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Interim Assistant Secretary for Financial Stability Neel Kashkari Remarks on Financial Markets and TARP Update

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U.S. DEPARTMENT OF THE TREASURY

Press Center

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Washington - Good morning and thank you for the opportunity to address you today. I am going to give a few minutes of prepared remarks and then I look forward to taking your questions. We are in an unprecedented period and market events are moving rapidly and unpredictably. We at Treasury have responded quickly to adapt to events on the ground. Throughout the crisis, we have consistently acted with the following three critical objectives: one, to stabilize financial markets and reduce systemic risk; two, to support the housing market by avoiding preventable foreclosures and supporting mortgage finance; and three, to protect taxpayers. The authorities and flexibility granted to us by Congress have been essential to developing the programs to meet these objectives.

Today, I will focus my remarks on one of our vital programs, the Capital Purchase Program, which Treasury launched on October 14 to stabilize the financial system by increasing the capital in banks. I cannot think of an example where a program of this scale and complexity has been launched and executed as quickly and as effectively as the Capital Purchase Program – in either the public or private sectors.

Backdrop to the Capital Purchase Program

Before we launched this program in October, we were at a tipping point. Credit markets were largely frozen, denying businesses and consumers access to vital funding and credit. Financial institutions were under extreme pressure, and investor confidence in our system was dangerously low. A number of institutions had failed or been re-structured. Throughout the crisis, we have been strongly encouraging financial institutions to raise capital and to recognize losses. However, as markets continued to deteriorate, it was clear to Secretary Paulson that we needed to use the authority and flexibility granted by Congress as aggressively as possible to quickly stabilize the system. And we believed that purchasing equity in healthy banks would be the fastest and most effective way to inject much-needed capital to the financial system and restore confidence and the flow of credit.

On October 24, Secretary Paulson announced that we would allocate $250 billion of the financial rescue package for a voluntary capital purchase program for banks and savings institutions of all sizes. We did this in combination with a guarantee of senior bank debt by the FDIC.

Goals of the Capital Purchase Program

The Capital Purchase Program was designed to first stabilize the financial system by increasing the capital in our banks, and then to restore confidence so credit could flow to our consumers and businesses.

As we have seen throughout this crisis, the loss of confidence in and between financial institutions can happen with lightning speed and with devastating effects. Increasing capital levels helps banks retain the confidence of depositors, investors and counterparties alike.

A stronger capital base stabilizes the system by enabling banks to take losses as they write down or sell troubled assets. With higher capital levels and restored confidence, our banks can continue to play their role as lenders in our communities; while difficult to achieve during times like this, this lending is essential to economic recovery.

Program Success

It has been 51 days since Secretary Paulson announced the Capital Purchase Program. In those seven weeks, the CPP has gone from an idea to a fully-functioning program. We started from scratch, recruited and built a world class team, designed the program details, hired necessary outside vendors, and implemented a complex, but efficient processing model: Applications are submitted to and reviewed by regulators. They recommend them to Treasury, where we review them before a final decision is made. And numerous transaction agreements are processed for each investment before it is funded. In just under two months, the CPP has achieved operational speed and quality that few government or private sector programs have ever reached. And our program is becoming more efficient each day.

Let me briefly touch upon the process, which is quite important because we are focused on meticulous execution, transparency and compliance with all oversight requirements set out by Congress.

Treasury created a standard investment agreement for all banks, regardless of size. We worked with the regulators to develop a consistent process for the regulators to review applications and make recommendations.

The Treasury Investment Committee meets daily and reviews dozens of applications per meeting and Treasury makes the final decision on all investments. It is typically less than a week between when a regulator submits a recommendation to Treasury and when Treasury makes an investment decision. It sometimes takes as little as two days.

We often close transactions in a couple weeks - which is a record for either the private or public sector.

- On October 28, we funded eight transactions for $115 billion to banks in four states.
- On November 14, we funded 21 transactions for $33.5 billion to banks in 16 states.
- On November 21, we funded 23 transactions for $2.9 billion to banks in 16 states.

In just over one month, we have disbursed an estimated $151 billion to 52 institutions in 25 states across the country, which means that over half the money is already out the door. We are ramping up quickly from here.

We have more applications under-review in the pipeline and many others have already been pre-approved from depositories across the country. Often banks need more time to complete their legal requirements than Treasury needs to execute the investments.

This progress is remarkable not only in its speed and quality, but also in its scope. We have touched almost every banking market in the nation with applications representing small and large banks alike. The largest investment has been $25 billion. The smallest investment has been $9 million.

Measuring Results

People often ask: how do we know our program is working? First, we did not allow the financial system to collapse. That is the most direct, important information. Second, we know the system is more stable than it was when Congress passed the legislation. While it is difficult to isolate one program's effects given regulators' numerous actions, one indicator that has pointed to reduced risk in the system is the average credit default swap spread for the eight largest U.S. banks, which has declined almost 207 basis points since before Congress passed the EESA. Another key indicator of perceived risk that we are tracking is LIBOR: 1 month LIBOR has declined 217 basis points and 3 month LIBOR 202 basis points.

People also ask: when we will see banks making new loans? First, we must remember that just over half the money is out the door. Although we are executing at record speed, it will take a few months to process all the remaining applications. The money needs to get into the system before it can have the desired effect. Second, we are still at a point of low confidence – both due to the credit crisis and due to the economic downturn. While confidence is low, banks will remain cautious about extending credit, and consumers and businesses will remain cautious about taking on new loans. As confidence returns, we expect to see more credit extended.

This lending won't materialize as fast as any of us would like, but it will happen much faster as a result of having used the TARP to stabilize the system and to increase the capital in our banks.

We firmly believe that healthy banks of all sizes should use this program to continue making credit available in their communities. As Secretary Paulson has said, we expect banks to increase their lending as a result of these efforts and it is important that they do so. As such, Treasury supports the statement issued by bank regulators on November 12 to that effect. The statement emphasized that the extraordinary government actions taken to stabilize and strengthen the banking system are not merely one-sided; all banks – not just those participating in the Capital Purchase Program – have benefited from the government's actions to restore confidence in the financial system. Banks, in turn have obligations to their communities, particularly in this time of economic disruption. They have an obligation to continue making credit available to creditworthy borrowers and an obligation to work with borrowers who are struggling to avoid preventable foreclosures. At the same time, institutions must not repeat the poor lending practices that were a root cause of today's problems.

Treasury is focused on determining the extent of the CPP's desired effect and contributions to our policy objectives, an issue raised by the GAO's first report on the program. As noted by the GAO, given the number and variety of financial stability actions being put in place by multiple entities, it will be extremely difficult to view the CPP effects in isolation. Moreover, each individual financial institution's circumstances are different making comparisons challenging at best. Tracking where individual dollars flow through an organization is also difficult. However, we are working with the regulators to try to develop ways to determine the effectiveness of the program.

Conclusion

While we have made significant progress, we recognize challenges lie ahead. As Secretary Paulson has said, there is no single action the Federal Government can take to end the financial market turmoil and the economic downturn, but the new authorities Congress provided in October dramatically expanded the tools available to address the needs of our system. In these extraordinary times, we must focus on developing the most effective combination of our tools to further stabilize our financial system and speed the process of recovery. We are confident that we are pursuing the right strategy to stabilize the financial system and support the flow of credit to our economy. Thank you and I would be happy to take your questions.

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