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Anthony W. Ryan

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# U.S. DEPARTMENT OF THE TREASURY

## Press Center

### Acting Under Secretary for Domestic Finance Anthony Ryan Remarks at the SIFMA Annual Meeting

10/28/2008

HP-1240

**New York** - Good morning. I am pleased to represent the Treasury Department at the Annual Meeting of the Securities Industry and Financial Markets Association (SIFMA). I welcome this opportunity to update you on the state of the capital markets and the global economy, and on Treasury's efforts to implement the Emergency Economic Stabilization Act, the EESA, which was recently passed by Congress and signed into law by President Bush.

Our primary focus at Treasury is to strengthen U.S. financial institutions and restore the flow of financing that is necessary to support and build our economy. This conference presents the ideal venue and is particularly timely given the convergence of financial market events, the critical contributions of private sector participants, the broader policy perspectives that need to be addressed, and the breadth of SIFMA's reach to the financial community. Moreover, this discussion is also opportune given SIFMA's mission to enhance the public's trust and confidence in the markets, to deliver an efficient, enhanced member network of access and forward-looking services, and to be the premier educational resource for professionals in the industry. We at Treasury appreciate SIFMA's efforts on disclosure, securitization, credit ratings, the restoration of investor and public confidence, and securities fails in the Treasury market. But the work is not complete. SIFMA must continue to address the current challenges as well as provide material and meaningful input to future policy issues.

#### Financial Markets

The stresses on U.S. and world financial markets are the most serious in recent memory. The disruptions of recent months have their roots in the housing correction. As housing prices have declined and the values of mortgage loans became more opaque, uncertainty spread to the investors and institutions that owned these assets. While some argue that this uncertainty has its roots in the subprime and the Alt-A markets, there are numerous factors to review and to understand before coming to any conclusions. Credit as a whole – not just in the housing sector – has been plentiful over the past decade and we have benefited by being able to finance the spectrum of assets and services, from complex collateralized obligations, to tender option bonds, to student loans, and to household spending with credit cards. Today, we are experiencing the repercussions of this unbridled expansion and access to credit. We needed to strike a balance between strong market discipline and regulatory oversight and we have not. Investor confidence was undermined, illiquidity then compromised our credit markets, and now the housing and financial market turmoil has spilled over into the rest of the U.S. economy.

Equity, credit, and funding markets remain under considerable strain, as banks have been forced to delever aggressively and risk appetite has abated. However, policy measures enacted by the Treasury, the Federal Reserve, the FDIC, other U.S. policymakers and our counterparts around the world have helped relieve some pressures in the funding market.

For example, Treasury implemented the temporary Money Market Mutual Fund Guarantee Program, which has been well received by funds and has helped to relieve large-scale redemption pressure among money market mutual funds--a key buyer of commercial paper. The Federal Reserve also introduced three programs: (i) the Asset-Backed Commercial Paper (ABCP) Money Market Liquidity Facility (AMLF) to provide investors the opportunity to sell ABCP through broker/dealers to the Fed; (ii) the Commercial Paper Funding Facility to enhance the availability of 90-day term funding for issuers of both secured and unsecured paper; and (iii) the Money Market Investor Funding Facility to further restore liquidity to the money market mutual fund industry by purchasing commercial paper, certificates of deposits, and bank notes with maturities of 90 days or less. The first two Fed facilities are already operational, and indications are that they too are helping to stabilize financial institutions' access to the commercial paper market. Accordingly, commercial paper yields are adjusting, volumes across the maturity spectrum are expanding and maturities have lengthened, although we are still far from what might be called "normal" conditions.

Several other funding market sectors, including London Interbank Offer Rates (LIBOR), have also experienced improvements in response to the passage of the EESA and the announcement of the FDIC's guarantee of short-term bank debt.

In the longer term credit markets; however, conditions remain quite challenging and U.S. companies are finding it very difficult to issue long-term debt at attractive rates.

Mortgage markets are also continuing to experience strain. While the yield on the current coupon mortgage-backed security issued by Fannie Mae and Freddie Mac has increased, overall consumer mortgage rates have improved, and currently average around 6.04 percent on fixed rate 30-year mortgages according to Freddie Mac's weekly survey, down from 6.35 percent before the GSEs were placed into conservatorship by their regulator, the Federal Housing Finance Agency (FHFA).

It is important to remember that as part of the Treasury's actions regarding Fannie Mae and Freddie Mac and in consultation with FHFA, the GSEs entered into a Preferred Stock Purchase Agreement with Treasury that effectively guarantees all debt issued by the GSEs, both existing and to be issued. The U.S. Government stands behind these enterprises, their debt and the mortgage backed securities they guarantee. Their mission is critical to the housing markets in the United States and no one will deny the importance of these institutions in assisting our housing markets in this downturn.

