their bonuses and major businesses and small businesses are delaying their key investment decisions as Washington moves on uncertain issues: health care reform, cap and trade, burdensome new regulations, and a host of new tax increases.

Mr. Secretary, you are the point man on the economy. The buck, in effect, stops with you. For several months, conservatives on Capitol Hill have called for you to step down. Last night, Congressman Peter DeFazio said there is a, quote, growing liberal consensus that Secretary Geithner should be removed. Quote, we need a new economic team.

Conservatives agree that as point person you failed. Liberals are growing in that consensus as well. Poll after poll shows the public has lost confidence in this President's ability to handle the economy for the sake of our jobs. Will you step down from your post?

Secretary Geithner. Congressman, it is a great privilege to serve this President, and I am very pleased to have a chance to address the range of concerns you gave.

I agree with almost nothing in what you said, and I think almost nothing of what you said represents a fair and accurate perception of where this economy is today.

Now, I think it is important to start—welcome the advice that you are providing after you left—you gave this President an economy falling off the cliff, values of American savings cut almost in half, millions of Americans out of work. Again, the worst financial crisis we have seen in generations.

Representative Brady. Remind me, Mr. Secretary, what post were you holding when President Bush left office? Just remind me what economic post you were holding.

Secretary Geithner. I was the president of the Federal Reserve Bank in New York. It was a great honor and privilege for me to serve at that time.

Representative Brady. Does the Federal Reserve Bank have any oversight over the economy or any input into its performance?

Secretary Geithner. The Federal Reserve established by Congress is responsible for trying to make sure that we keep inflation low and stable over time.

Representative Brady. Are you shirking responsibility for the design of the bailout or its role in the economy?

Secretary Geithner. Absolutely. The actions that the Congress made possible—too late—but made possible last fall were absolutely necessary to breaking the back of this financial panic. And without those actions and the actions the President put in place with the Congress—support of many people in the Congress at the beginning of this year, you would have an economy still falling, not growing. You would have had job loss still accelerating, not slowing. You would have had the value of American savings still falling, not rising. You would have had——

Representative Brady. But that has been changed. That has created several quadrillion new jobs; is that right?

Secretary Geithner [continuing]. Congressman, again, it is just a basic fact. A year ago, a year ago, this economy was falling at the rate of 6 percent a year. We were losing between half a million and three-quarters of a million jobs a month; and that process was accelerating, not slowing, until the President of the United States came and took office.

Representative Brady. Mr. Secretary, the public has lost all confidence in your ability to do the job. It is reflecting on your President.

Secretary Geithner. Congressman, if you look at——

Representative Brady. Conservatives agree, liberal Democrats agree that it really is time for a fresh start; and I would urge you to consider that.

Chair Maloney. The gentleman's time has expired.

Secretary Geithner [continuing]. Chairwoman Maloney, may I just respond on this?

If you look at any measure of consumer and investor confidence today, if you look at any measure of the strength and the stability and health of the American economy, if you look at any measure of confidence in the financial system, it is substantially stronger today than when the President of the United States took office. And that happened not on its own. It happened because of a set of tough, difficult choices.

And this economy did not come into this simply facing the worst financial crisis in generations. It came into this with almost a decade, certainly 8 years, of basic neglect of basic public goods in health care, in education, in public infrastructure, in how we use energy. And fixing those problems is a central obligation of this Congress and this Administration.

Representative Brady. Tell all of that to the millions of Americans who no longer have jobs because of your decision.

Secretary Geithner. They would have had more jobs, there would have been more confidence, more employment in this country if we had not let this crisis get to the point that it did. And we would have had a stronger fiscal position if we had had 8 years of paying for our commitments and not borrowing against them.

Chair Maloney. The gentleman's time has expired.

Mr. Hinchey is recognized for 5 minutes.

Representative Brady. You have to take responsibility for your decisions.

Secretary Geithner. I take responsibility for anything that I am part of doing. I would be happy to. What I can't take responsibility for is for the legacy of the crisis you bequeathed——

Representative Brady. This is your budget, this is your bailout, this is your stimulus, this is your act——

Secretary Geithner [continuing]. I take full responsibility for those with great honor and——

Chair Maloney. The gentleman's time has expired.

Mr. Hinchey is recognized.

Representative Hinchey. Mr. Secretary, thank you very much for being here; and I very much appreciate much of what you said in the context of your testimony.

In the context of your reaction to the statement that was made just a moment ago, it was also pretty solid and secure, too.

It is just amazing to me how there are some people here who are trying to pretend—and I think consciously and intentionally pretending—that the economic circumstances that we are confronting, all of them mysteriously materialized over the course of the last 9 months or so, which is totally, completely false.

We know what the situation is here. We have been facing one of the most difficult and dangerous economic circumstances in the history of this country. Nothing compared to it other than the collapse in 1929. And mostly that experience of economic decline was based upon the Gramm-Leach-Bliley bill which, among other things, repealed the Glass-Steagall Act. And the Glass-Steagall Act, of course, was something very, very wise which was set up in 1933 to deal with the collapse in 1929 and make sure it didn't happen again, and it was very successful. It did so for a long period of time.

But then it was repealed. And after it was repealed, we saw the gross manipulation of economic circumstances in this country, one of the worst—maybe the worst that we have ever seen. And all of that has led to the situation that we are dealing with.

In order to attempt to deal with it, your predecessor came here and said that we needed $700 billion to just give out to the banks. And eventually that was done, even though some of us thought that it was being done in a very casual way, not with enough oversight, not with enough attention, not with enough care and not with enough requirements in the context of receiving all of that huge amount of money.

But that wasn't all. A lot more came out. We are estimating now something in the neighborhood of $4.3 trillion in various ways were sent out to financial institutions. So all of that occurred in a way that really needs to be dealt with now.

One of the interesting things that you said was there are no financial institutions—none of them are too big to fail. And I think that that is exactly right. We are introducing legislation—as a matter of fact, has been introduced in the Senate. We are introducing it in the House today—that would just simply say, if it is too big to fail, it is too big to exist. And that is something that really needs to be done. It needs to be done in the context of responsibility.

You can't be a financial institution, do whatever you want, do it recklessly, carelessly, which is impeding upon all of the people across this country and then step forward and say, we are too big. You can't do anything to us. We are going to continue. That needs to stop.

There is also initiation of a modern Glass-Steagall Act that is also going to be introduced here in this Congress, and it is about time that that were put back into play. We need a regulation of these economic circumstances here which have been so grossly, intentionally, purposefully, consciously, manipulated by these financial institutions and which have caused the crisis that we are confronting.

All of that is true, unlike what you just heard a few minutes ago. So I would like you, if you wouldn't mind, to tell us a little bit more about the idea that none are too big to fail and if there is an estimation that it is too big to fail it really is too big to exist. And what we should be doing to stop the manipulation of financial investment activities, that manipulation which began to occur right after the repeal of the Glass-Steagall Act and which has continued to occur over the course of the last 10 years and which now has no serious impediment to begin to occur again. And unless we step forward to deal with it, there is a strong likelihood that this economy is likely, over the course of the next several years, to experience another deep decline.

Secretary Geithner. Congressman, no financial system can work if firms live with the expectation that the government will come in and save them from their failures. One of the most important things we have to do is to make sure that we prevent firms from taking on the level of risk that can threaten the system and make sure the system is strong enough to allow them to fail and that we contain the devastating panics that can come if you allow a system to become too fragile.

The bill that is working its way through both Houses of Congress now provides authority that did not previously exist, to limit risk taking, limit the scope and size of institutions if they take on too much risk relative to capital and to, as we said earlier, to allow them to fail, manage their failure without putting the taxpayer at risk of taking on losses.

That is hard to do right, hard to get right. But it is a critical thing to do.

Now, it is important to recognize that you had actually relatively small firms like Bear Stearns and Lehman cause a huge amount of damage. So one of the things to make this hard—it is not just about the large institutions. It is about smaller institutions that are so risky, so interconnected, play such a critical role in the system, that even their failure, if your system is too fragile, can cause a lot of damage. So you have to worry about containing risk, and it is more complicated than just focusing on size, although size sometimes means more risk. But the critical thing is you need to make sure the system is strong enough that you can let these firms fail and you don't have the taxpayer exposed to bear losses.

Representative Hinchey. We have seen a lot of banks fail, but the banks that have failed are small ones. They failed because they weren't prevented from failing. The big ones were prevented from failing, and they are the ones that really need the attention.

Secretary Geithner. I agree with you about that. And there actually were a lot of large firms that failed. And the firms that are surviving are actually substantially smaller and have much less leverage, which is very important. We need to make sure we sustain that.

Chair Maloney. Thank you.

Senator Brownback.

Senator Brownback. Pass to the Congressman.

Representative Campbell. Thank you, Senator; and thank you, Madam Chair; and thank you, Secretary Geithner.

As you know, as was alluded to earlier this week, that the Inspector General for TARP came out and was quite critical of your actions while President of the New York Fed relative to AIG. I don't dispute the necessity to stop what would have been a precipitous failure of AIG. The question I have is, why did you choose to pay all the counterparties a hundred cents on the dollar when some of them were even for months offering to accept less? It is like you are going to buy a car, the dealer offers it to you for a discount, you say no, no, no, I insist on paying sticker price. Why did you do that?

Secretary Geithner. Excellent question and thank you for what you said at the beginning, which is recognizing the importance of preventing default by that institution.

I think the clearest way to say this—because it seems basically inexplicable and unfair. The clearest way to say it is that this institution, like almost any financial institution in the world, made thousands, tens of thousands of contractual commitments. If you default on those commitments, then you will end up defaulting on all commitments and the firm will come collapsing down and fail.

When you make a choice to prevent failure, you are basically deciding that you have to have the firm meet its contractual commitments. There is no middle choice.

Now if you had resolution authority, as the chairman alluded to, you would have a better set of—better capacity to make sure that——

Representative Campbell. Let me stop you. Because even in the case where one of those parties offers?

Secretary Geithner [continuing]. Exactly. This is a very important thing, and that is why I think it takes a lot of care and experienced people to walk through the history of this to do it justice.

There was no creditor at AIG, no counterparty to AIG that offered any concession. It was not contingent on everybody else providing an equivalent concession. You would never do that. No one would do that. And you cannot selectively impose haircuts, break your contractual obligations without courting default, downgrade, and the basic failure of the firm.

So it is really like a light switch. Unless you have resolution authority, if you decide you prevent default, then you prevent default and that firm is able to meet its obligations. You can't selectively go and impose haircuts or default without courting the big, cascading collapse of the firm.

Representative Campbell. I am not sure I agree. I am not sure the Inspector General agrees.

But let me just go onto the second question so that we don't——

Secretary Geithner. Can I just say there is no—this is a very important thing, and it is going to take a lot more time and review for people to understand this. But there is no credible argument that there was a middle path with the existing authorities available to the Treasury and the Fed at that time to selectively default on the counterparties firms. There is no credible argument to that. But the key thing is to make sure we have authority in the future to give us better choices.

Representative Campbell [continuing]. Mr. Secretary, let me go on.

You talked a lot about resolution authority, different regulatory things that we have to see that we don't have this problem happen again in the future, that we have a way to deal with it. And I agree with that. I don't agree with your bill which is working its way through financial services, because I think you have to find a sweet spot here which is a place where you have the necessary tools but you don't go overboard and too far to restrict market activity. And I think you have not found that sweet spot. In my opinion, you have gone overboard on that.

Let me ask you instead with—because there are a lot of risks to the economy out there right now. We know things are not good. The stock market seems to like things, but obviously employers don't right now. There are a number of risks going forward.

Banks aren't lending. I would argue part of that is because they don't trust the Treasury on a number of different activities, whether it is taxes or executive comp or various other things.

We have the looming CMBS crisis, which everybody talks about and that it is going to be a very negative impact on the economy next year, but I am not sure quite what you are doing about it.

There will be a whole bunch of additional mortgage foreclosures next year, not just subprime, as you know, but also a number of things because of some of the mortgage resolution—I don't know, whatever you want to call them—that we put in place earlier this year. They are taking a long time to work, but they are actually delaying foreclosures. So there are a lot of foreclosures that would have happened this year that are going to happen next year because they are going through that regulatory process to make the foreclosure. But they are going to happen.

We have a huge amount of debt that the Treasury is going to be borrowing, which is sucking up more capital that could otherwise be available to lend or to invest in businesses.

We have tax increases on the horizon, huge—I mean, it seems like everything that this Administration proposes has a tax increase. Plus there are the expiring tax increases at the end of next year; and, obviously, we have the looming—the unemployment rising all over.

That is six different threats to a double-dip recession going on in the economy next year, and I don't see what Treasury or the Administration is doing except making them all worse.

Secretary Geithner. Congressman, I could not agree with you more. I think you are right, though, to point out that—and it is very important to be able to hear what you said. You are acknowledging that there are still lots of things broken in our financial system, that there are many challenges ahead for parts of our financial system. And you see it in housing, commercial real estate. You see it in small business credit. It is very good for you to acknowledge that, because I think it underscores the basic reality that this is going to take some time to fix.

There is nobody who cares about this more than I do and nobody who has not been more honest and open about the scale of challenges we still face in this financial system. And it takes time to work through these things. But the important thing to recognize is that there is today something that did not exist a year ago and did not exist 10 months ago, which is there is confidence in the stability of the financial system. Mortgage interest rates are at historic lows. Treasury is borrowing at historic lows. Americans are saving more. We are borrowing dramatically less from the rest of the world than we were a year ago and 2 years ago. We have companies around the country now that can issue debt, can issue capital, can borrow at dramatically lower interests rates. None of that was possible a year ago.

And I could not agree with you more, though, that it is important for everyone to understand the magnitude of the challenges we still face and this is going to take time and effort or we are going to face a risk of a weaker recovery because a credit crunch could get in the way of job creation.

Representative Campbell. I guess my point is simply that I agree with that. But you have to be doing things to help these problems, not either ignore them or do things that make them——

Secretary Geithner. We are ignoring no problem facing the country. We also understand it is going to take more effort, and I am glad to hear you appreciate that, too.

Chair Maloney. Thank you.

Congresswoman Sanchez.

Representative Sanchez. Thank you, Madam Chair; and thank you, Mr. Secretary, for being before us today.

I have a lot of questions and not enough time, so hopefully you will give me concrete, fast answers because I have several to go through.

Do you have any concern about our monetary base tripling in the last 4 years and how is this Administration going to deal with the inevitable inflation?

