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9-10-2009

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Secretary Timothy F. Geithner
Written Testimony
Congressional Oversight Panel
September 10, 2009

Chair Warren, Representative Hensarling, members Neiman, Silvers and Atkins, thank you for the opportunity to testify today. Mr. Atkins, the last time I appeared before this panel you had not yet joined, so let me first say welcome and thank you for your continued public service.

On October 3, 2008, confronting a financial system on the verge of collapse, Congress gave the Treasury Department unprecedented authority to stabilize the U.S. economy. In doing so, Congress also created an unprecedented framework of oversight to protect taxpayer interests.

The Treasury Department welcomes this oversight and we have adopted a broad range of recommendations made by the Congressional Oversight Panel, the Special Inspector General for the Troubled Asset Relief Program and the Government Accountability Office.

Our nation has traveled a great distance over the past year.

The emerging confidence and stability of September 2009 is a far cry from the crippling fear and panic of September 2008. Back then, the United States was living through one of the worst periods in our financial history. Fannie Mae and Freddie Mac were taken into federal conservatorship; Lehman Brothers went bankrupt and AIG nearly followed; Wachovia, Washington Mutual and Merrill Lynch were sold in distress; and weakness at a prominent mutual fund sparked a dangerous "run" on money market mutual funds.

Policy interventions at the end of last year succeeded in achieving the vital, but narrow, objective of preventing a catastrophic systemic meltdown. But by the time President Obama took office, the financial system remained extremely fragile and the new Administration faced a rapidly evolving set of grave challenges.

In the financial sector the flow of credit to businesses and families had frozen; the issuance of new asset-backed securities (ABS) had essentially come to a halt; and liquidity in a broader range of securities markets had fallen sharply.

In addition, the broader economy was in a free fall. In January we lost 741,000 jobs, the largest single month decline in 60 years; our GDP contracted at a rate not seen in more than 50 years; American families had lost $10 trillion in household wealth; and there was increasing concern we were headed towards a second Great Depression.

Today, thankfully, that is no longer the case.

The consensus among private forecasters is that our economy is now growing; the financial system is showing signs of repair; and the cost of credit has fallen dramatically.

For example, American families are spending less each month on mortgage payments. Because of near historically low interest rates, a family with an average 30-year mortgage is saving around $1,200 each year.

And for businesses, the cost of long-term investment grade borrowing has fallen from a peak of roughly 400 basis points to about 135 basis points today, when viewed as a spread over Treasuries.

Credit is now more readily available. Issuance of corporate bonds has surged, more than offsetting a modest decline in lending by the banking system.

For state and local governments, improved conditions in the municipal bond market have allowed for lower-cost financing to help them through this recession. Last December, higher-rated municipalities – which have historically borrowed at rates lower than the rates on U.S. Treasury securities – were facing interest rates nearly twice the Treasury rate. Since then, the cost of borrowing has again fallen below the Treasury rate, and state and local governments have been able to issue debt at levels in line with recent years.

We still have a long way to go before true recovery takes hold. This Administration will keep at it until that happens. We know that millions of ordinary Americans are suffering through no fault of their own and their well being is the driving force behind every policy we enact and every dollar we spend.

But, a year on from that moment of crisis, it is clear that we have stepped back from the brink and that, as the President recently said, we are pointed in the right direction. It is also clear that such a turn-around was not inevitable, nor was it an accident. It happened because the Obama Administration and Congress put in place a comprehensive strategy that was unprecedented in size and scope.

Our response included the most sweeping economic recovery package in our nation's history, meant to address the dramatic contraction in demand. And it included a Financial Stability Plan designed to recapitalize our financial system with as much private capital and as little taxpayer funding as possible; to repair the institutions and markets that provide credit to American families and businesses; and to stabilize the spiraling housing crisis.

On each front we are seeing progress.

First, since the "stress test" results were released in early May, banks have raised over $80 billion in common equity and $40 billion in non-guaranteed debt. Importantly, that has meant that more than 30 firms have repaid $70 billion in Treasury investments, with the taxpayers earning a double-digit return on these equity investments. It's worth noting that when we first announced that our largest banks would be subjected to the most comprehensive, forward looking examination ever undertaken, the banks were resistant and the markets were skeptical. But the extraordinary level of transparency attached to the tests generated increased credibility and confidence.

