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Statement by

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INTRODUCTION

Good morning. Thank you for the opportunity to appear before you.

The challenges that our financial system faces are complex, interrelated, and the result of developments over many years. Earlier in this decade, a combination of fundamental factors and financial innovations generated unsustainable bubbles in many housing markets across the country. When those bubbles began to burst, starting in early 2006, housing price declines led to a sharp acceleration in mortgage delinquencies and charge-offs. Those unanticipated losses revealed deep-seated problems in our financial and economic systems. A protracted period of rapid innovation, excessive risk taking, and inadequate regulation produced a financial system that was far more fragile than was generally appreciated during the boom times.

In the years before the crisis, businesses, consumers, and importantly financial institutions had become increasingly complacent about risk. The volatility of the U.S. economy appeared to decline after the stabilization of inflation in the early 1980s. In recent years, savings outside the United States surged, generating strong global demand for financial assets, particularly U.S. financial assets. Nominal interest rates generally trended lower, and became less volatile, in the years before the current crisis.

The financial system itself was evolving at a rapid pace in the decades before the current crisis. Advances in information technology dramatically reduced transaction costs and made it possible for banks and other financial institutions to introduce a tremendous range of new products, including everything from ATMs to new complex financial contracts. In some areas, such as transaction services and credit cards, new technologies created economies of scale that favored large institutions. Just a few large firms are now responsible for processing the preponderance of credit card transactions. In other ways, advances in information technology favored markets over institutions. In recent decades, securities markets have grown more rapidly than financial institutions. For example, the share of securitized products in overall private financial intermediation grew from just 4 percent in 1980 to 26 percent in 2007. Over the same period, the share of banks and thrifts, which rely primarily on deposits, fell from 62 percent to 30 percent. The explosive growth of financial derivatives was also fueled by rapid advances in information technology. Given that much of this development occurred in a relatively stable macroeconomic environment, financial innovation in many cases increased complexity without sufficient concern for how new products would respond to shocks.

The combination of a stable macroeconomic environment, with strong risk appetite, and significant structural changes in the financial system, led to a buildup of leverage and risk throughout the system. That buildup was compounded by compensation systems that were not aligned with the long-term interests of shareholders, giving many managers and employees

incentives to take excessive risks. Investors looked for higher returns by taking on greater exposure to the risk of infrequent but severe losses. At the same time, consumers, businesses, and a range of financial entities became too reliant on easy access to the credit that major financial institutions could readily provide. Misaligned incentives without transparency, market discipline, or appropriate regulation widened conflicts of interest throughout the financial system.

Our regulatory system did not respond adequately to the challenges inherent in this environment. Regulators did little to contain the risks posed by the growth in complex financial instruments. The structure of our regulatory system is unnecessarily complex and fragmented. It operates with large gaps in meaningful oversight. Investment banks, the holding companies and affiliates of large insurance companies, finance companies, and the government-sponsored enterprises were subject to only limited oversight. These highly leveraged institutions lacked strong, federal, prudential regulation and supervision, and they did not have established access to central bank liquidity. Moreover, they were permitted by law to choose among regulatory regimes, often allowing them to avoid a stronger regulatory authority that might have been applied if they had been supervised as bank holding companies.

Starting in 2007, unexpected losses experienced by major banks on mortgage-backed securities set off a vicious cycle. The losses reduced their capital, which forced them to pull back on lending. This put downward pressure on asset prices, which generated further losses for the banks. Tightening financial conditions became a drag on the broader economy. As workers lost jobs and as prospects for businesses darkened, prospective losses on consumer and business loans increased. As the scale of the potential financial losses increased, market concerns about the viability of individual institutions started to emerge.

In March of 2008, these pressures led to an acute funding crisis for the investment bank Bear Stearns. In an emergency operation, JP Morgan purchased Bear Stearns after the Federal Reserve agreed to effectively ring fence roughly $30 billion of Bear Sterns' assets. Following the Bear Stearns rescue, pressures in financial markets eased for a time. But the economy continued to weaken, and alarm bells were sounded about the lack of tools available to the government to contain the emerging crisis.