Secretary Geithner. We have established by the Congress an independent Fed with a basic obligation to make sure we keep prices low and stable over time. The Fed has an exceptional record in doing that; and I am completely confident if we preserve their independence, make sure they have that authority, they will be able to do that.

If you look at the economy today, though, we have—although growth is just starting, unemployment is very high, and inflation is very low, and it is actually still decelerating, not accelerating. And If you look at broad measures of inflation expectations, what consumers think will happen to prices in the future, they actually look pretty stable at relatively low levels.

As I said earlier, the Treasury is actually borrowing to finance these exceptionally high deficits at the very low interest rates. That indicates a lot of confidence among Americans and countries around the world in the basic strength of the Fed's independence and about the ability of this Congress, the ability that we will all have to prove together we will have the will to bring these deficits down to a sustainable level when this economy recovers. So I would not put that concern you referred to as anything like among the most pressing concerns facing the country.

Representative Sanchez. Well, I will just answer to that, Mr. Secretary, when the Euro is 1.62 against the dollar, when we have lost a lot and we have had a lot of devaluation with respect to our dollar with almost every country's currency, I know my dollar is worth less today.

Secretary Geithner. Can I just address that?

Because, Senator Brownback, you made some very thoughtful and I think appropriate comments at the beginning of your opening statement about this, and I want to make sure—I know we will have a chance to talk about it. But let me just say something in response to this now.

What your chart missed and which is very important is that, as this crisis intensified, particularly starting in September of last year and into February/March of this year, you saw, as the panic intensified, as fear of global depression, financial collapse, perhaps global deflation increased around the world, you saw not just Americans but countries around the world put their savings in treasuries. And you saw the dollar play its classic role as safe-haven at that point, and you saw a lot of money come into the United States, and that pushed the dollar up very substantially. And as growth recovered, as the financial system stabilized, as interest rates come down, you have seen part of that process reverse.

And that is a very important thing. It underpins how important a role this country plays in the global financial system.

But we all have to understand that we have a deep obligation to make sure that we are doing things that sustain confidence in this financial system and in how we run our country, and that is going to require us working together over time to make sure we bring down these large inherited fiscal deficits down to a sustainable level over time.

Representative Sanchez. Mr. Secretary, you are using my time up.

How can you seriously be discussing reform when Wall Street is paying out record bonuses and at the same time people, including some from the Administration, are proposing a tax increase on the public in the form of a trading tax? I think that our markets, especially our equities markets, are very vulnerable right now. They are very volatile. We are beginning just in the last 2 days to see a downswing again. And to propose that we establish a trade tax at a time when people are still afraid to go into the market I think would just plummet the market even more.

And I really would like you to answer—I know that maybe 35 executives or something are going to get their compensation slashed. And, believe me, I come out of a financial industry. I understand—I used to work with Wall Streeters. But I think America still feels that it is completely outrageous that Main Street is out of jobs and that Wall Street is still getting bonuses.

Secretary Geithner. You are raising two different concerns.

Representative Sanchez. Correct.

Secretary Geithner. You are right that Americans are angry and frustrated with what they have seen happen to the country and the financial system, and they are right to be angry and frustrated. And it is very important that, as part of the reform of the financial system, we change the structure of compensation so it is not generating excess risk taking in the future, leaving our financial system as vulnerable as it was coming into this.

Now, I agree with you that I think we have to be very careful in talking about imposing taxes on the financial system that might undermine this process of recovery that we have seen in confidence.

Representative Sanchez. That is what I am saying. But I have heard from the Administration that you would be supportive of some taxing of transactions on Wall Street, and I think that is completely inappropriate at this time.

Secretary Geithner. That is not something you have heard from the Administration. But I want to make sure you understand what we would consider and what thing is important.

As part of financial reform, in designing the future rules of the game for this financial system going forward, we think there is a very important principle that exists now for banks and thrifts, which is if the taxpayer is ever exposed to the risk of loss in the future, that those losses be recovered by a fee on the financial industry imposed over time so that taxpayers are not exposed to absorb losses made by private institutions. That is a basic, fair principle of justice. It is a principle we have today for banks and thrifts. And it is a necessary, essential thing. But that is about a long-term set of reforms, and it is not the type of tax that you described.

Representative Sanchez. So you would be against that type of a per transaction tax?

Chair Maloney. The gentlewoman's time has expired. The gentleman may respond if he——

Secretary Geithner. As I have said many times before, I have not seen a version of that kind of tax that I think would work, be effective, and would be appropriate for our country.

Representative Sanchez. Thank you, Mr. Secretary.

Chair Maloney [continuing]. Congressman Burgess.

Representative Burgess. Thank you for the recognition.

Secretary Geithner, you were referencing in your answer to an earlier question about whether the financial catastrophe started in September or October of last year. If I understood you correctly, you said that this country did not have the tools to manage that panic, but the inference that I took from that was that there were countries overseas that did have such tools.

Now, I recall a phone call with your predecessor in late October of 2008 when it became public that the United States was pumping monies into the Central Bank in Europe and other places, and I suggested that was not the correct thing to be doing. And he said, if the United States is not helping these countries then they will collapse.

So which is it? Were we the savior of those countries that, according to the current President, didn't even like us that much until he took office? Were we the savior of those banks and those countries? Or were we, in fact, incapable of dealing with the problem? And was that money, in fact, going to foreign banks at that time in October of last year as was widely reported in the press?

Secretary Geithner. Congressman, there is no country that came into this crisis with the tools to manage effectively. And the basic failure described here was a common failure. One thing you saw around the world——

Representative Burgess. Let me ask you a question then. How did George Bush cause those countries to be unprepared for a financial crisis? Glass-Steagall has come up this morning. If I recall, Glass-Steagall was repealed—that bill was signed by Bill Clinton, not George Bush. And I frankly don't understand if that is such a good protection—this President has been in office for 10 months—where is the signed legislation reinstating Glass-Steagall?

Secretary Geithner [continuing]. I would not support reinstating Glass-Steagall, and I actually don't believe that the end of Glass-Steagall played a significant role in the cause of this crisis.

Representative Burgess. Let me move on, because my time is going to be limited. I do hope we will be able to submit some of our questions in writing, because this is a critical hearing, and time is limited.

Chair Maloney. Absolutely.

Representative Burgess. All right. We have got the TARP. It is supposed to expire. Why won't we let it die a natural death, rather than letting it painfully linger and absorbing tax dollars?

Secretary Geithner. We are working to put the TARP out of its misery, and no one will be happier than I am to see that program terminated and unwound. And I want to point out we are moving very aggressively to close down and terminate the programs that defined TARP at the beginning of the crisis.

Representative Burgess. Well, it looks like the money is going out with little or no oversight.

Secretary Geithner. That is absolutely not true. The Congress established three separate oversight committees.

Representative Burgess. Your own Special Inspector General for the Troubled Asset Relief Program has got several concerns. Why not just stop spending on the TARP funds and why not repeal the program? We don't need it anymore. The American people never liked it. Let us just do away with it.

Secretary Geithner. Let me just point out the disagreement between what your colleague said and I think what most people across the country understand and believe, which is that if you look at what is happening in housing, if you look at what is happening to small businesses, this economy still faces tremendous financial challenges.

Representative Burgess. What is happening to small businesses, people are frightened to add jobs because they don't know what we are going to do to them in health care. They don't know what we are going to do to them in financial regulation. They are scared of what we might to with energy prices in the future with cap-and-trade. Small business, medium-sized business is frightened at jobs right now.

I can help the President and his panel. He doesn't need another program. We don't need another stimulus. We need to provide some tax relief, and then get the heck out of the way and the American economy will recover as it has always done.

Secretary Geithner. That broad philosophy helped produce the worst financial crisis and the worst recession we had seen in generations. We had a pretty good test of that philosophy, pretty good test of those policies. That did not serve the country very well.

Representative Burgess. Mr. Geithner, when I came here in 2003, we were in a jobless recovery. Tax relief was passed in May of 2003; and, as a consequence, by July of that year, we were adding jobs at a significant rate. It seems to have worked fairly well.

Let me finish up and say I disagree with Mr. Brady. I have the greatest respect for him. I don't think that you should be fired. I thought you should have never been hired.

And I objected when the hearings were going on over in the Senate. I thought there were too many question marks about things that had occurred in the past, and it did not leave the American people with a good feeling about the person who was going to be responsible for this economic recovery.

What can you say today—I mean, I will tell you, my constituents, they are not just anxious. They are mad. They are fighting mad about what has happened in the economy. They are fighting mad about the stimulus. They are fighting mad about how many jobs we created in Arizona's 9th district. Do you know the Member of Congress from Arizona's 9th district? They won't have a 9th district until after redistricting next year. They only have 8 right now. This kind of nonsense is what the American people are seeing, and that is why they are so upset.

Chair Maloney. The gentleman's time has expired, and the Chair would like to ask a question.

During the Bush Administration, real median income fell by over $2,000, or about 4.5 percent, and a very disturbing trend in our country is that the gap between the haves and the have-nots grew by 2 percentage points, and an additional 8.2 million Americans are now living in poverty. And do you think that these factors contributed to the overleverage of American households and ultimately contributed to the financial crisis?

Secretary Geithner. Chairwoman, we had a decade-long increase in inequality in America. It did not start in this decade. It really started a long time ago.

But, in the 1990s, we had a long period with budget surpluses, rapid growth in private investment, rapid growth in productivity across the American economy, with broad-based gains in income for middle-class Americans. That record should make one optimistic about this country and what is possible if you get the basic policies right.

But you can see from the state of this economy looking back just a year ago what happens when you get those broad judgments wrong; and it is—as I said in my opening statement, it is unfair and unjust because the people who bear most of the burden of those crises are the people that are most vulnerable.

Chair Maloney. Thank you.

Mr. Snyder, Congressman Snyder.

Representative Snyder. Madam Chair, I will let Senator Casey go first; and I will take the next round.

Chair Maloney. Senator.

Senator Casey. Thank you so much, Madam Chairwoman.

Secretary Geithner, thank you for being here, And I appreciate your public service. I voted for your confirmation, and it was the right vote.

We have got and you have been tasked with the responsibility, among others, of dealing with the most adverse economic circumstances one could imagine. I won't get into the discussion of what you walked into, but suffice it to say economically and otherwise you had to deal with a mess.

The question I have and I think you can hear some it of in the questions today. I know you are cognizant of this. When we talk to our constituents and when they contact us, it is pretty fundamental it is about jobs. And often in Washington we are debating things that have an impact on jobs, we hope, in a positive way. But, too often, we are not focused enough on that essential problem.

In Pennsylvania, we have at last count about an 8.8 percent unemployment rate, very high, a very high number, but not as high as many states like Michigan and others that are suffering much higher numbers in the double digits. But in our state it still adds up to half a million people. We know that the foundation of that or the origin of that started with the housing market and all of the things that we have discussed today.

I guess I would ask you this fundamental question. If our focus has to be, as it is, I believe, the President—President Obama's Administration and others are focused on attacking the job problem directly, and I think there is broad agreement about that, but the more specific question about that comes to us in the form of: I run a small business. I cannot get access to capital. How do we deal with that literally in the next 6 months in a better, more targeted way than we have up to date?

Secretary Geithner. The most important constraint on small business getting access to capital is what is happening to small banks. Small businesses get about 90 percent of their capital from banks. Most of those are small banks; about half of them are small banks. And the best way to be responsive to that was to make sure they have access to capital.

Now, we have put in place a series of programs to make it possible for small community banks to come and get capital from the Treasury. And, as the chairwoman said at the beginning, the President announced a new program 3 weeks ago to make it even more attractive. And, under this program, if you come and provide a plan to increase lending to small businesses, we are prepared to provide access to even cheaper capital for a temporary period of time. And we think these kind of investments would have a good return over time.

But for that to work, banks have to be prepared to come. And banks, as you know, are very reluctant to come, because they are worried that they are going to be stigmatized with the association with the TARP. And they are worried that, to be direct about it, that the Congress is going to change the conditions in the future in a way that could disadvantage them. So we are trying to figure out a way to make that work, but we are going to need some help from the Congress on that front.

Now, the SBA, the Small Business Administration, because of actions put in place in the Recovery Act to temporarily reduce guarantee fees and increase the loss-sharing under those programs, has already produced a 75 percent increase in SBA lending over the months since the Recovery Act was passed. And we have proposed, the President has proposed a range of measures to increase the limits under those loan limits temporarily, other actions that would help make sure we are maximizing the potential benefit of that program.

Now, we are also doing some broader efforts to try to make sure that the securities markets that are so important to small-business lending, auto financing, some consumer lending as well, even commercial real estate, are opening up again. You have seen issuance in those markets increase very substantially, and the cost of borrowing in those markets has come down substantially. But that has to reach the broader economy as a whole.

But you need to work on all those fronts, all those fronts.

Now, you saw Chairman Bair, yesterday, highlight some new guidance the supervisors provided to make sure examiners are bringing a balanced approach to looking at risk and exposure to commercial real estate. Those things are important. Those things are important, too.

We proposed in the Recovery Act and have proposed to extend and expand a range of tax credits for small businesses. Those can help, too.

You need to move on all fronts, and it is going to take a sustained effort.

Senator Casey. Well, I would urge you to consider the immediacy of those policies, because I think people's patience is fast running out, if it hasn't run out already.

One more point before we wrap up. I want to thank the congressman for allowing me to jump ahead of him in line. That doesn't happen often in the Senate, so we like when it happens over here.

Finally, you will be getting a letter, you may already have it in your office or you may be seeing it in the next couple days, regarding a Pennsylvania program that was put in place in the early 1980s, the Homeowners' Emergency Mortgage Assistance Program, so-called HEMAP. I would urge you to take a look at that as a model for helping on the foreclosure housing problem in the midst of, or tying it to, job loss and the adverse effects of that.

Madam Chair, thank you very much.

Chair Maloney. Thank you very much.

Senator Brownback.

Senator Brownback. Thank you, Madam Chairman.

I would ask, just formally, unanimous consent that Members can submit additional questions for the record.

Chair Maloney. Absolutely.

Senator Brownback. Thank you very much.

Secretary, I want to ask a couple of areas, if I can, going into the regions that we talked about. First, you are familiar with the Kansas City Fed Chairman Hoenig's proposal on his solutions to the too-big-to-fail proposals. And, as I understand, you are generally supportive of that approach? Are you familiar enough to be able to say that?