To further address other market issues and offer a comprehensive plan for tackling challenges in the financial system, the President worked with Congress over the past 21 days to move quickly to grant the Treasury Department extraordinary authority to address these unprecedented situations facing Americans. Congress recognized that frozen credit markets pose a significant threat to our economy and to all Americans. With unprecedented speed, Congress enacted a rescue package with a broad set of tools ---including authority to purchase or insure troubled assets which in turn assists Americans by permitting the extension of credit, and implementing temporary increases in the FDIC deposit guarantee. These tools are being deployed aggressively to strengthen large and small financial institutions across the country that serve businesses and families and directly impact the well being of Americans.

Treasury is moving rapidly to implement these and other programs and is continuing collaborative efforts with the Federal Reserve, the FDIC, and other financial regulators to address the many challenges we face.

Let me summarize our actions thus far and provide some additional details.

### **Implementation**

Treasury has moved quickly since the enactment of the EESA to implement programs that will provide stability to the markets and help enable our financial institutions to support consumers and businesses across the country. We are focused on applying the authorities Congress provided in ways that are highly effective and protect the taxpayer to the maximum extent possible. As Interim Assistant Secretary for Financial Stability Neel Kashkari recently testified before the Senate Committee on Banking, Housing and Urban Affairs, we have accomplished a great deal in a short time. A program this large and complex would normally take months or years to establish. We don't have months or years and so we are moving quickly, and methodically, to facilitate the necessary results. We are also moving with great transparency, communicating with Congress and the oversight authorities at every step.

### **Capital Purchase Program**

Earlier this month we announced a capital purchase program under which Treasury will purchase up to \$250 billion of senior preferred shares from qualifying U.S. controlled banks and financial institutions. Last week Treasury and financial regulators outlined a streamlined, systematic process for all banks wishing to voluntarily participate in the capital purchase program. Since that time, we have seen a broad range of interest. We signed final agreements with the initial nine major financial institutions that hold 50 percent of all U.S. deposits over this past weekend, and directed our custodian to deliver the capital to these institutions starting today. We also granted preliminary approval to several more regional banks over the weekend. There will be a rolling process for selecting financial institutions for capital injections as we go forward.

This program is aimed at healthy banks, and provides attractive terms to encourage lending. The minimum subscription amount available to a participating institution is one percent of risk-weighted assets. The maximum subscription amount is the lesser of \$25 billion or three percent of risk-weighted assets. Treasury intends to fund the senior preferred shares purchased under the program by the end of this year. We worked with the four banking regulatory agencies to finalize the application process. Qualified and interested publicly-held financial institutions will use a single application form to submit to their primary regulator – the Federal Reserve, the FDIC, the OCC, or the OTS. These regulators have posted this common application form on their websites.

As Secretary Paulson said last week, this capital purchase program is an investment, not expenditure. This is an investment in Americans, in our community banks, credit unions, and main street banks.

As these banks and institutions are reinforced and supported with taxpayer funds, they must meet their responsibility to lend, and support the American people and the U.S. economy. It is in a strengthened institution's best financial interest to increase lending once it has received government funding.

### **Capital Purchase Program Disclosure**

Treasury is committed to transparency and disclosure as we implement this program. Once a financial institution is granted preliminary approval, Treasury and the institution will work to complete the final agreement and final authorization of payments. Once the payment is authorized, within two business days Treasury will publicly disclose the name and capital purchase amount for the financial institution. We will disclose the names of financial institutions at the same time every day with postings on our EESA website.

### **Financing the Financial Rescue Package**

Let me now focus on another topic that is just as important – the financing of the Troubled Asset Relief Program (TARP) as well as the various initiatives implemented this past year.

As you know, we make announcements regarding debt management policy at our Quarterly Refunding after consulting with our Treasury Borrowing Advisory Committee as well as after significant internal consultation. This year's financing needs will be unprecedented. We firmly believe that investors value greatly and pay a premium for Treasury's predictable actions, the certainty of supply, and the liquidity in the market. To the very best of our ability, we intend to stay the course.

However, specific policy actions or market conditions have recently caused us to take new actions.

For example, two weeks ago I stated that Treasury will continue to increase auction sizes of our bills and coupon securities and continue to issue cash management bills. As has been the case over the past year, some of these cash management bills may be longer-dated. Treasury is also considering its options regarding the frequency and issuance of additional nominal coupons, including a possible reintroduction of the three-year note, beginning in November 2008.

I noted at the time that the announcement was being made, outside the customary Quarterly Refunding announcements, to allow Treasury to adequately respond to the near-term increase in borrowing requirements and to give market participants notice of the potential changes.

Specifically, Treasury may need to address many different policy objectives, including TARP related programs and purchases, FDIC bank resolution measures, liquidity initiatives conducted by the Federal Reserve including the Supplementary Financing Program, the Agency MBS program, student loan program, and the GSE Senior Preferred Stock Agreement. All of these initiatives are not factored into the \$482 billion FY 2009 deficit projected by the Office of Management and Budget in July's Mid-Session review. The potential for deterioration in economic conditions given the contraction in credit may also affect budget conditions this year.