Second, the Term Asset-Backed Securities Loan Facility program is helping restart critical channels of credit to American households and businesses. Since March, the TALF program has backed nearly $62 billion of consumer and small business credit; over 2.7 million consumer and small business loans and leases; and over 200 million active credit card accounts.

Since the peak of the crisis, spreads for the asset classes backed by the program have come down from between 50 to 85 percent. Spreads on credit card and auto loans have fallen from a peak of 600 basis points to approximately 100 basis points over the benchmark, the same levels that existed before Lehman Brothers went bankrupt in September 2008. In addition, investors are gaining confidence in the market without the need for government support. In March approximately 60% of new ABS issuance was purchased with the support of our program. This month that is down to 40%.

Third, to help clean up the balance sheets of major financial institutions and re-liquefy key markets for financial assets, we proposed the creation of a public-private investment program for the purchasing of legacy loans and securities. Since the announcement of the program, non-agency mortgage-backed securities have gone up substantially in price. Prime fixed rate securities issued in 2006 that traded as low as $60 in March have increased in value by over 40 percent as liquidity has come back to the markets. That improvement in financial market conditions has created the positive backdrop to proceed with the program at a scale smaller than initially envisioned.

Fourth, the Administration attacked the housing crisis across multiple fronts using various authorities. We boosted demand by implementing a new homebuyer's tax credit in the Recovery Act, which over 314,000 Americans have used to date. We supported historically low mortgage rates by strengthening confidence in Fannie Mae and Freddie Mac, including through a $200 billion increase in stock purchase agreements, enabling American families to reduce the cost of their monthly mortgage payments by refinancing. Given that many Americans were unable to refinance because their loan to value ratio was above 80, we expanded our refinancing program to include borrowers with loan to value ratios up to 125, providing the opportunity for more underwater homeowners to refinance. And we created a $75 billion loan modification program, including $50 billion in Troubled Asset Relief Program funds, designed to allow 3 to 4 million families the chance to stay in their homes.

To date, over forty-five servicers have signed up for our Making Home Affordable Modification Program, including the five largest. Between loans covered by these servicers and loans owned or guaranteed by the government sponsored entities, more than 85% of loans in the country are now covered by the program. In addition, these participating servicers have extended offers on over 500,000 trial modifications and over 360,000 trial modifications are currently underway.

Finally, I would like to provide an update on our support for the auto industry. The New General Motors and the New Chrysler recently emerged from expedited bankruptcies and are operating as independent companies. The government's support in that process has prevented substantial job losses, led to an orderly restructuring, and stabilized economic and financial markets. In

exchange, the taxpayer received equity stakes, warrants, and direct loans in each company, along with a government commitment to manage that investment commercially and exit its position as quickly as is practicable.

The government is a reluctant, careful shareholder in General Motors and Chrysler. It committed tax dollars on the strict condition that these companies and their stakeholders were willing to fundamentally transform, address prior bad business decisions, and chart a path toward long-term financial viability without ongoing government assistance. Throughout the restructuring process, the Auto Task Force has refrained from intervening in the day-to-day decisions of these companies. Such intervention could seriously undermine the companies' long-term viability and, consequently, their ability to repay the taxpayer for its investment.

The termination of the Auto Warranty Commitment Program demonstrates the government's prudent use of taxpayer funds and commitment to exit. The government invested $641 million in the Warranty Program to give confidence to GM's and Chrysler's customers during a period of substantial uncertainty. Following the companies' emergence from bankruptcy, the money invested in the program has been returned, along with interest payments from New Chrysler.

Because of these early signs of progress in each area, we are now in a position to evolve our strategy as we move from crisis response to recovery, from rescuing the economy to repairing and rebuilding the foundation for future growth.

As we enter this new phase we must begin winding down some of the extraordinary support we put in place for the financial system.

Earlier this year, we added a contingency fund to the President's budget to provide for the possibility that we might need another $750 billion in stabilization funds. Today, we believe that money is unlikely to be necessary and we have removed it from budget projections, lowering this year's deficit.

Later this month, Treasury's guarantee program for money market mutual funds, which, at its peak, covered over $3 trillion of combined fund assets, will end. While the program had no direct cost to taxpayers, it earned more than $1 billion in income.