Secretary Geithner. Well, I don't—I wouldn't support all of the details on that. But I completely agree with the basic principle you stated so clearly at the beginning: that you have to contain the risk that, if these institutions get too big and too risky, they could cause this kind of damage. And you have to have the ability to allow them to die and fail without causing catastrophic damage.

And that basic objective is at the center of what Tom Hoenig has proposed. And he is a very thoughtful early advocate of reforms in this area.

Senator Brownback. And you generally support that concept?

Secretary Geithner. Absolutely, 100 percent.

Senator Brownback. All right. Because we will be developing the specifics on this.

The health-care bill was rolled out in the Senate last night. And, any way you slice it or dice it, it is a multi-trillion-dollar entitlement program, paid for, according to CBO scoring, by Medicare cuts, reductions, tax increases, some other things.

I want to say to you that the proposal has a 15 percent annual decrease in Medicare cost going to pay for the health insurance proposal. The likelihood of that actually happening is, say, between slim and none, and slim just left town. I don't see that happening, from past practices in Congress.

So the likelihood is you are going to add to the debt and deficit with this proposal, because you are not going to get the reforms you are talking about. Plus, on top of that, Medicare is not financially sound, according to your own Medicare trustees report that you are a part of.

So I just really think this is a wrong idea at a horrific time. And I can't help but think that the international community that is after us and particularly you to get the fiscal house in order is not particularly excited about, "Okay, you are going to do all this, and, yes, this will actually happen." Now, I really want you to think about that.

And just, finally, because my time is going to run out, and you hold the key on this one, is the Chinese currency. And Senator Schumer, Senator Graham have a bipartisan bill pushing that this has got to get realigned. And you have seen this chart, you know this chart. You were commenting about, "Well, I think the tax cuts and things produced this tough economy."

Secretary Geithner. I didn't say that.

Senator Brownback. Well, maybe I misheard you. But, if I could, I have had a number of pretty good economists say to me that what happened was we got too highly levered as a country. A lot of people—we hit the energy crisis where you get $4 gasoline. It emptied their wallets for fuel. They didn't have money to make the housing payment. The money was coming back into the country because it was recycled because of our trade imbalances, whether it is on fuel or whether it is on things from China. So the money is coming back in, searching for places to go, to move to. People get highly levered. They hit a bad problem, an energy crisis, and it triggers the whole thing.

My point in saying all of that is, I think there are other bases to look at for why the economy failed, but, clearly, to climb out of it, we have to get the currency back, right? Particularly against our largest trading partner in China. And you are the guy to do this.

Secretary Geithner. Senator, can I—I want to respond. Both of these——

Senator Brownback. Please.

Secretary Geithner [continuing]. Things are very important. And I will do it very briefly. Let me just start with health care.

I think as you understand, the biggest long-term fiscal problem we have as a country is the rate of growth in health-care costs. And the most important thing we have to make sure we do as we try to improve this basic health-care system is to make sure that we are bringing down those long-term costs.

Now, this bill, in the eyes of CBO, will make a material difference, for the first time in decades, in bringing down those long-term costs. That is the most important thing we can do for the long-term fiscal deficit. Now, this bill meets another critical test, which is, over that first 10-year time frame, it reduces the deficit; it does not add to the deficit.

Now, you are absolutely right that that depends, in part, on realizing very substantial cost savings in Medicare. And it requires the Congress be willing to enact those reforms and hold to them. But they are a necessary thing to do. I don't think there is any credible argument to say that, at the heart of reform, you need to, like, bring down those costs and do those savings——

Senator Brownback. Why not put those back into Medicare, then, to save that program? If you are going to make these savings in Medicare, which are the heart of funding of this proposal, Medicare is not financially solvent, by your own Medicare trustees' report.

Secretary Geithner [continuing]. Again, the biggest threat to long-term solvency of Medicare and Medicaid and the biggest threat to our long-term fiscal solvency as a country is a health-care system that has enormous hidden costs, and those costs are rising at an exceptionally high rate of unsustainability. And fixing that problem is absolutely critical to our economic future.

Now, you are right to say, you have to do it in a way that is fiscally responsible and credible. And what the Congress is now doing and what the President proposes is something that is critical to that, which is to say, "We are not going to do new things, new, expensive things, long-term commitments, without paying for them and without committing to pay for them." And there is no path to credibility on the fiscal side that doesn't start with that basic commitment.

Now, I wanted to address your point about the exchange rate question. You are absolutely right that, to try to make sure we have an economy that is growing again globally, in a balanced way that is sustainable over time, that doesn't create the same kind of risks we saw helping contribute to this crisis, we need to see a broad move to more flexible exchange rates across our major trading partners. And most of them have already done that, and that is helpful.

But China, as I have said many times, has committed to—they understand they need to do it. I think they want to do it, and I am actually quite confident they will do it. But that is only part of trying to make sure that, again, they are changing the structure of their economy to one that is less reliant on exports, more reliant on domestic consumption and investment. And that is starting to happen; that process, though, is going to take some time.

But you are right to emphasize the importance of this. And you are right, also, to emphasize that there is a broad consensus around the world that that is important to happen. It is not just an issue for us and China; it is an issue for every economy that competes with China in our markets and around the world.

Chair Maloney. The gentleman's time has expired.

Congressman Snyder.

Representative Snyder. Thank you, Secretary Geithner, for being here. I appreciate you being here today, and I appreciate you being in the position you are in at this very difficult time in our Nation's history.

I wanted to make a brief comment about the 1997 Balanced Budget Act. It was one of the first big votes I made. And, as you know, it was a bipartisan vote. Newt Gingrich was Speaker; Bill Clinton was President. I think the facts show that, in fact, it worked amazingly well, and we had budget surpluses in fiscal years 1998, 1999, and 2000. And you may remember the days when Alan Greenspan was testifying, concerned we were going to pay down national debt too rapidly.

And then we had a change of administrations. We had the April 2001 economic plan, which I did not vote for, and the $5.6 trillion surpluses as far as the eye can see, for a variety of reasons, including the attacks on September 11th. But I think that the record of the 1997 act is clear.

I can only speak for the House bill, but the CBO says that it adds 5 years to the trust fund. It does it by, in fact, expanding some services to seniors, including gradually closing the donut hole. But it does it by trying to get better and more efficient: preventing readmissions into hospitals, more efficient with pharmacy, better pricing on pharmacy, avoiding medical errors. I think there are just a lot of reasons to think that we can address the long-term fiscal soundness of Medicare.

I wanted to ask two or three quick questions. First of all, with regard to Cuba, in your position, you actually have authority to deal with some of the policies we have with regard to Cuba.

Can you assure us today that you have done everything you can to maximize the ability of Arkansas farmers to sell products to Cuba without laborious financial arrangements? Can you assure us that you have done everything you can to allow travel by businesspeople, agricultural interests to Cuba without some of the convoluted permitting that seems to be required?

Secretary Geithner. I believe we have. You know, as you know, we have to obey the laws as passed by this body. And, consistent with that constraint, I believe we met that test. But I would be happy to spend some time talking to you and your staff about whether we have got that balance right.

Representative Snyder. I would hope that it would not be a balance. I would hope you would be doing everything you can to maximize sales of agricultural products. It is legal to sell. It seems like the financial arrangements ought to not stand in the way.

I wanted to ask, with regard to community banks, one of the issues that will go along as this progresses is our local bankers—you know, I don't have many Wall Streeters drive by my house when I am mowing my lawn. I have a lot of bankers that drive by my house and stop in their pickups and say, "What is going on with this?"

But, as you know, the community banks get jumpy when they see these things coming down. At some point, we are going to have a final version of a bill, and I hope that it will be evaluated very thoroughly by you all about what potential impact it could have on smaller banks.

I was talking to a bank the other day, and they are apprehensive. And we talk about novelty products that got the financial system worldwide in trouble. A novelty product for a community bank may be a Christmas gift card, and yet somehow the rules could be written in such a way that it would be brought under that.

What is going to be your process for evaluating the impact on community banks as we get down to a final version?

Secretary Geithner. I completely agree with you that, as we fix what was broken in our system, we need to make sure we are preserving opportunities for innovation, choice for consumers, competition among banks—very important thing to do. And this bill recognizes the critical role community banks play in our system. You know, it is a great strength of our system that we have 8,000 small community banks existing alongside what are still some of the largest institutions, most successful institutions in the world. We want to preserve that.

Now, at a core part of our reforms, we are doing one very simple important thing, which is to make sure that the large institutions are held to tougher standards, higher standards than a small community bank. It is sort of the reverse of what has happened to date. If you look back at the last 5 years or so, you saw big banks hold basically less capital than small banks held, and that is untenable. And we need to change that.

We have also tried to be very careful to make sure that taxpayers aren't exposed in the future without putting additional burdens on small banks. But, on the consumer side, as we design stronger protections for consumers, as well as on the basic sense of fairness, more risky firms held to tougher standards; smaller, less risky, appropriately not. And, as we make sure taxpayers are protected from bearing the costs of future financial crisis, we want to do so in a way that doesn't burden small community banks.

Representative Snyder. My last question. I think there is bipartisan interest in dealing with our national debt and indebtedness. It is just a question of when and how you will go about doing it.

We talk about States having balanced budgets, but, in fact, States borrow money all the time for infrastructure projects. Governor Huckabee led a bond issue that was approved by the voters to dedicate the Federal money coming to the State for highways and expedite the building of roads.

Should we be looking at our infrastructure indebtedness at the Federal level differently than we do indebtedness on other items? Or is it helpful just to have it all lumped together?

Secretary Geithner. Well, I think you are absolutely right that we have had a long-term degradation in the basic quality and adequacy of large parts of our public infrastructure. And that, left unaddressed, will hurt growth.

But we have to figure out a way to fix that without adding to what is an unsustainable long-term fiscal position. And that is going to require new approaches, more creativity, to try to make sure we are getting more leverage for any additional taxpayer dollars we put at improving these basic investments in public infrastructure.

So I agree with you that it is a critical problem. And not least because of the scale of the needs and the size of our long-term fiscal problems, we have to figure out new ways of doing it that is going to give more leverage for the taxpayers' dollars and do a better job of catalyzing private investment alongside the government.

Representative Snyder. Thank you, Mr. Secretary.

Thank you, Madam Chair.

Chair Maloney. Thank you.

Senator DeMint.

Senator DeMint. Thank you, Madam Chairman.

Mr. Secretary, I apologize for being late. Thank you for being here today.

And I will ask a question I know that has been asked in one way, but I will try to put it in context.

As you know, I mean, you are in the trenches trying to deal with problems, but, as America looks in on us, there is growing concern about the reach of government, the debt, the spending, the takeovers. And this is hitting a lot of people square in the face. I mean, they are seeing reports now of the stimulus, of jobs created in congressional districts that don't exist and jobs created where—hundreds were created, when only 20 or 30 were working there.

They look at the bailout. I hear about it regularly as I travel around the State, as money for TARP that was supposed to buy toxic assets that then went to do something else. And there is a great concern that this is going to be some kind of a permanent slush fund.

I just came from a hearing on financial reregulation, where we are going to start a new consumer product or consumer protection agency; and the cap and trade.

But, anyway, the whole point here is, there is growing alarm that the power here in Washington to take over goes much beyond the constitutional role of providing a framework of law and justice for our free country to operate in.

And it brings me back to the TARP funds. And it would be a great signal to our country if, regardless of how any of us felt of whether or not it was used the way it was supposed to or whether it was necessary, if Treasury made a definitive plan to bring the TARP funds back in, put them back in the general fund, and to not continue the program as some kind of permanent intervention beyond where we were before, it would give, I think, a lot of people relief that, no matter how we felt about it in the first place, at least there is an end time.

But I think, as we have asked the question of you before, you have hesitated to say that the plan is to let it come to its natural end. There is talk of winding it down, but there is also talk of having some kind of permanent TARP type of structure.

And so, as clear as you can be, is the plan of Treasury to allow this thing to wind down and finish and not to continue it?

Secretary Geithner. Senator, I just want to start where you started, and I will come to your question directly.

I think you are absolutely right. If you look at how Americans feel today, they are deeply worried, not just about the level of unemployment, they are deeply worried about our long-term fiscal positions. And they are uncertain, frankly, whether the Government of the United States is going to be able to do an effective job, the Congress is going to be willing to pass a set of reforms not just to fix what is clearly broken in our economy—in education, health care, public infrastructure, how we use energy—but also whether we are going to have the will—will we did not have in the past—to bring these fiscal positions down to a level that we can afford, go back to living within our means.

And I think you are absolutely right that this crisis, this recession caused a huge amount of damage to the basic fabric of confidence among businesses and consumers. And we share a responsibility together to try to restore that confidence.

Now, on the TARP, a few very important things. When I came in office, we had hundreds of billions of dollars in investments outstanding in the U.S. banking system. Today we have reduced those by more than a third. We have had $70 billion come back into the Treasury, go directly to reduce the debt. We have had substantial earnings and dividends on those investments, proving that the actions taken by my predecessor, with the support of the Congress, were good investments by the taxpayer.

We have terminated already and are winding down those early emergency programs that were necessary to break the back of the panic and stabilize the system. And we are going to—I would not ever support providing a permanent capacity for the government like what was designed in that TARP authority. We are going to terminate it as quickly as we can.

And we are going to be able to because we have been successful in stabilizing this financial system, with very little incremental additional cost, we are going to be able to put substantial resources directly to reduce the debt. And that is the most important thing for people to understand about how this program has been working and operating.

So, when I came into office, the government, under President Bush, had been forced to take just extraordinary actions to try to stabilize the system. And we have been able to unwind and reverse, to a very substantial degree, those actions already, as I said, at quite good return for the taxpayer. You see it not just in the value of their savings increasing and the cost of borrowing to finance a home declining, cost of credit to businesses declining, but you see it directly in money coming back to the Treasury with pretty good return to the taxpayer.

But we will not support and I will not support any effort to permanently extend this authority. And we are winding it down, and we will close it as soon as we can, recognizing, of course, that small businesses across the country are still facing the risk of a pretty acute credit crunch.

Senator DeMint. Well, as you know——

Chair Maloney. The gentleman's time has expired. And we have been called for a vote, so you will have time for a second round, and we won't.

And I want to recognize Mr. Cummings and Mr. Hill before they go to vote. And welcome, Senator Klobuchar, who will assume the chair.

Mr. Cummings.

Representative Cummings. Thank you very much, Secretary Geithner. It is good to see you. And I think, as I have listened to some of the criticism from the other side, I join Senator Casey. I am glad you are there. And I don't know how many people could stand the pressure of what you are dealing with and do it in the way that you are doing it.