Amidst rising unemployment and a significant correction in housing prices, delinquencies on conventional mortgages increased sharply. This was a significant challenge for Fannie Mae and Freddie Mac, government sponsored enterprises (GSEs) operating in the secondary market for home mortgages. Market pressures on the GSEs intensified over the summer as housing prices fell sharply and the performance of conventional mortgages deteriorated further. Moreover, the GSEs' forays into investments in alternative mortgage products turned out to be a brutal mistake. In early September, the decision was taken to put Freddie Mac and Fannie Mae into conservatorship. That decision had adverse consequences for the GSEs' shareholders and this

heightened pressures on other troubled financial intermediaries. After intense discussions with federal authorities and potential private investors, Lehman Brothers filed for bankruptcy protection less than a week after the GSEs were put into conservatorship. Because the government lacked the necessary tools to contain the fallout, the Lehman failure had an immediate impact on short-term money markets, particularly money market mutual funds and the market for commercial paper. A few days later, the Federal Reserve stepped in to provide substantial support to AIG because of the broad potential for contagion to many other financial institutions that would have followed its failure. These events significantly heightened market participants' fears that rising losses might irreparably deplete the capital of major financial institutions. In this volatile environment, special guarantee programs for money market mutual funds and parts of the commercial paper market were established. Importantly, the U.S. Congress passed the Emergency Economic Stabilization Act of 2008 (EESA) establishing the Trouble Assets Relief Program (TARP). EESA also increased the limit on the Federal Deposit Insurance Corporation (FDIC) deposit insurance, and the FDIC established a new guarantee facility for medium-term bank borrowing.

Acute concerns about the viability of major U.S. financial institutions persisted, inducing a further retraction in the credit markets and a more severe economic contraction. As a result, the Department of the Treasury shifted the focus of TARP from purchasing "toxic" assets to providing new capital to banks. Treasury established the Capital Purchase Program (CPP) to provide capital support for U.S. banks using TARP funds with the goal of ensuring that they could continue to play their important role in the credit markets and maintain lending to consumers and businesses.

In early phases of the crisis, some financial institutions were able to raise significant amounts of private capital. But as the crisis deepened, and asset markets became more distressed, uncertainty about the value of bank assets became an obstacle to raising private capital. The initial thrust of CPP was to inject capital into all major institutions in an environment where systemic risk appeared significant.

The intense financial stresses generated by these developments in September and October of 2008 had a profound effect on the U.S. and global economies. U.S. consumers and businesses became much more cautious and cut back their spending as credit became scarce. The sharp fall in equity prices since the summer, in addition to falling house prices, generated significant declines in household wealth. Similar pressures emerged in other countries. The United Kingdom and Western Europe had been facing financial pressures similar to those in the United States since mid-2007. To some degree, this reflected the fact that European financial institutions held U.S. mortgage-backed securities. But it also reflected the fact that their financial systems suffered from many of the same problems as ours. Much of the global economy was already slowing over the summer of 2008, but acute financial stress in September and October also generated sharp declines in economic activity around the world. Domestic demand slowed in

much of the world, particularly where financial stresses were acute, but there was an almost unprecedented collapse in global trade. Capital flows to emerging economies were also affected. The negative feedback between financial stress and collapsing economic activity had become global.

THE OBAMA ADMINISTRATION'S RESPONSE

Policy interventions at the end of 2008 were, in the end, successful in achieving the vital, but narrow, objective of preventing a major systemic meltdown. Acute concerns about counterparty risk within the financial system that had peaked in the wake of the failure of Lehman Brothers eased towards the end of the year. For example, the spread between three-month interbank interest rates and the market's expectation for short-term rates over the same period, a measure of distress in money markets, fell from a peak of 365 basis points in early October to about 100 basis points in early January. Even with that improvement, the spread remained high relative to the levels before the crisis; it averaged about 10 basis points in the first half of 2007.

While overt concerns about systemic risk had diminished since October, as President-Elect Obama and his economic team prepared their economic program, they faced a grave and rapidly evolving set of challenges in the financial sector.

The outlook for the economy was deteriorating rapidly and that had important implications for the financial sector. Economic data that became available in November and December pointed to a very sharp fall of in economic activity. For example, U.S. auto sales for October, which were released on November 3, were reported at a 10.6 million annual rate. This compares to an average level of 12.9 million in the third quarter. On December 4, it was reported that payroll employment had fallen by 533,000 in November.[1] This was the largest monthly decline since the deep recession of 1973-74. Quickly worsening prospects for the economy meant that likely losses for U.S. financial institutions were rising sharply as well, and this heightened concerns about the adequacy of their capital.