The FDIC's program to guarantee senior debt (TLGP), which has generated more than $9 billion in income, has seen significant declines in usage as private sector alternatives become more economic.

Many of the programs to provide liquidity were designed to phase down as markets improved and government guarantees became more expensive. That planned phase down has taken place, dropping usage of the Federal Reserve's Commercial Paper Funding Facility (CPFF) by 87 percent, the Asset-Backed Commercial Paper Money Market Fund Liquidity Facility (AMLF) by 99 percent, the Term Auction Facility (TAF) by 57 percent, and the Federal Reserve's program on currency swaps by 90 percent. Financial institutions paid to use each of these programs, and they generated considerable income for the taxpayers with no significant losses.

Over the past eight months, support needed for the banking sector has decreased significantly. When I took on this job, the government had outstanding commitments of $239 billion to banks. Since then we have invested $11 billion through the Capital Purchase Program in more than 350 financial institutions, while banks have repaid more than $70 billion, reducing the total size of the government's capital investments in the banking system to $180 billion. We now estimate that banks will repay another $50 billion over the next 12 to 18 months.

The dividends paid on those investments and the repurchases of warrants we received for those investments now total about $12 billion. For the 23 banks that have fully repaid, Treasury has earned an annualized average return of roughly 17 percent.

These are all important steps towards recovery. But we must remember that it took years for this crisis to take hold. Given the extent of damage done to the financial system, the loss of wealth for families and the necessary adjustments after a long period of excessive borrowing around the world, it is realistic to assume recovery will be gradual, with more than the usual ups and downs.

Going forward, we must continue reinforcing recovery until it is self-sustaining and led by private demand. The classic errors of economic policy during crises are to act late with insufficient force and then put the brakes on too early. We are not going to repeat those mistakes.

Unemployment is still unacceptably high; the mortgage market, outside those covered by Fannie Mae and Freddie Mac, is still significantly impaired; commercial real estate financing remains extremely strained; small businesses are still grappling with unusually tight credit in part because they have few alternatives to banks for loans; and as job losses continue, families are finding it increasingly difficult to meet their mortgage payments causing foreclosures to rise.

We are going to do everything necessary, for as long as is necessary, to make sure American families and small businesses see sustained, material improvement in their lives.

In addition, the critical imperative we face as a country is making sure that the same vulnerabilities in our system which gave rise to this recession are not allowed to trigger another. To do that, we must pass comprehensive regulatory reform legislation by the end of the year.

The Administration's proposals are focused on three key areas: protecting consumers, making the financial system more stable, and creating better tools to respond to financial stress in large, interconnected institutions.

There is broad agreement that consumer protection needs to be stronger. Achieving this objective requires mission focus, market-wide coverage and consolidated authority, none of which exist in today's system. That is why we are proposing a Consumer Financial Protection Agency to make sure that responsible Americans receive the protection they deserve and access to fair and transparent mortgages and credit cards.

The need is undeniable. With 78 percent of American families using credit cards and 44 percent carrying a balance, deceptive terms and practices affect nearly every family. More than half of the high cost loans at the center of the mortgage crisis were made to middle class families and in middle class communities. And yet there was no federal regulator dedicated to consumer protection.

To make the system more stable, we have proposed requiring financial institutions to hold more capital and manage liquidity risk more effectively; closing loopholes in regulation; requiring stronger federal supervision of all major financial firms; putting the market for over-the-counter derivatives under a comprehensive system of regulation; evolving the Federal Reserve's authority to create a single point of accountability for the consolidated supervision of all large, interconnected firms; and creating a Financial Stability Oversight Council to bring together all regulators to identify emerging risks and coordinate responses.

And to provide the government better tools to respond to future crises, the Administration has proposed new resolution authority. The Administration's proposal gives the government a legal mechanism, similar to the authority that the FDIC already has for managing the closure of insured depository institutions, to more effectively manage the wind down of large non-bank financial institutions in a way that protects taxpayers.

We have come a long way since this panel was first created. While significant challenges remain, and while a great deal of work still needs to be done, it is important to remember that a year ago our financial system stood at the verge of collapse. We remember that because where we stand today is testament not just to the President, not just to Congress but to the resilience of the American people.

This is a moment of great challenge and consequence. But as our nation has done time and again, we will not simply recover from this crisis, we will rebuild and emerge stronger than before.