At the same time, you hear the frustration, I know. And I know that the Obama Administration has done a lot of things to keep people in their houses. In my district, we have held two, what we call, foreclosure-prevention events. And if you were to attend one of them, you would see people literally crying. And we are getting ready to do a third one. And we have been able to save about, I would say, somewhere between 1,500 to 2,000 people to keep in their houses.

This is the question. One of the problems that we have run into is—and you are probably well aware of this—the banks have not staffed up quickly enough. So that when people even try to take advantage of the programs that have been created, they are not getting answers, they are not getting anybody on the phone, as a matter of fact.

And that is why, what we have done in our congressional district to pull the lenders and the borrowers together, and they literally work out the process right there. And I know that you, I think, had a meeting some time ago with the bankers and said, "Look, we have to do more with regard to foreclosure."

I guess—and the number-two problem we are running into is, it is one thing when somebody has a job; when they don't have a job, that is really a problem. And I am not talking about some people who just—I mean, these are people who lost their jobs through no fault of their own, and now they are stuck, and so they are trying to figure out where they go.

What are your plans with regard to foreclosure? What is the next step? And, you know, what can we do to try to help our constituents stay in their houses?

And, by the way, these are prime loans. I know people will say, "Oh, that is subprime." No.

[The prepared statement of Representative Cummings appears in the Submissions for the Record on page 49.]

Secretary Geithner. Yes. Congressman, I think the type of investments you have referred to are very important, and they can make a big difference.

Under these programs now to help some homeowners benefit from lower interest payments, we have had now 600,000 households take advantage of this program. That is about half of the 1.2 million Americans that are eligible under these programs. That pace of modifications is accelerating.

You are absolutely right that, for us to reach people who are eligible, banks have to put many more resources into their servicing operations. And we are working very hard to encourage that. And you can see now, every month we release servicer-by-servicer, bank-by-bank data to show how many banks are reaching how many of their eligible customers. And so you can see who is lagging, who is leading in that performance. And that is helping the people who were behind initially feel the pressure to catch up more quickly.

Representative Cummings. Are you continuing to put pressure on these folks?

Secretary Geithner. Absolutely. And my colleagues at Treasury meet with that group of people regularly and try to put, again, in the public domain very, very clear metrics of how they are doing a better job of meeting the needs of their borrowers in this area.

But, remember, 600,000, about half of eligible. And, under these modifications, interest payments come down quite a lot. The average monthly savings on those things exceed $500 for a typical family. It is like a tax cut on a very significant scale, and it is a very important benefit.

And if you look at that combined with what we did to help bring mortgage interest rates down, working closely with the Fed and Fannie and Freddie, millions and millions of other Americans now are benefitting from lower interest rates. And that has helped bring some initial signs of stability in the housing market. House prices have now risen, modestly, for 3 or 4 months. That is because of the impact of these programs to try to help stabilize the market. And that is fundamentally critical.

But we have more to do to help people who are facing foreclosure. We can't reach all those people because some people, as you know, just borrowed too much and are just not going to be able to stay in their home. And it would not be appropriate for the taxpayer to help them stay in homes they can't afford over time.

Representative Cummings. I am running out of time. Let me just ask my last question.

Mr. Secretary, some have levied criticism at the House proposal to reform the derivatives marketplace after significant debate on the need for standardized products, clearinghouses and exchanges and exemptions for end-users.

I want to get your opinion on, did the House address the main issue of how an unregulated, over-the-counter derivatives market led to unprecedented market interconnectedness and true systemic instability?

Secretary Geithner. I believe the House bill did, and it is a very strong bill. And the bill that Senator Dodd is proposing has also very strong protections to make sure we bring the derivatives market under oversight, bring it out from the darkness.

But it is very important, as you said, to make sure that we don't have these exceptions undermine those basic protections. So we have to make sure they are very tight and very limited and don't erode these hugely consequential reforms that will bring oversight to derivatives markets for the first time.

Representative Cummings. Thank you, Madam Chair.

Chair Maloney. The gentleman's time has expired.

Congressman Hill.

And we have roughly 10 minutes remaining on the vote.

Representative Hill. Thank you, Mr. Secretary. And I, too, appreciate your service as our Secretary to our country.

I will be very brief. I had several questions, but I think I will just cut to the one that concerns me the most. And that is, how sick is our commercial real estate market? And what kind of threat is it to our economy?

Secretary Geithner. Commercial real estate is very difficult, still. And it is going to be difficult for a while to come.

What you had, of course, was just a substantial amount of leverage created to finance those properties. And those who have to face the need to refinance now face a much tougher environment. So it is going to be a difficult period for a long period of time.

One reason why it is so important, just to go back to some of the comments made by your colleagues on the other side of the aisle, to make sure that we are doing carefully designed, sensible things to help to make sure that the banking system can manage through that and that we get these security markets, so important to commercial real estate and financing, to open up further.

But it is a big challenge, and it is getting worse still, I think, to be fair about it. And it is going to take a while to work through. I think the economy can manage through that challenge, but it is one reason we have to make sure that we don't prematurely end programs that are going to be critical to the capacity of the economy to manage through it.

Chair Maloney. Thank you very much. I also want to thank you for your service to our country. And I am so proud of the job that you are doing. I particularly want to thank you for your efforts to help financing of small businesses. And I look forward to working with you to create jobs and to further strengthen our financial sector and grow our economy.

We have roughly 7 minutes left, so I am going to have to leave, and Senator Klobuchar will be the Chair.

Thank you so much for your service.

Senator Klobuchar [presiding]. Good to see you, Secretary Geithner.

Secretary Geithner. Senator, nice to see you.

Senator Klobuchar. I hear this has been an interesting hearing. I had some other ones early on, so I just got here.

But I wanted to focus on something that I am just hearing a lot from the people in Minnesota and, really, around the country, and that is small businesses. And I appreciate that a jobs summit is coming up at the White House and that the President has established this commission.

But, specifically, this issue of credit for small businesses has been raised many times. And I think part of why I am hearing more of it now is that a lot of our businesses in Minnesota, which has a thriving small-business community, have been pretty frugal, and they had some reserves, and they kind of made it through the bumps of this year, and now they see hope in the economy. They actually are starting to get some requests for orders, and things are looking a little better. But they simply don't have the credit to stretch it out.

And I know you were asked about this, but I wanted to delve a little more into detail about the work that I have been doing with Senator Warner of Virginia. And I think it is a pretty good idea, and the idea is to try to use $40 billion in the TARP funds to be made available to small banks so that they can use those to loan to small businesses. The idea would be that the banks would put up about $10 billion themselves so they have some skin in the game.

And what we love about this in Congress, especially in the Senate with our 60-vote requirement, is that we don't have to vote on anything. And it is not that we wouldn't want to vote for it; it is just that it will take too much time. And our concern is especially for some of our retailers, as we head into this holiday season. That would be very helpful, to give them this jump start and to do something that would help with credit for our small businesses.

So I would love to see you comment on this.

Secretary Geithner. We think it is basically the right idea. It has a lot of promise. And we have been working very closely with your colleague in trying to figure out a way to make it work.

There is a challenge, though, as I said, which is that, to use TARP for this, you need to get—you are working through banks. You need to get banks to be willing to come. And banks are very reluctant to come participate in these programs, even if they are designed to be directly about small-business lending. Even if they are designed for the strong and not for the weaker institutions, they are exceptionally reluctant, because they feel that it is stigmatizing to come and they feel that it——

Senator Klobuchar. Do you have to call it TARP if you give them this money?

Secretary Geithner [continuing]. I would like to call it anything but TARP. And that would help. But what you need is a framework where—and it really has to come from the Congress—that leaves them confident that they are not going to have the rules of the game changed and they are not going to face a set of restrictions that make it, in their view, harder to run their institutions.

And that is the balance. You know, we want to make sure that we don't put the taxpayers' money at risk. There are protections, that that money is used to expand credit, not for other reasons. So the conditions are necessary——

Senator Klobuchar. No, I mean, we don't have a—I think everyone understands that we are not just going to give them a blank check. The idea would be that there would be conditions.

But it just seems—you know, I heard someone say the other day that Wall Street got a cold and Main Street got pneumonia. And I am one to say, I appreciate the fact the Administration wants to put the TARP money into deficit reduction. I voted against a number of proposals to do other things with the TARP money. But for this, where it is going to be, again, credit that I believe will be a good use of that credit, it seems to me, to take this portion of the money—and it would only be, given how much money was at stake, not as large a portion as we have already gotten back——

Secretary Geithner [continuing]. I agree completely.

Senator Klobuchar [continuing]. That this could be a good use.

Secretary Geithner. I think it is a good use. And we are committed to using resources in the TARP—continue using them for this basic purpose. I was just underscoring one piece of the challenge.

I think the other things that Congress is considering on the SBA front will be very helpful, too. Those would be a helpful complement to what we do directly using TARP with small community banks.

Senator Klobuchar. Uh-huh, very good.

A second issue which is also interesting, I don't know if it has been raised here, is that a group of us would really like to see some significant work done on the long-term deficit reduction. And, as we look ahead to a vote to lift the cap and those kinds of things, we think it is very important that this go hand-in-hand with this notion.

I was on a bill last year that we had—and, again, we are open to changes—with Senator Conrad and Senator Gregg to set up a commission that would produce some ideas on Social Security and other topics of how to bring this down with an up-and-down vote from the Congress.

And I wondered if you think that these kinds of ideas would be helpful without having you have to embrace a certain proposal.

Secretary Geithner. Without embracing or commenting on the specifics of any of those proposals—because, as you know, the President is looking carefully at those, and I don't want to get ahead of him—I want to state very clearly: We have to find a way to give the American people confidence that we are going to have a framework that brings these deficits down, to build consensus on the types of changes that are going to make that possible.

It is going to require a sustained effort over a long period of time. It is going to have to begin as soon as we have growth under way. And the proposals you referred to are one way, potentially a promising way, to do that. But I don't want to get ahead of the President in commenting on any of the specific proposals.

Senator Klobuchar. All right. Thank you very much.

We are having now a—Dr. Burgess, we will let you go. Please, ask your questions.

Representative Burgess. I am putting in jeopardy my vote on the previous question on the rule for the Wild and Scenic River Act. So I am willing to do that because I do think this hearing is so important.

Now, Mr. Secretary, you told me in response to a question that you would be agreeable to letting TARP die a natural death. You told Senator DeMint that it would die as soon as it can.

Now, those two statements may not be the same thing, because we all remember, when we passed that big bill—I voted against it, just for the record—but when we passed that big bill in Congress last year, Section 120, subparagraph (a) called for the termination of TARP on December 31, 2009. My background as a physician would say that is a natural death. Subparagraph (b) allowed for an extension, which then would get into the realm of "as soon as I can."

Will you tell us today which of those two versions of reality we should expect? There is a bill out. Senator Thune has introduced it on the Senate side. It is on the House side, H.R. 4110, which would repeal Section B, the extension of EESA. Would you be in support of that?

Secretary Geithner. I would not be in support of that bill. But I am completely supportive of the basic proposition that we need to bring this program to an end as quickly as we can.

But I want to underscore one very important thing. If you look back at almost any crisis experienced by a major economy, including the United States in the 1930s, Japan in the 1990s—it is true in many other cases—the basic, consistent, most costly mistake governments made was to prematurely walk back, unwind, reverse at a time when growth was weak, leaving the financial system very damaged.

And the reason why that is so important not to do is because, if you do that, it is going to be more expensive to solve it. And what my obligation is——

Representative Burgess. And I would just point out, not everyone agrees with that philosophy.

Secretary Geithner [continuing]. I don't think—I think there are two things it is hard to find people to disagree with.

One is that, if you look at our system today, there is still a lot of damage and a lot of risk of constraints on credit, constraining job growth. And I think almost everyone would agree, if you look back at how countries have mismanaged these things in the past, a typical mistake has been to create a premature cliff and end to things before you have growth, led by private demand, firmly established.

Representative Burgess. Well, Mr. Secretary, my time is short. No one believes right now that TARP is doing the job that it was set out to do. The money, the oversight—Inspector General Barofsky has 70 people under his employ for a $700 billion bill. I mean, that is a dangerous ratio as far as the oversight, as far as I am concerned.

We are asking people, we are begging people to steal money from TARP. The only way to prevent that, if we are not going to beef up the oversight side, the only way to prevent that is to end the program and incorporate it in some other structure if we must. But this program needs to be ended because the American people see this as a slush fund that is just going to continue.

Secretary Geithner. What would that structure be?

Representative Burgess. If I can just add one other thing, I would submit to you, it is not the fear that there is going to be another hiccup to the economy. It is the fear of what Congress is going to do that is chilling the job market right now.

This health-care bill scares people to death. An 8 percent payroll tax that is going to be levied on every small business across the country, that is frightening to people. Our cap-and-trade bill, which is still in limbo right now, but nevertheless, people look over their shoulder and say, "Well, what will I do if I am paying three times or four times the amount for gasoline and diesel when I try to run my business in a few years?" And people are looking at the financial protection bill and wondering, "How in the world am I going to be able to have access to capital? How in the world am I going to be able to depend upon any sort of stability in the financial market in the future when you are changing all the rules constantly?"

Secretary Geithner. Congressman——

Representative Burgess. If we would just get out of the way, I firmly believe that the resolve of the American people is enough to solve this. I have lived through up-and-down cycles in my life. I have seen some terrible things happen to the economy back home in Texas, when the savings and loans melted down. I don't recall anyone from the Treasury Department or the FDIC coming with a big bag of cash and saying, "Can I help you through these tough times?"

Secretary Geithner [continuing]. Oh, to the contrary——

Representative Burgess. No, we were required to get through it ourselves.

Secretary Geithner [continuing]. To the contrary——

Representative Burgess. We cut spending. My business drew in its resources and kept going through that time. We didn't depend upon the government for help at that time.

Secretary Geithner [continuing]. Congressman, I don't want to slow your momentum, but I want to try to tell you what I agree with you on because I think it is important. Always good to try to find agreement.

You are absolutely right, businesses hate uncertainty. And they face a lot of uncertainty today, not just about the strength of the economy and not just because of the basic damage done to the confidence by the crisis, but they face uncertainty about how these broad reforms moving through Congress are going to come out.

And it is one good reason to try to make sure that we bring clarity on what those rules are going to be as quickly as possible. It would not be good to business confidence to stretch and draw these things out.

And I also agree——

Representative Burgess. So you are on record as being opposed to dithering?