In addition, Acting Assistant Secretary for Financial Markets Karthik Ramanathan recently issued a statement regarding dislocations in the Treasury market. Specifically, Treasury closely monitors conditions in the Treasury securities market as well as financing markets, and realizes that the depth and liquidity of the Treasury market benefits investors both domestically and globally. To address its borrowing needs and further enhance liquidity in the Treasury market, Treasury reopened multiple securities which relieved severe dislocations in the market causing acute, protracted shortages. In addition, Treasury stated that regulators will be monitoring situations in which aged settlement fails are not cleared and will encourage actions by market participants, including the use of netting and bilateral processes, cash settlement, negative rate repo trading, margining of aged settlement fails, and identifying pair-offs.

Once again, we are strongly urging the private sector to lead this effort. We all benefit from a deep, liquid Treasury market, and SIFMA and the Treasury Markets Practices Group have the opportunity to take a leadership role in devising and implementing private sector solutions to current challenges.

Efforts by the private sector to address challenges in the marketplace will go a long way to strengthen market discipline, improve market liquidity and enhance market confidence. It will also help build credibility with market regulators.

### **Addressing the Challenges and Disequilibrium in the Markets**

Our financial market system rests on a balanced tension between private-sector market discipline and public-sector regulatory oversight. However, that balance has been weakened by deficiencies on both sides; market discipline failed and regulatory efforts were compromised. Rules, guidance, and oversight did not mitigate the failures of market discipline. From a public policy perspective, we must restore equilibrium to financial markets, which in this context means market stability. We must strike the optimal balance between market discipline and supervision. Aligning the interests of the private sector and the public sector is critical to the long term success of our economy. When discipline and oversight are balanced, market participants better manage risks, financial institutions operate in a safer and sounder manner, and our economy is served by more competitive, innovative, and efficient capital markets. In March, Treasury released its Blueprint for a Modernized Financial Regulatory Structure. This report outlines a series of steps to improve the U.S.'s antiquated regulatory system. Both market practices and regulatory practices must be reviewed with a critical eye towards improvement and material strengthening. We need to focus on moving forward, with all parties contributing to the collective effort.

### **President's Working Group on Financial Markets**

In order to address the unprecedented and extraordinary disequilibrium and challenges that our financial markets have experienced, the President's Working Group on Financial Markets, or "PWG" as it is known, has been taking proactive steps to mitigate systemic risk, restore investor confidence, and facilitate stable economic growth. The PWG issued a policy statement on the financial market turmoil last March, which contained an analysis of underlying factors that contributed to the market turmoil.

The PWG identified weaknesses in global markets, financial institutions, and regulatory policies, and made a set of comprehensive recommendations to address those weaknesses. The analysis focused on six areas: mortgage origination, improving investors' contributions to market discipline, reforming the ratings process and practices regarding structured credit products, strengthening risk management practices, enhancing prudential regulatory policies, and enhancing the infrastructure for the OTC derivatives market. The PWG's recommendations cover the practices of a broad array of market participants, as well as supervisors, addressing all links in the

securitization chain: mortgage brokers, mortgage originators, mortgage underwriters, securitizers, issuers, credit rating agencies, investors, and regulators.

Since March, the PWG has worked to ensure implementation of its recommendations, and issued an update just over two weeks ago on progress to date. We noted that, while no single measure can be expected to place financial markets on a sound footing, implementation of the recommendations is an important step in addressing weaknesses. Substantial progress has occurred, and more progress has been made in some areas than in others as efforts have been prioritized to address the most immediate problems. The pace of implementation must be balanced with a need to avoid exacerbating strains on markets and institutions. Still, further effort is warranted, and the PWG is continuing to carefully monitor markets and implementation and will not hesitate to make recommendations if necessary.

Another PWG effort, which pre-dates the current turmoil, concerns private pools of capital, including hedge funds. Recognizing that private pools of capital bring significant benefits to the financial markets, but also can present challenges for market participants and policymakers, the PWG in February 2007 issued a set of principles and guidelines to address public policy issues associated with the rapid growth of private pools of capital and to serve as a framework for evaluating market developments, including investor protection and systemic risk issues. These principles contained guidelines for all links in the pooled investment chain: pool managers, creditors, counterparties, investors, and supervisors. In September 2007, the PWG facilitated the formation of two private-sector groups to develop voluntary industry best practices: the Asset Managers' Committee and the Investors' Committee. In April of this year, the two groups issued draft best practices for hedge fund managers and for investors in pools, and they expect to issue finalized practices very soon.

### **Conclusion**

We remain vigilant as Americans face strong headwinds in this challenging financial environment. We will focus on addressing or mitigating immediate problems while being mindful that longer term regulatory reform is critical to our continued status as the world's preeminent capital market. Our Blueprint and the PWG's reports clearly outlined some of the changes that need to be addressed. Maintaining the balance between regulatory measures and market discipline is critical to highly efficient markets. Most importantly, such a balance fosters market confidence. There is important work for all of us and I appreciate your efforts and dedication. Thank you.