The disruptions to the financial system were the major factor undermining the economy. Liquidity in a broader range of securities markets, including the market for long-term Treasuries, fell sharply. Credit spreads for virtually all credit products reached historic highs in the fourth quarter. Loan growth and bond issuance slowed in the fourth quarter. In particular, the issuance of new asset-backed securities (ABS) essentially came to a halt in October. Part of the decline in credit growth reflected falling demand for credit as consumers and businesses became more cautious. But a variety of factors pointed to meaningful constraints on the supply of credit. For example, a record number of banks reported tightening credit standards in the fourth quarter.

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[1] The estimated change in payroll employment in November was later revised to a decline of 597,000.

In this context, doubts about the viability of major institutions persisted. Fannie Mae, Freddie Mac, AIG, Citigroup and Bank of America had all received substantial government support by mid-October. But these institutions had complex and opaque balance sheets that were heavily exposed to the deteriorating economy. Given the economic and financial environment, including illiquid markets and "fire sale" asset prices, investors were not convinced that the actions taken to that point were sufficient to ensure that the institutions were sound. Those doubts were reflected in pressure on equity prices and credit spreads. Further actions were ultimately necessary to shore up market confidence in these institutions.

In this context, President Obama decided that a new approach was needed. Leaving that situation unaddressed would have undoubtedly risked a deeper recession and more damage to the productive capacity of the American economy. It would have resulted in higher unemployment and greater failures of businesses, and it would have greatly undermined the substantial spending and tax incentives in the American Recovery and Reinvestment Act (ARRA). In addition, given the substantial burden placed upon the American taxpayers, there was deep public anger, skepticism about whether the government was using taxpayer money wisely, and a perceived lack of transparency, all of which led to eroding confidence.

In response to this inheritance, President Obama, upon taking office, outlined a series of changes designed to improve transparency, accountability, and oversight. This included a number of new online resources so that Americans could see exactly how their money was being spent; a monthly lending and intermediation survey to better gauge, in ways readily accessible to the public, the performance of banks participating in the CPP; and strong taxpayer protections to ensure that Americans receive a return on these long term investments, and are not rewarding failure, including with respect to executive compensation.

Alongside the reforms, earlier this year we laid out a broad strategy designed to address the five major challenges facing the financial system.

First, since the onset of the crisis, major financial institutions have reported unprecedented losses. Looking ahead, substantial additional shortfalls are all but certain. Uncertainty about the real value of distressed assets and the ability of borrowers to repay loans has contributed to a decline in the confidence required for the private sector to make much needed equity investments in our major financial institutions. We must ensure that individual banks have sufficient capital to absorb future losses, even under adverse circumstances, and still be able to provide the credit the economy needs. Moreover, we cannot allow doubts about the viability of major institutions to undermine the financial system as a whole. The U.S. government must continue those policies critical to sustaining confidence in the core of the system.

Second, the breakdown of key markets for new securities has constrained the ability of even creditworthy small businesses and families to get the loans they need. In today's financial

system, markets for asset-backed securities, as opposed to just deposit-taking banks and thrifts, raise a substantial portion of the funds that ultimately support new credit creation. It is essential that we get these markets working again so that families and businesses can have access to credit on reasonable terms.

Third, a range of legacy assets remain on the books of major banks. Pressure on banks to shrink their balance sheets has depressed the prices of these assets to "fire sale" levels and liquidity for these assets is limited. Uncertainty about the value of legacy assets is undermining confidence in major banks and impairing their ability to raise capital. We need to increase liquidity for legacy assets, break the cycle of deleveraging, and improve price discovery.

Fourth, the ongoing adjustment in the housing market remains at the center of the economic and financial crises. Falling home prices are a major financial challenge for many families. At the same time, financial losses related to the housing sector adjustment continue to be a significant headwind for banks and other financial institutions. Foreclosures are particularly problematic because they not only impose significant financial and emotional burdens on families, they are also costly for communities and banks. For all these reasons, addressing the housing crisis and reducing foreclosures is an important objective.

Finally, the lack of a modern regulatory regime and resolution authority helped create the current crisis, and it will limit our ability to address future crises until we put in place fundamental reforms. We need to expand our capacity to contain systemic risk. We have to make sure that when households make the choice to borrow, or to invest their savings, there are clear and fair rules of the road that prevent manipulation, deception, and abuse. Our regulatory structure must assign clear authority, resources, and accountability for each of its key functions. We must also seek to ensure that international rules for financial regulation are consistent with the high standards we will be implementing in the United States. The Federal government needs new tools for dealing with situations where the solvency of major financial institutions is called into question.