Secretary Geithner [continuing]. No. I am in support of Congress deciding and acting and bringing some clarity about what the shape of reforms are going to be. And I think if you stretch it out indefinitely, you will be adding to the problem.

Another thing I agree with you on: This is a very resilient economy, enormously resilient economy. Huge amounts of strength and innovation in our economy. And we should all be optimistic and confident that, if the government does what it has to do, which is to put out fires, fix crises, make sure that basic public goods governments provide in education and infrastructure are done better for the future, this will be a very strong, resilient economy with the gains more broadly shared, like we saw in the 1990s.

Now, the S&L crisis was incredibly expensive for this country. It cost the taxpayers 2 to 3 percent of GDP. It was not a crisis solved by the market. It was a crisis where the taxpayer was put on the hook for enormous losses and risks. And we are doing a very good job of limiting the taxpayers' exposure to risk in this, as I said in pointing out to you that we have $70 billion of taxpayers' money come back since I took office, at more than $12 billion in dividends and warrants.

Representative Burgess. How many people on your staff are involved in oversight of the TARP funds?

Secretary Geithner. Oh, good, thank you for bringing up oversight. When Congress passed the TARP, it put in place three separate, new, additional oversight bodies looking over, appropriately, every judgment we make: the congressional oversight panel, the GAO, and a special inspector general——

Representative Burgess. We have had the congressional oversight panel in here. To be perfectly frank with you, I can't see that they have been doing their job.

Secretary Geithner [continuing]. Monthly—they all report monthly. Again, they look over—and this is the great strength of our country. They look over every decision we make. We put every action we make in the public domain so the taxpayer can see it for themselves and they have a way to judge the basic return for the taxpayer. And that is very important.

And these oversight panels—just one fact that is, sort of, helpful. The number of people involved in oversight panels exceeds by a significant multiple, a significant fraction, the number of people that are involved in the Treasury in implementing the unwinding and dismantling and termination of this program.

But that basic oversight is very important. I am committed to it. We have actually embraced the vast bulk of the suggestions they have made. And I think that is an important thing to do, because transparency is very important. And the American people can see, since I took office, what was not possible before; they can look at every contract we have made and look at the details and see what impact that has had on judgments by those institutions.

Representative Burgess. Mr. Secretary, end TARP by the start of the new year. The American people do want to see that program concluded.

I will yield back. Thank you for your consideration.

[Questions from Michael C. Burgess, M.D. to Timothy F. Geithner appear in the Submissions for the Record on page 50.]

[Responses of Timothy F. Geithner to Questions from Representative Michael C. Burgess, M.D. appear in the Submissions for the Record on page 51.]

Senator Klobuchar. Thank you very much, Dr. Burgess.

Just a quick follow-up here, Secretary Geithner. I know you were looking for consensus there, but I do want to point out this notion that this whole economic collapse was caused by some kind of uncertainty about a health-care bill. In fact——

Secretary Geithner. Well, absolutely not. I totally disagree.

Senator Klobuchar [continuing]. Yeah, it started—no, I want to take on some of the things he said. I mean, it started, as you know, over, what, a year ago or before that. The seeds were planted with the mortgage crisis and some very bad decisions, I think, that have been made.

But I was just thinking, as I listened to this, having gone to all the unemployment hearings here, the sector where we have actually seen some increases in this country is in health care. And so I was sort of thinking to myself, if this is so much uncertainty in an area, maybe this—have you seen the increases? And I don't think there is any relationship, except to say that to say that this whole economy tanked because of uncertainty over a health-care bill seems absurd.

And could you please respond?

Secretary Geithner. Well, of course. Of course. I completely agree.

And, again, I think it is important for people to understand that this is not just, again, the deepest recession in generations and the worst financial crisis we have seen, but we have an economy where, over time, suffering deeply from not just the basic hidden costs of the health-care system, but inadequate education system, terrible incentives for how we use energy, and a deep erosion in the basic quality of public infrastructure.

So this was not just a typical recession caused by a boom in real estate; it was a recession made substantially worse by this financial crisis but on top of some long-term neglect in things governments have to do well. And fixing those things is important to reestablishing confidence, demonstrating to the American people we can make the government better at doing these things. And that will be important to how fast we grow in the future and how broadly based these gains in growth are shared.

Senator Klobuchar. Thank you very much.

Senator Brownback.

Senator Brownback. Thank you very much.

Thank you, Secretary.

I want to back up here to something that Senator Klobuchar made a point of. There is a commission coming together on entitlement reform. I have been putting in a bill for a dozen years on a BRAC-type process to review all of the Federal Government. Right now we do that on military bases. And, to my knowledge, it is the only successful way we have ever found to end anything.

You have a commission, try to set it up as fair as possible. It makes recommendations on things to eliminate to the President. It does that as a package; it may be 200 military bases. The President has to chop off on it. It goes to Congress, one vote up or down, deal or no deal. And that is the only way I have found, anytime, anything around here we have been able to end anything, is that process. So it is not amendable; it is a required vote.

We really need to do something like this for the totality of government, particularly for entitlement programs, if we have any hope of being able to get these things structured. You guys will be key in deciding whether to go forward with this process, Senator Klobuchar and others.

And it isn't going to be fun, by any means, because now, instead of military bases, you are talking about things that may be delivering services to individuals that you are looking at and saying, "This is something we just can't do." I would highly urge you looking at that as, in my estimation, the only successful model.

The second one—and I have made this point to you twice before. I just want to get it out. We have had four votes now, since 2006, to waive the Medicare physician reimbursement cuts. Each time those have been passed—they have been proposed by Republicans and Democrats. Each year, the provider community comes up and says, you know, "We can't take these cuts. We are no longer going to provide these health-care services." I voted for them all but once.

That is the reality. And if you are going to make these big Medicare savings on it, which I think are completely smoke and mirrors, that is the track record here. And you can decide what you want to do with that, but I just don't see it happening.

The final thing I would like to ask and get as specific, if I can, on it. You have noted on the currency issue—and I want to just double back to this one final time. You believe that the Chinese are going to allow their currency to float—I presume some; they are probably not just going to put it on an open float—is what you have stated here.

When do you think they—or what time frame do you think they will start to allow it to float? And if they don't, what sort of tools are you willing to use to force it?

Secretary Geithner. Senator, I think that is a judgment, we have to recognize, that they have to make. They have made it clear many times in the past in public statements that they are committed to moving to a more flexible exchange rate over time. I think they recognize that is important to them, and I think they recognize it is important to the world.

But that is the necessary condition, is the basic understanding and recognition that it is necessary not just for them but for the global economy as a whole.

Senator Brownback. When? What time frame? And do you have tools you are prepared to use?

Secretary Geithner. I don't have a—I don't know yet when they are likely to move——

Senator Brownback. I mean, are we—next year?

Secretary Geithner [continuing]. And I don't want to speculate, I think, as you can understand, what the world could do to be persuasive about that. Not appropriate for me to speculate on that.

Senator Brownback. It seems like they are going to, kind of, drag this along for a long period of time if you are not willing to push them.

Secretary Geithner. Possible, but unlikely. And it is—I just say the obvious, that when you talk about exchange rates, exchange rates are sort of like icebergs. Most of what has to happen happens below the surface.

And I assure you—and I assure you the President believes this strongly—we have a strong obligation to making sure we are aggressively pursuing our interests as a country, our economic interests, and trying to make sure that we see in our major trading partners policies that are going to open their markets further, shift sources of future growth to domestic demand, and make sure you have a set of broader policy arrangements that help facilitate that. It is very important to us. We take that very seriously.

Senator Brownback. Thank you.

Senator Klobuchar. Before I shift over here to Senator Schumer, I just want to ask you one quick question here in the second round about the credit-rating agencies. I was one of the first cosponsors of Jack Reed's bill, the RATE Act, to try to make some sense out of this. I think this was a major failure. And we did a forum on this in Minnesota with a number of business people, and I know there are hazards each and every way.

And I just wonder what you think of that provision; if you have had a chance to look at Senator Dodd's regulatory reform provisions in this area?

But it seems to me that, if people are getting paid to rate these companies, that they should be able to do it in an unbiased way and we shouldn't be having corruption of this system.

Secretary Geithner. I agree with you. It is a centerpiece of reform. I think we are very supportive of that provision of the bill and the broad bill that Senator Dodd has helped craft. There is a similar set of provisions that has come out of the House Financial Services Committee in this area, and it is an important thing to do.

And part of it, as you referred to, is trying to make sure there is no conflict of interest produced by the basic way rating agencies are paid.

Senator Klobuchar. Very good. Thank you.

Senator Schumer.

Senator Schumer. Thank you. Thank you, Madam Chair.

Senator Klobuchar. Hold it down.

Senator Schumer. Oh.

Senator Klobuchar. You have to be patient, Senator Schumer.

Senator Schumer. Patient? I say to myself, patience is a virtue, many times each day.

Senator Klobuchar. Very good.

Senator Schumer. Thank you, Madam Chair. And I appreciate everybody being here and waiting for me to get over. We had the markup in Judiciary of the shield law, which I know you are a co-sponsor of.

Senator Klobuchar. That is right.

Senator Schumer. So thank you.

And, Secretary Geithner, thank you for being here. I know what a difficult job this is. And these are tough times. You know, people criticize, and that is legitimate. But you inherited a really difficult situation, an extremely difficult situation. When you have an economy in bad shape, interest rates at about 0 to 1 percent, a deficit that is skyrocketing, the tools that are left are small.

I don't want to add to your problems, except I feel passionately about this issue and have for a long time, which is currency. Five years ago, Senator Graham and I started talking about the Chinese manipulating their currency. At that point, everyone thought, "Oh, no, they shouldn't even let their currency float." *New York Times*, *Wall Street Journal* criticized us for even mentioning it.

And now it has become clear that, not only is the currency manipulation unfair to our manufacturers, our country, but, as has been written just this week in a very stunning op-ed piece in *The New York Times* by Niall Ferguson, Chinese currency manipulation was one of the major causes of the global economic downturn.

Today, there are certainly hundreds of thousands, and maybe even more, Americans who are out of work because the Chinese are unfair and manipulate their currency. And they are mercantilist, in my opinion. They want to accumulate their wealth and reserves. And they basically, while they occasionally give verbiage, they give the back of their hand to the world economy, even though they gain from it.

And, frankly, I am tired of us just shrugging our shoulders and walking away. The world economy is at stake here, nothing less. You cannot have China have 9 percent growth and a huge balance of trade surplus and peg its currency. And, to me, it is probably the most important thing we can do with the Chinese. I know there are lots of other things on the plate, but nothing is more important than this.

And, if they continue to do this, there will be many more people out of work in America and in other countries. It is infuriating, infuriating. And we have the tools, but we don't use them.

And so, here is what I would like to ask you, because, in January, "President Obama, backed by conclusions of a broad range of economists, believes China is manipulating currency." Here is what you said. I am quoting you. This was your written response to questions during your confirmation process.

Quote, "President Obama, backed by conclusions of a broad range of economists, believes that China is manipulating its currency." You actually used the word "manipulation" two times in your answers. It is nothing astounding. It would be one of the great lies to say China is not manipulating its currency, sort of 1984-ish.

And yet, in the two currency reports issued by Treasury since you have been confirmed, in neither one did the Administration determine that China is manipulating its currency.

Given that the yuan has not appreciated at all this year—you look at the charts. When they let it appreciate, I will tell you, I think that the legislation that Senator Graham and I posed played an effect. Everyone will deny it, but it played an effect. That is the only thing that they will respond to.

But you now say they don't manipulate the currency. What has changed? Why did they manipulate it in January and not manipulate it today, when the situation is worse today?

Secretary Geithner. Senator, you were right 5 years ago to draw attention to this, and you are right that it is critically important——

Senator Schumer. By the way, I was called a protectionist.

Secretary Geithner [continuing]. Not by me.

Senator Schumer. No, not by you, for sure. I mean, even though a tenet of free trade and Bretton Woods is you let the currency float. All these high-minded editorial boards who love to just say, "We are so much smarter than politicians," were wrong.

Secretary Geithner. And I think you are absolutely right there, too. And you have seen, I think, the recognition of that reality. A broad shift to more flexible exchange rates happened across the vast bulk of our major trading partners. And China did, as you know, did allow the currency to appreciate about 20 percent over a period of time, until the crisis where they stopped the appreciation.

And, I think as you also recognize, over the last several months things have changed a bit. Over the last several months, you have seen countries across the region, as confidence has returned, you have seen countries across the region, in China and elsewhere, starting to intervene again to lean against the upward pressure in their currencies.

And it makes it harder for the system to work, it makes it harder for the overall financial system to work if you have a large country like that tying its currency directly to the dollar. And I think that is going to have to change, and I think it will change over time. And my own sense is it is not going to actually take that much time.

But what has changed recently, again, as you point out, is that, after a long period where intervention had stopped, it started to increase again as——

Senator Schumer. Sorry to interrupt you. It hadn't stopped. It had been modified. They still didn't let the currency freely float, but they——

Secretary Geithner [continuing]. True. But the currency——

Senator Schumer [continuing]. They were still manipulating it, but they let it rise.

Secretary Geithner [continuing]. Right. But the scale of intervention declined dramatically in the peak of the crisis. It has started to increase again, again, not just in China, but in countries around the world. And it is related, of course—it is harder for those countries to move if the biggest economy—among the biggest economies in the region is not moving as well.

Senator Schumer. Do you have any hope based on the President's meetings in China? I mean, maybe——

Secretary Geithner. Again, my——

Senator Schumer [continuing]. Should we just sit here again——

Secretary Geithner [continuing]. Absolutely not.

Senator Schumer [continuing]. And watch people be thrown out of work?

Secretary Geithner. No, absolutely not.

Senator Schumer. Watch the world economy system tie itself into a pretzel because the most prosperous country of them all is saying, "We want to be more prosperous at everybody's expense"?

Secretary Geithner. Senator, I agree with you. And I think, if you look at what China is doing and you look at what they are saying, I think they recognize that it is not just important to us and to their trading partners, but it is important to them that they move over time. I mean, just think of it this way ——

Senator Schumer. Haven't they gotten worse in the last year? Yes or no?

Secretary Geithner. Well, no, the—again, I think, just on context—but, Senator, I agree with both the importance of the issue and commend you for your leadership in drawing attention to it.

But one thing is important to point out, which is that China has taken very aggressive actions to stimulate domestic demand, demand for our products, over this period of time. So our exports to China are actually growing at a pretty healthy rate because of that broad thrust of policies they have put in place.

Senator Schumer. If the currency were allowed to float, wouldn't they grow at a much greater rate?

Secretary Geithner. They would.

Senator Schumer. I would just urge you to figure out some things that can be done here. I don't think—I am not happy, but

I don't think any Americans who follow this are happy with the present pace.

And, frankly, what came out of China on this issue was terribly disappointing. Now, maybe there is something I don't know. I hope and pray there is. But we have to keep pressure. And Senator Graham and I are going to try to do some things legislatively.

Sorry. Thank you, Madam Chair. Thank you. I apologize for going on for a while. Let the record show I feel terrible.

Senator Klobuchar. No, that is okay. We like your impatience in this situation, Senator Schumer.

Secretary Geithner. Let the record show I was not asking you to be patient.

Senator Klobuchar. I was just talking to Senator Brownback, and I think that Senator Schumer's thoughts are shared on a bipartisan basis up here.

I also just wanted to—I believe that Chair Maloney is returning here. Is this correct? No. Okay, false. But she has been busy voting down there.

But I wanted to just conclude that the reason that we are able to get to this next step, which I think is incredibly important, to focus on this financial regulation, I don't think anyone wants to go back to their home districts and say, "Well, this really bad thing happened to our country. It wasn't really your fault, but it happened. And then we haven't done anything to make sure that it won't happen again." That just can't happen.

So I appreciate your focus on financial regulation. I think that our economy, while it is nowhere near where anyone wants it to be, has stabilized to a point where we now can focus on that financial regulation. And we have had that time to look back at what went wrong and what we need to do. So I appreciate your work in that area.

We know some of that TARP money is coming back. And I, for one, can say that I am glad you are focused on—the Administration is focused on putting it back into deficit reduction.

At the same time, as I mentioned, if we could squeeze out some money here for credit for these small businesses, who were not the recipients of some of this big money. And while Wall Street is starting to do better and the GDP is going up and there are all kinds of good signs here and there, Main Street is still suffering. And so, I would just urge you, as quickly as possible, and urge the President to work on these areas.

So, just in conclusion, from what I have heard from this last hour on this panel, the focus on financial regulation is something we need to do and must do as soon as possible; focus on small business and jobs; and then doing something about the deficit reduction, as well as this Chinese currency issue.

Because I think that people want to believe again. There is some optimism out there. There is some optimism, as you noted, Secretary Geithner, in this country. But we cannot stop what we are doing, in terms of job promotion.

And I am, for one, glad that we are focused on health care right now. It is something that has long been sitting there. People talk about it in every political speech. Nothing has been done. But it is time, after this is completed and while it is being completed, to focus, laser focus, on jobs in this country and getting our economic ship in shape. And I think you know that.

So we look forward to working with you on this in the future. Thank you very much.

Secretary Geithner. Thank you very much.

Senator Klobuchar. With that, this hearing is adjourned.

[Whereupon, at 12:10 p.m., the committee was adjourned.]

SUBMISSIONS FOR THE RECORD

PREPARED STATEMENT OF CAROLYN MALONEY, CHAIR, JOINT ECONOMIC COMMITTEE

Good morning. I want to welcome Secretary Geithner, and thank him for his testimony here today.

The severe breakdown in our financial system under the watch of the previous Administration triggered a cascade of events, including a freefall in household wealth, paralysis in consumer spending, frozen credit markets, and a tailspin in the labor market. A recession grew into a near depression.

By some measures, what happened to our economy was worse than what happened during the Great Depression. During the first year of the recession, household wealth plunged by 17 percent, more than 5 times the decline seen from 1928 to 1929. In addition, stock prices became even more volatile than they were at the heart of the Great Depression.

Treasury, the Federal Reserve and the FDIC, along with Congress took an extraordinary series of measures to preserve financial stability and restore the proper functioning of credit markets. These initiatives included recapitalizing banks and creating a series of new lending facilities at the Fed. They have clearly contributed to the recovery of the financial system. Interbank lending rates are back to normal after having spiked during the crisis and the S&P 500 is up by over 64 percent from its March 2009 low.

However, as Chairman Ben Bernanke noted earlier this week, constrained bank lending and a weak job market will prevent the recovery from being as robust as we would hope.

Treasury has taken actions recently to help spur lending and create jobs. Treasury will provide lower-cost capital to community banks that submit a plan to increase small business lending and increase lending to small businesses in the hardest-hit communities.

But, more needs to be done. As Professor Stiglitz testified at a JEC hearing this spring "Where there are perverse incentives, there are perverse outcomes—unless we constrain behavior." The regulatory reform that we are considering will do just that—it will eliminate the incentives for banks to engage in the same risky behavior that led to the financial crisis.

The House Financial Services Committee under Chairman Frank's leadership has already passed or marked up a number of bills related to financial regulatory reform. First, a systemic risk regulator will make sure that no firm is too big to fail. Second, firms will not be bailed out—they will be taken over and shut down in an orderly way. Third, regulatory gaps will be plugged. Hedge funds and the over-the-counter derivatives market will not be allowed to grow unchecked and threaten the viability of the financial system. Finally, we will stop fraudulent and predatory lending or banking practices by creating a Consumer Financial Protection Agency. This agency will help spur the demand for credit to the many Americans who are now nervous about the financial products available to them. Like the Credit Card Holder's Bill of Rights that I introduced and Congress passed, it will stop the most abusive practices of lenders of credit.

Although much more needs to be done to help American workers and small businesses, reforming the financial system is a crucial step in this process. Restoring trust in our financial system will help revive the job market and jumpstart the flow of credit in the economy.

Secretary Geithner, we thank you for your testimony here today, and I look forward to hearing your thoughts on how financial regulatory reform will impact the economy as a whole, and help working Americans in particular.

PREPARED STATEMENT OF TIMOTHY F. GEITHNER, SECRETARY OF THE TREASURY

Chairwoman Maloney, Vice Chairman Schumer, I am pleased to appear before the Joint Economic Committee today. The House and the Senate are both making rapid progress toward the goal of comprehensive financial reform, and I appreciate the opportunity to talk about why that reform effort is so essential for the health of our economy and what, in our view, is necessary to make the effort successful.

The United States is in the process of recovering from the worst financial and economic crisis in generations. After an extended and painful contraction, we saw solid annualized GDP growth of 3.5 percent last quarter. We expect continued growth in the fourth quarter and ahead in 2010.

But as we press forward towards recovery, there is still much work to do—not only to ensure that many more Americans see the tangible benefits of recovery, but also to help ensure that Americans are never again forced to suffer the consequences of a preventable economic collapse.

In the years leading up to the crisis, our financial regulatory regime permitted an excessive build-up of risk, both inside and outside the traditional banking system. The shock absorbers critical to preserving stability—capital, margin, and liquidity cushions in particular—were inadequate. Outdated, ineffective regulation left our system too weak to withstand the failure of major financial institutions.

Firms took huge risks with borrowed funds and little of their own capital at stake. They funded long-term, illiquid assets with cheap, short-term debt. This risky behavior migrated from the regulated and partially regulated parts of our financial system to the almost entirely unregulated parts, making it difficult for us to control or even gauge its dimensions.

The result was a financial system vulnerable to bubbles, panic and collapse.

And unfortunately, the regulatory regime that failed so terribly leading up to the financial crisis is precisely the regulatory regime we have today. That is why recovery alone is not enough. To ensure the vitality, the strength and the stability of our economy going forward, we must bring our system of financial regulation into the twenty-first century. We need comprehensive financial reform.

To achieve financial reform, the Administration has advanced a broad set of proposals. We have worked closely—and continue to work closely—with Chairman Frank, Chairman Dodd and members of their respective committees and other important legislators, including many on this Committee, to craft strong financial reform legislation that we hope will be enacted as soon as possible.

Given the range and complexity of the issues with which we are dealing and the critical stage at which our work has now arrived, it is important to step back for a moment and remind ourselves of the central objective of reform—and the key principles that, in the Administration's judgment, are essential to achieving that objective.

The central objective of reform is to establish a safer, more stable financial system that can deliver the benefits of market-driven financial innovation even as it guards against the dangers of market-driven excess. It is to ensure that the financial system functions in a way that creates opportunity and reduces risk. It is to provide stronger protections for consumers, investors, and taxpayers.

In our view, there are at least four key principles that we must follow in order to achieve that objective. These are not meant to be exhaustive. But we do believe they are essential.

First, firms must not be able to escape or avoid regulation by choosing one legal form over another. Firms engaged in the same kind of business, performing the same essential economic functions, must be subject to fundamentally the same regulation and supervision.

Today, bank holding companies are subject to one supervisory regime, thrift holding companies to another, investment bank holding companies to yet another. Without changing its core business, a firm can change—or avoid altogether—regulation at the holding company level simply by switching its legal form.

The fact that investment banks like Bear Stearns or Lehman Brothers or other large firms like AIG could escape meaningful consolidated federal supervision simply by virtue of their legal form should be considered unthinkable from now on. The largest, most interconnected firms must be subject to one uniform, consistent set of standards, regardless of charter.

Similar inconsistencies plague the market for consumer lending. Banks and non-banks operate in the same market and compete for the same customers. But they play with a different rulebook. Non-banks like mortgage brokers, consumer credit companies and payday lenders escape federal supervision almost entirely. The inconsistent regulatory regime sparked a race to the bottom in the mortgage lending market, and the consequences are tragic and well known.

The second principle of reform is that there must be clear regulatory accountability. The principle is particularly important with respect to oversight of the largest, most interconnected firms.

The regulation of the largest, most interconnected firms requires tremendous institutional capacity, clear lines of authority and single-point accountability. This is no place for regulation by council or by committee. The stakes are simply too high to allow diffuse authorities and responsibilities to weaken accountability.

In addition, an essential element of accountability is that rule-writing and enforcement authority must not be divided. Separating rule-writing from enforcement deprives the rule-writer of vital, hands-on information—and gives both the rule-writer and the supervisor an excuse for failure. A rule-writer that is also a supervisor and enforcer, on the other hand, is unmistakably accountable for success—or failure.

Today, responsibility for consumer financial protection is divided among numerous regulators, none of whom regard consumer protection as their top priority. To ensure more responsive and more effective rule writing and enforcement, we have proposed the creation of the Consumer Financial Protection Agency (CFPA). Consolidating the consumer protection authority of the Fed and other prudential regulators, the CFPA would be fully accountable for setting and enforcing rules of the road for the benefit of responsible consumers.

The third principle is that the financial system as a whole must be more capable of absorbing shocks and coping with failures.

One of the most salient lessons of the recent crisis is that financial firms are deeply intertwined, linked by a complex web of contractual and reputational connections. These inter-firm connections allow financial distress to spread contagion across the system. The risk of such contagion means that capital, liquidity and margin requirements must be increased, system-wide—and set with a view to ensuring the stability of the financial system as a whole, not just the solvency of individual institutions.

In addition, there must in the future be a greater focus on the quality of capital, and an effort to design capital requirements that are more forward-looking and reduce pro-cyclicality. While the buffers need to be increased system-wide, the largest firms should face still higher prudential requirements. They should be forced to internalize the cost of the risks they impose on the financial system, and to strengthen their ability to withstand shocks and downturns.

While strengthening prudential standards for firms is one element of making the system as a whole more resilient and risk-absorptive, it is not alone sufficient.

To strengthen the system overall, the Administration has called for measures to strengthen financial markets and the financial market infrastructure. For example, we have proposed to strengthen supervision and regulation of critical payment, clearing, and settlement systems and to regulate comprehensively the derivatives markets.

We should never again face a situation—so devastating in the case of AIG—where a virtually unregulated major player in the derivatives market can impose risks on the entire system.

The fourth and final principle is that no financial institution should be considered "Too Big to Fail."

During the recent crisis, in order to preserve the stability of the financial system, protect the savings of Americans and prevent a far more devastating economic collapse, the government was forced to provide financial support to individual institutions *in extremis*. Those interventions were necessary, but they must not—and do not—set a precedent.

Institutions and investors must be responsible for their decisions. No financial system can operate efficiently if financial institutions and investors assume that the government will protect them from the consequences of failure. And as the President said two months ago in New York, "Those on Wall Street cannot resume taking risks without regard for consequences, and expect that next time, American taxpayers will be there to break their fall."

Part of the answer is simply making the financial system more resilient—as just discussed—by strengthening supervision, eliminating loopholes, building up capital and liquidity buffers, and increasing transparency in key markets. In most circumstances, those precautions will be enough. And for that reason, bankruptcy will remain the dominant means of dealing with the failure of a non-bank financial firm.

But as Lehman's collapse showed quite starkly last year, the U.S. government does not have the tools to respond effectively when failure of large, non-bank financial institutions truly threatens the stability of the system at large.

That is why the Administration has proposed that the government have the authority—as we have today for banks and thrifts—to break apart or unwind major non-bank financial firms in an orderly way, imposing pain on shareholders, creditors, and managers, but limiting collateral damage to the system and sparing the taxpayers.

The proposed resolution authority would not authorize the government to provide open-bank assistance to any failing firm. In other words, the authority would facilitate the orderly demise of a failing firm, not ensure its survival.

Moreover, if there are losses to the government in connection with the resolution, the losses will be recouped from the largest financial institutions in proportion to their size. The financial industry—not taxpayers—will be on the hook.

We must be sure we have the necessary tools to cushion the broader financial system against potential shocks, in times of severe stress. Otherwise, in a financial panic, credit to our economy, to small businesses and homeowners could grind to a halt. To make sure the tools we have are effective but narrowly tailored to achieving financial stability goals, we have proposed to modify the emergency authorities of the FDIC and the Federal Reserve. Their authorities should be subject to appropriate checks and balances and should be available only to protect the financial system as a whole, not individual institutions.

Should new financial crises occur, despite our best efforts to prevent them, these tools are essential to preserve the government's ability to respond in an effective, responsible way.

Let me close by saying this: In today's markets, capital moves at speeds unimaginable when our current regulatory framework was created. Financial instruments that were mere novelties a few decades ago have grown to play a critical role in our financial system. Whatever statutory framework we erect today will, undoubtedly, encounter new, unfamiliar institutions, instruments and markets.

But if we put in place a set of financial reforms that prioritizes consistency, accountability, and resilience, and responsibility; if we fight to close gaps, eliminate loopholes, empower regulators and hold them accountable, raise standards, and give the government the tools it needs to manage crises while ensuring that no one is insulated from the consequences of their actions; if we do those things, we will be able to say that we have met our obligation to the next generation.

Finally, let me thank again the members of this committee. And let me thank again those members of the House Financial Services Committee and the Senate Banking Committee for the good work that you are all doing to advance this important legislation.

Thank you.

Prepared Statement of Representative Elijah E. Cummings

Thank you, Madam Chair for convening this important hearing on the financial regulatory reform proposals currently working their way through Congress.

I am honored to be part of a Congress that has answered the call to reform both the health care system *and* financial sector, so that Americans are both *physically* and *fiscally* healthier.

Thank you also to Secretary Geithner for appearing before the Committee. You lend a unique perspective, and I appreciate the work you and the entire Obama Administration have done during these unprecedented economic conditions.

While we as policy makers may become mired in the substantive details of the regulatory reform proposals—whether over end-user exemptions on over-the-counter derivatives or the required levels of Tier One capital at banks—we cannot lose sight of the ultimate objective—creating an America that is *safer* for our constituents.

It must be safer to retire, safer to innovate, and safer to buy a home.

That is why I remain troubled and discouraged by constant stories of reckless and abusive practices by Wall Street firms.

This decision to prey on hardworking Americans—whether in mortgage lending, credit cards, or bank overdraft "protection"—must be prosecuted and not allowed to happen again.

Chair Maloney has been an outspoken advocate for improving consumer protections, and I applaud her for it.

Unfortunately, some of the worst abuses were done not only to individual consumers, but also to the entire American people.

We held a hearing on Tuesday in the Oversight committee—during which staggering details were revealed about how Bank of America officials got advice from both their in-house and outside lawyers saying they probably couldn't get out their deal to acquire Merrill Lynch.

Still they went to the government during a time of great financial unrest and threatened to walk away from the deal, knowing the U.S. economy could ill-afford the collapse of another major financial firm.

$20 billion dollars in government money later, they decided to keep Merrill Lynch after all. And the lawyer who gave advice they didn't want to hear—he was conveniently fired—"downsizing" they said.

In closing Madam Chair, with the thorough and honest discussion that I know today's hearing will be, the regulatory reform process can prevent future abuses against both consumers and the economy as a whole—and accomplish that goal I stated—making America safer for our constituents.

With that, I yield back.

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JOINT ECONOMIC COMMITTEE

CONGRESSIONAL HEALTH CARE CAUCUS, CHAIRMAN

November 23, 2009

The Honorable Timothy Geithner
Secretary, U.S. Department of Treasury
1500 Pennsylvania Avenue, NW
Washington, D.C. 20220

Dear Secretary Geithner:

Thank you for your appearance before the Joint Economic Committee this past Friday. I appreciated the opportunity to question you regarding the important issues addressed by the Department you currently oversee.

Below, please find additional questions which I have submitted for the record.

1. What actions have been undertaken by Treasury thus far as it relates to TARP? How many suspected accounting fraud cases have there been? Securities fraud? Insider trading? Mortgage servicer misconduct? Mortgage fraud? Public corruption? False statements? Tax investigations?
2. According to SIGTARP, there were little, if no, efforts made by Treasury to reduce AIG counterparty payments at 100% of face value, including to some foreign institutions. Is this correct? If not, when were the efforts made and for how much?
3. What is your understanding of why TARP was implemented?
    a. How many troubled assets have you bought?
    b. Why have homeowner support programs only gotten $27.1 billion whereas the Automotive Industry Support Programs gotten $81.1 billion?
4. The debt is over $12 trillion dollars and, in fiscal year 2009, the year TARP was funded, the Federal Government paid for approximately 46% of its expenditures by issuing new debt. How can we lower the debt and continue to expend the nearly $200 billion unobligated funds in TARP?

With kindest regards,

Michael C. Burgess, M.D.

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RESPONSES OF SECRETARY TIMOTHY F. GEITHNER TO QUESTIONS FROM REPRESENTATIVE MICHAEL C. BURGESS, M.D.

Question 1. What actions have been undertaken by Treasury thus far as it relates to TARP? How many suspected accounting fraud cases have there been? Securities fraud? Insider trading? Mortgage servicer misconduct? Mortgage fraud? Public corruption? False statements? Tax investigations?

Answer. Section 121 of the "Emergency Economic Stability Act of 2008" ("EESA") established the Office of the Special Inspector General for the Troubled Asset Relief Program ("SIGTARP"). SIGTARP has the duty, among other things, to conduct, supervise and coordinate audits and investigations of the purchase, management and sale of assets under the Troubled Asset Relief Program ("TARP"), and to report to Congress on a quarterly basis the results of such audits and investigations. As its most recent quarterly report states, through December 31, 2009, SIGTARP has opened 86 and has 77 ongoing criminal and civil investigations, including investigations of suspected TARP fraud, accounting fraud, securities fraud, insider trading, mortgage servicer misconduct, public corruption, false statements, obstruction of justice and tax-related investigations. SIGTARP's investigative activities generally remain confidential.

Question 2. According to SIGTARP, there were little, if no, efforts made by Treasury to reduce AIG counterparty payments at 100% of face value, including to some foreign institutions. Is this correct? If not, when were the efforts made and for how much?

Answer. On January 27, 2010, the House Committee on Oversight and Government Reform held a hearing that addressed the government's role in negotiations with AIG's counterparties.[1] As part of that hearing, I, former Treasury Secretary Henry Paulson, and others provided extensive testimony on the subject. Although I provide an answer to your question below, I also refer you to the testimony from that hearing, at which Mr. Paulson stated: "I was not involved in any of the decisions made with respect to [counterparty] payments . . . . Those matters were handled by the Federal Reserve Bank of New York and the Federal Reserve Board. They sought to make appropriate decisions on those matters, and I am confident that this review will show that they did." [2]

Since the Federal Reserve Bank of New York (FRBNY) established a credit line for AIG in September 2008, the government's sole purpose in supporting AIG has been to contain the financial panic and limit its impact on the economy, while protecting U.S. taxpayers.

The government did not act to protect the financial interests of individual institutions, or to help foreign banks. The government acted because the consequences of AIG failing at that time, in those circumstances, could have been catastrophic for our economy and for American families and businesses. Those same principles applied to the government's involvement in counterparty negotiations related to Maiden Lane III LLC.

THE DECISION TO SUPPORT AIG AND COUNTERPARTY NEGOTIATIONS

In the fall of 2008, a near-complete collapse of our financial system was a realistic possibility. Americans were starting to question the safety of their money in the nation's banks, and a growing sense of panic was producing the classic signs of a generalized run. Peoples' trust and confidence in the stability of major institutions, such as AIG, and the capacity of the government to contain the damage was vanishing. Lehman Brothers filed for bankruptcy just a few days after AIG alerted Federal authorities that its problems had become acute. In the wake of Lehman's failure major institutions such as Washington Mutual and Wachovia experienced debilitating deposit withdrawals, eventually collapsed, and were acquired by competitors.

Money market funds also suffered a broad run, threatening what was considered one of the safest investments for Americans and severely disrupting the commercial paper market, a vital source of funding for many businesses. In this chaotic environment, the Federal Reserve and Treasury concluded that AIG's failure could be catastrophic. At the time, the failure of a large, global, highly-rated financial institution that had written hundreds of billion dollars of insurance on a range of financial in-

[1] House Committee on Oversight and Government, Hearing, "The Federal Bailout of AIG," Jan. 27, 2010, transcripts and webcast of hearing available at *http://oversight.house.gov/index.php?option=com__content&task=view&id=4756&Itemid=2*.
[2] *Id.*

struments could have tipped an already weak and fragile financial system and economy into the abyss.

The company's failure would directly threaten the savings of millions of Americans to whom it had provided financial protection through investment contracts and products that protect participants in 401(k) retirement plans. AIG was one of the largest life and property/casualty insurance providers in the United States. The withdrawal of such a major underwriter at the time risked creating a void for millions of households and businesses for basic insurance protection. And doubts about the value of AIG life insurance products could have generated doubts about similar products provided by other life insurance companies, feeding the panic that was crippling the economy.

There was no effective existing mechanism to contain the damage of an AIG failure. There was no legal tool comparable to the Federal Deposit Insurance Corporation's authority to manage the orderly wind-down of a troubled bank. In particular, the government did not have the ability to quickly separate the stable underlying insurance businesses from the complex and dangerous financial activities carried out primarily by the parent holding company. Experts suggested that achieving that separation would take several years. Bankruptcy was not a viable option.

If the AIG parent holding company had filed for bankruptcy protection, it would have resulted in immediate default on over $100 billion of debt and trillions of dollars of derivatives. Further, the bankruptcy filing would have caused insurance regulators in the United States and around the world to take over AIG's insurance subsidiaries, potentially disrupting households' and businesses' access to basic insurance. And since many of the insurance products that AIG sold were a form of long-term savings, the seizure by local regulators of AIG's insurance subsidiaries could have delayed Americans' access to their savings, potentially triggering a run on other institutions.

The Federal Reserve, under the law, had no role in supervising or regulating AIG. Instead, the company was subject to a patchwork of regulators, none of whom was adequately aware of the risks that AIG had assumed, and none of whom had the tools to address the company's funding needs or to provide for its orderly resolution. However, Congress gave the Federal Reserve authority to provide liquidity to the financial system in times of severe stress, and it acted to fulfill that responsibility with respect to AIG.

Aware that the Federal Reserve was the only institution capable of acting, and convinced that the failure of AIG could be catastrophic for a financial system already in free fall, the Federal Reserve and Treasury determined that it was in the best interests of the United States to support AIG in order to slow the panic and prevent further damage to our economy.

On the afternoon of September 16, 2008, the Federal Reserve extended AIG an $85 billion line of credit, secured by a substantial proportion of the assets of AIG. In designing the intervention, the government made sure that there were appropriately tough conditions that put the burden of failure on AIG's existing equity holders and management and started the process of designing a comprehensive restructuring plan. Taxpayers received an approximately 80 percent ownership stake in what was still the world's largest insurance company, thereby substantially diluting existing shareholders. The government also required AIG's CEO to step down and immediately began the process of changing the Board of Directors.

From the beginning, it was clear that AIG needed a durable restructuring of its balance sheet and operations. Although the government faced escalating and unprecedented challenges on many fronts of the financial storm in September and October, it continued to work to address AIG's challenges. Falling asset prices generated both substantial losses on the company's balance sheet and increases in required payments to AIG's counterparties under the terms of its credit protection contracts. The insurance companies also experienced significant cash outflows related to a securities lending program, as the value of residential mortgage-backed securities they had purchased and loaned against cash collateral continued to fall. These factors undermined market confidence in AIG and put its investment-grade credit rating again at risk.

Understanding the counterparty negotiations addressed by your question requires an understanding of the role of the rating agencies in AIG's businesses. Avoiding further downgrades of AIG's credit rating was absolutely essential to sustaining the firm's viability and protecting the taxpayers' investment.

Under credit protection contracts that AIG had written and the terms of various funding arrangements, AIG was required to make additional payments to its counterparties if its credit rating was downgraded. A downgrade (to below a certain level) also constituted an event of default or termination under many contracts. In addition, rating downgrades of the AIG parent holding company would have significantly undermined confidence in its insurance subsidiaries. People do not buy insurance products from firms they do not believe have the financial capacity to make good on those commitments over the long term—firms that they do not believe will pay out a life insurance policy or compensate a business if a factory burns down. Credit ratings are central to how people judge that viability.

On November 10, 2008, the Federal Reserve and Treasury jointly announced a package of actions designed to address the vulnerabilities in AIG's balance sheet that threatened its viability and the stability of its credit ratings. In part, the FRBNY helped establish and fund two new companies to purchase troubled assets that AIG had either acquired or insured, and to manage those assets for the benefit of the taxpayer. Purchasing those assets removed significant exposure from AIG's balance sheet and helped insulate the company from further liquidity drains, thereby preventing the company from being downgraded and failing. One company, Maiden Lane II LLC, purchased assets from AIG's insurance subsidiaries. The other company, Maiden Lane III LLC (ML III), purchased securities insured by AIG's Financial Products subsidiary and owned by third parties.

AIG's Credit Default Swap Exposure – Simplified Example

While the financial contracts involved were complex, AIG had basically agreed to insure the value of certain risky securities called multi-sector CDOs. The value of these securities was tied to pools of other assets, mostly subprime mortgages. As the financial crisis intensified, the value of the securities fell sharply. AIG incurred losses on these contracts and had to post collateral or make payments on the insurance.

To help understand this kind of contract, imagine AIG had provided insurance on the value of a tangible asset, such as a house, to the homeowner. If the price of the house fell, AIG would be required to post collateral, or essentially make a payment to the owner, equal to the decline in the value of the house. So, if the house was originally worth $200,000 and fell to $125,000, AIG had to give $75,000 to the homeowner as collateral and would incur a loss of the same amount. In addition, AIG would have to post more collateral if the credit rating of the house fell, because it would signal that that the home's value was in jeopardy. Finally, if AIG's credit rating fell, it would have to post even more collateral because the homeowner would be concerned about whether AIG could ultimately pay on the insurance.

The problem was AIG had written billions of dollars of such insurance without sufficient capital. AIG was fine as long as the prices of the assets they were insuring -- housing prices, in the example -- didn't fall, the credit rating of the assets didn't fall, and AIG's own credit rating didn't fall. But if any of those events happened, it would be in trouble. In the fall of 2008, each of these events occurred. The value of the assets, their credit rating, and AIG's own credit rating all fell, bringing AIG to the brink of bankruptcy.

The counterparty/homeowner was fully protected and had all the leverage. If AIG failed to pay on the insurance, the counterparty could keep the collateral and the asset (house) and sue AIG for damages. Further, if AIG had failed to pay or threatened not to pay, it would have been downgraded and collapsed—threatening the economy. If the government had guaranteed the insurance, as some have suggested, and asset prices fell, the counterparty could demand more collateral and keep the asset (house). Therefore, the government funded ML III to buy the asset (house) at fair market value ($125,000). The counterparty kept the collateral ($75,000) in exchange for tearing up the insurance. As a result, the counterparty received par ($200,000), but the taxpayer gained the opportunity to benefit from recovery in asset prices—as has occurred. The transaction supported AIG's viability and credit rating, removing a substantial threat to the economy at the crisis's peak.

The counterparty negotiations were conducted in connection with the formation and funding of ML III. Before the Federal Reserve became involved with AIG, the company had entered into credit default swap (CDS) contracts with various third parties to protect the value of certain risky securities, called multi-sector CDOs, in exchange for periodic premium payments. The value of these securities was tied to pools of other assets, mostly subprime mortgages. The contracts required AIG to provide its counterparties collateral as the market value of the underlying CDOs, the credit rating of the assets behind the CDO, or AIG's credit rating declined. As the financial crisis intensified, each of these events occurred. As of November 5, 2008, AIG had already posted approximately $37 billion in collateral against these exposures in accordance with the terms of the contracts, and these collateral calls contributed significantly to the $25 billion in losses that AIG reported for the third quarter of 2008.

To remove the persistent threat that these contracts posed to AIG's continuing viability, ML III purchased the underlying CDOs from the counterparties at their then fair market value. The counterparties received $27 billion in payment from ML III, retained approximately $35 billion in collateral previously provided by AIG, transferred the CDOs to ML III, and terminated the CDS contracts. Thus, the counterparties essentially received the "par" value of $62 billion, consistent with the terms of their insurance contracts with AIG. ML III's purchase was funded by a $24 billion loan from the FRBNY and $5 billion equity contribution by AIG.

In designing and implementing this transaction the FRBNY's objective was, as it always is, to protect the taxpayer. The FRBNY made judgments about these transactions carefully with the advice of outside counsel and financial experts. As they had done when establishing the lending facility in September, the FRBNY and its advisors reviewed a range of materials, including details regarding AIG's exposure to each counterparty under the CDS contracts.

However, the FRBNY faced significant constraints. The CDS contracts entitled the counterparties to full or par value. The FRBNY could not credibly threaten not to pay without being willing to follow through on that threat and put AIG into bankruptcy. At the time, the government was working desperately to rebuild confidence in the financial system. Any suggestion that it might let AIG fail would have worked against that vital aim. The FRBNY could not risk a protracted negotiation. AIG's financial position was deteriorating rapidly, and the prospect of a further ratings downgrade was imminent. AIG was scheduled to report a $25 billion loss for the third quarter on November 10, and the ratings agencies had informed AIG that, absent a parallel announcement of solutions to its liquidity and capital problems, they would downgrade the company yet again.

Such a downgrade would have led to AIG's failure and triggered the same catastrophic consequences the government had been trying to avoid since September 2008. Moreover, a bankruptcy would have entitled the counterparties to terminate the CDS contracts and keep the collateral that AIG had previously posted, as well as the underlying CDOs that AIG had insured.

The Special Inspector General for the Troubled Asset Relief Program (SIGTARP) has suggested that the FRBNY should have used its regulatory authority, or some other means, to coerce AIG's counterparties to accept concessions.[3] This was not a viable option for several reasons. First, if the FRBNY had tried to force counterparties to accept less than they were legally entitled to, market participants would have lost confidence in AIG leading to the company's failure. Once a company refuses to meet its full obligations to a customer, other customers will quickly find other places to do business. Second, the counterparties could have refused to grant such concessions, kept the collateral they had already received, kept the CDO securities that AIG had insured, and sued AIG for breach of contract. This would have increased the taxpayer's potential exposure and precluded them from benefiting from any recovery in the value of the CDOs, which has in fact happened.

Third, if the FRBNY had attempted to use its regulatory authority to coerce or extract concessions from AIG's counterparties, that attempt would likely have led to a further downgrade of AIG's ratings, precisely the result that all of the government's actions were intended to avoid. An "investment grade" credit rating is the rating agencies' judgment that creditors will likely be repaid in accordance with the terms of their contracts, not according to a hypothetical government-coerced discount. If the FRBNY had attempted to force counterparties to accept less than they were legally entitled to, then AIG would not have met the ratings agencies' standards for "investment grade" status, and it would likely have lost its "investment grade" rating.

Such a downgrade could have led to the company's collapse, threatened government efforts to rebuild confidence in the financial system, and meant a deeper recession, more financial turmoil, and a much higher cost for American taxpayers. In addition, the SIGTARP has stated that Treasury and the Federal Reserve "were fully prepared to use their leverage as regulators to compel the nine largest financial institutions (including some of AIG's counterparties) to accept TARP funding." The SIGTARP suggests that the government should have similarly compelled concessions from AIG's counterparties. First, I disagree with the SIGTARP's characterization of the government's discussions with the initial recipients of TARP funds. Second, the circumstances and authority in that situation were fundamentally different from what existed in the ML III transaction.

Congress granted the Federal Reserve and, through EESA, Treasury with the responsibility to ensure the safety and soundness of the financial system. In the Federal Reserve's case, that authority was limited to providing liquidity and regulating bank holding companies. In Treasury's case, it was limited to purchasing or guaranteeing assets. Consistent with that responsibility and authority, in the midst of the financial crisis the government encouraged nine banks to accept additional capital. They were not forced to forfeit contractual rights for the benefit of another financial institution.

The latter would have been an abuse of the authority granted by Congress, violated private parties' contractual rights, and undermined confidence in the government's strategy to stabilize the U.S. financial system.

Operating with these constraints, the FRBNY and AIG initiated discussions with the major counterparties about whether they would be prepared to accept conces-

[3] Factors Affecting Efforts to Limit Payments to AIG Counterparties, Nov. 17, 2009, available at *http://www.sigtarp.gov/reports/audit/2009/Factors_Affecting_Efforts_to_Limit_Payments_to_AIG_Counterparties.pdf.*

sions on the prices of the securities. The FRBNY knew that the likelihood of success of such a negotiation was modest, especially given the imminent deadline and the bargaining constraints under which it was operating. Not unexpectedly, the FRBNY discovered that most firms would not, under any condition, provide such a concession. One counterparty (UBS) said that it was willing, but only if every other counterparty would agree to equal concessions on their prices.

In the end, the prices paid for the securities were their fair market value, and because the counterparties retained the collateral they had previously received from AIG, they all received an aggregate amount equal to par value of their securities. In return, the insurance contracts were terminated, and ML III kept the securities.

I strongly believe that the strategy that the Federal Reserve pursued in establishing ML III will generate a better outcome than any alternative. In particular, attempting to coerce concessions risked making the U.S. taxpayer significantly worse off.

AIG TODAY AND OUTLOOK FOR GOVERNMENT INVESTMENTS

Since ML III purchased the CDOs, they have generated significant cash flows that have been used to pay down the FRBNY's loan by more than 25 percent. The Federal Reserve and Treasury expect ML III to pay the FRBNY back in full and to generate a substantial profit for U.S. taxpayers. The FRBNY is not only the senior creditor to ML III. It also has a right to two-thirds of any profits from the portfolio, once its loan has been repaid. Moreover, because ML III can hold the CDOs to maturity, it is largely immune from trading prices and liquidity needs, and is therefore in a better position to maximize the value of the portfolio.

However, the government's return on ML III should be considered in the context of the overall return on its support for AIG. On the one hand, the Federal Reserve will likely earn a positive return on its financial support of AIG, including the FRBNY Credit Facility, its loans to Maiden Lane II and Maiden Lane III, and its preferred interests in AIA Aurora LLC and ALICO Holdings LLC. On the other hand, it is unlikely that Treasury will fully recover the direct costs of its capital investments in AIG. In June 2009, the Congressional Budget Office estimated that Treasury would lose $35 billion of its $70 billion total commitment to AIG, including undrawn funds in the equity facility. And the 2011 Budget reflected an expected loss of $48 billion on that commitment.[4]

Today, on the basis of a range of measures, Treasury believes that losses on its investments in AIG are likely to be lower. If market conditions continue to improve and AIG's businesses perform well, the actual recovery on Treasury's preferred stock could be significantly higher. The Congressional Budget Office recently estimated that losses on all Treasury investments in AIG would be $9 billion.[5]

The President has put forward a concrete plan to recover every penny that Treasury committed to stabilize our financial system, including Treasury investments in AIG. The President's proposed Financial Crisis Responsibility Fee would be imposed on large financial institutions to recoup all losses from TARP investments.

NEED FOR COMPREHENSIVE FINANCIAL REFORM

In addition, the President's proposals and the legislation working its way through Congress to reform our financial system address the shortcomings in regulation and authority that forced the government to support AIG. Those proposals and legislation would provide the government with the ability to limit risk-taking for institutions that threaten the overall stability of the financial system and economy. The government needs this ability not just for banks, but also for institutions like AIG. The proposals and legislation also provide the government with the authority to resolve failing major financial institutions like AIG in an orderly manner, with losses absorbed not by taxpayers but by equity holders, unsecured creditors and, if necessary, other large financial institutions. I look forward to continuing to work with Congress to help pass legislation that provides this necessary authority.

Question 3. What is your understanding of why TARP was implemented?

Answer. In mid-September 2008, we were in the midst of one of the worst periods in our financial history. The economy was contracting sharply. Fear of a possible depression froze markets and spurred businesses to lay off workers and pull back

[4] Congressional Budget Office, The Troubled Asset Relief Program: Report on Transactions Through June 17, 2009, Jun. 2009, 2, available at *http://www.cbo.gov/ftpdocs/100xx/doc10056/06-29-TARP.pdf*.

[5] Congressional Budget Office, The Budget and Economic Outlook: Fiscal Years 2010–2020, Jan. 2010, at 13, available at *http://www.cbo.gov/ftpdocs/108xx/doc10871/01-26-Outlook.pdf*.

from investment and lending. Immediate, strong action was needed to avoid a complete collapse of the financial system. The Treasury, Federal Reserve, Federal Deposit Insurance Corporation, and other U.S. government bodies undertook an array of unprecedented steps to avert a collapse and the dangers posed to consumers, businesses, and the broader economy. However, additional resources and authorities were needed to help address the severe conditions our nation faced. Recognizing the need to take difficult but necessary action to confront a financial system on the verge of collapse, Congress enacted EESA and granted the Treasury Department authority to restore liquidity and stability to the U.S. financial system by purchasing and guaranteeing troubled assets in a wide range of financial institutions.

a. How many troubled assets have you bought?

The 2011 budget reflects that $546.4 billion has been planned for particular TARP programs. Of that amount, $484.73 billion has been committed to specific institutions under signed contracts. $379.20 billion has been paid out by Treasury under those contracts.

b. Why have homeowner support programs only gotten $27.1 billion whereas the Automotive Industry Support Programs gotten $81.1 billion?

The Administration is committed to taking the steps necessary to stabilize our housing market, including providing support for mortgage affordability across the market. The homeowner support program, to which you refer, the Home Affordable Modification Program (HAMP), is only one part of this effort. Treasury has committed up to $50 billion of TARP funds to HAMP. Under this program, Treasury provides incentives for mortgage servicers, borrowers and investors to modify loans that are delinquent or at imminent risk of default to an affordable monthly payment equal to no more than 31 percent of a borrower's gross monthly income. As of our most recent Making Home Affordable Public Report (covering modification activity through the end of January 2010), nearly 1 million homeowners are in active trial and permanent modifications. Over 116,000 homeowners are in permanent modifications. In addition, over 76,000 homeowners are in pending permanent modifications awaiting only final approval from homeowners, for a total of nearly 200,000 homeowners in permanent or pending permanent modifications. The program's central focus at this point is converting borrowers into permanent modifications where they qualify.

The Administration has taken a number of additional steps to stabilize the housing market and support mortgage affordability. The continued support for Fannie Mae and Freddie Mac and the Treasury's Mortgage Backed Securities ("MBS") purchase program, along with MBS purchases by the Fed, have helped to keep interest rates at historic lows. More than 3 million Americans took advantage of these lower rates in 2009 to save money through refinancing. For example, on a median house purchase of $200,000, a one-percent reduction in interest rates on a purchase or refinance, saves the family over $120 per month for the thirty-year life of the loan—real help for America's homeowners. We are also working to provide increased access to financing for state and local housing finance agencies, which provide sustainable homeownership and rental resources in all 50 states, for working Americans. In addition, the first-time homebuyer tax credit has helped hundreds of thousands of responsible Americans purchase a home. As of the end of December 2009, an estimated $1.8 million returns have acclaimed the first-time homebuyer tax credit and about $12.5 billion in credits have been claimed.

The American Recovery and Reinvestment Act ("ARRA") also supported the housing market by creating an innovative Treasury Tax Credit Exchange Program ("TCEP") and providing gap financing through the HUD Tax Credit Assistance Program ("TCAP"). In combination, these programs are estimated to provide over $5 billion in support for affordable rental housing.

ARRA also provided $2 billion in support for the Neighborhood Stabilization Program, which is designed to rebuild value in areas hardest hit by foreclosures, in addition to $4 billion provided for the program in the Housing and Economic Recovery Act.

With respect to the automotive industry programs, outright failure of GM and Chrysler would likely have led to uncontrolled liquidations in the automotive industry. The repercussions of such liquidations could have included immediate and long-term damage to the U.S. manufacturing/industrial base, a significant increase in unemployment with direct harm to those both directly and indirectly related to the auto sector, and further damage to our financial system, as automobile financing accounts for a material portion of overall financial activity. Therefore, the previous Administration provided initial assistance late last year to the automotive companies pursuant to TARP.

When the Obama Administration took office, it required the companies to develop long-term reorganization and viability plans before Treasury would provide additional assistance. The government provided the minimum capital necessary to these companies to facilitate their restructurings. The new companies are now leaner and more efficient and poised to help further the ongoing economic recovery and the competitiveness of the American automotive industry.

Question 4. The debt is over $12 trillion dollars and, in fiscal year 2009, the year TARP was funded, the Federal Government paid for approximately 46% of its expenditures by issuing new debt. How can we lower the debt and continue to expend the nearly $200 billion unobligated funds in TARP?

Answer. Due to improved market conditions and effective performance in the management and use of TARP authority, the projected cost to the taxpayer is now significantly lower than earlier anticipated. We now estimate that the cost to taxpayers and the deficit will be about $224 billion lower than the estimate of $341 billion projected in the Midsession Review in August. However, as part of our commitment to ensuring that taxpayers do not face the costs of the extraordinary efforts taken to stabilize the financial system, the Administration proposed the Financial Crisis Responsibility Fee on January 14, 2010. This fee—which fulfills the President's commitment to submit a plan to recoup TARP losses three years early—would be levied on the liabilities of financial institutions with over $50 billion in assets, and is expected to raise $117 billion over about 12 years, and $90 billion over the next 10 years.

Our proposed fee fulfills the requirement of Section 134 of EESA—ensuring that taxpayers are paid back in full—while also providing a deterrent against excessive leverage among the largest financial firms. In the coming weeks, we will be developing further details concerning the Financial Crisis Responsibility Fee, and we look forward to working with Congress and members of this Panel in designing it to most effectively recover the costs of TARP.