Capital Assistance Program

Currently, the vast majority of banks have more capital than they need to be considered well capitalized by their regulators. However, concerns about economic conditions – combined with the destabilizing impact of distressed "legacy assets" – have created an environment under which uncertainty about the health of individual banks has sharply reduced lending across the financial system, working against economic recovery. For every dollar that banks are short of the capital they need, they will be forced to shrink their lending by eight to twelve dollars. Conversely, every additional dollar of capital gives banks the capacity to expand lending by eight to twelve dollars. Providing confidence that banks have a sufficient level of capital even if the economic

outlook deteriorates is a necessary step to restart lending so that families have access to the credit they need to buy homes or pay for college, and businesses can get the loans they need to expand. Moreover, reassuring investors that banks have sufficient resources to weather even a very adverse economic scenario will make it possible for banks to raise additional private capital.

One of the major components of the Administration's Financial Stability Plan (FSP) is the Capital Assistance Program (CAP). The CAP is designed to ensure that individual banks have sufficient capital even in adverse circumstances. This strategy begins with the idea that in order to ensure our largest banks have adequate capital to weather a more severe economic scenario and continue to lend, we must first accurately diagnose their problems. Federal banking agencies will soon complete a forward looking assessment or "stress test" for the 19 largest banks. The stress tests will determine the capital needs of these banks by estimating losses that they might face if economic conditions were to deteriorate more than expected over the next two years, as well as the appropriate level for loss loan reserves at the end of the period. The analysis will take into account the likely path of earnings for individual banks over the same period. By focusing on individual banks, this approach allows the analysis to take into account the unique exposures that individual banks face as well their individual prospects for generating earnings.

If a judgment is made, in consultation with management, that a bank needs additional capital, it will be encouraged to raise that capital from private sources. Where needed, the CAP will provide additional capital in the form of convertible preferred stock as a backstop until private capital becomes available. Furthermore, all eligible banking organizations, not just the 19 organizations undergoing the stress test, will be able to apply to issue to Treasury convertible preferred stock equal to between one and two percent of their risk-weighted assets.

Because today's financial system is highly interconnected, a failure of a major financial institution can create severe challenges for the financial system and the wider economy. The events of last September and October are a concrete reminder of this very real threat. Maintaining confidence in key financial institutions, particularly as they raise new capital and restructure, has to remain a central objective of financial policy.

On February 10, Treasury, the Federal Deposit Insurance Corporation, the Office of the Comptroller of the Currency, the Office of Thrift Supervision, and the Federal Reserve clearly stated their commitment to ensuring that confidence is maintained in the core of the financial system.[2] These institutions put in place a range of programs over the last year and are committed to continuing these programs to help reinforce confidence in core institutions, including a variety of guarantee programs, to ensure that key institutions continue to have access to stable funding.

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[2] See Treasury Press Release, February 10, 2009.

In March, the FDIC extended its Temporary Liquidity Guarantee Program (TLGP).[3] Under this program banks and other eligible financial institutions can issue medium-term debt that carries an FDIC guarantee. This program was an important factor in helping to stabilize the banking system in the wake of the failure of Lehman Brothers. Treasury has also recently extended its Money Market Funds Guarantee Program through September 18, 2009.[4]

Consumer and Business Lending Initiative

Securitization has come to play a very important role in the U.S. financial system. Banks develop and maintain expertise in originating certain types of loans. This includes loans to individuals through credit cards, mortgages, student loans, and other forms of consumer credit as well as loans to businesses, particularly those that are not able to raise funds directly in securities markets. In recent years, an increasing portion of these loans have been aggregated into pools and sold as so-called ABS. The rapid growth of the market for ABS in the years before the current crisis increased the supply of credit available to individuals and small businesses because once banks pool and sell loans to the securitization market, it opens up their balance sheet to create new loans.

As the economy deteriorated over the summer of 2008, credit spreads on ABS began to rise, and the disruptions that followed the failure of Lehman Brothers severely disrupted the market of newly issued ABS. Issuance of consumer ABS averaged $20 billion per month in 2007, and $18 billion per month during the first half of 2008. However, ABS issuance slowed sharply in the third quarter before coming to a virtual halt in October 2008. The closure of this market is a major constraint on the supply of new credit to individuals and businesses, particularly in an environment where banks have little scope to expand their balance sheets.

An important part of the Obama Administration's FSP is a significant expansion of the Term Asset-Backed Securities Loan Facility (TALF) through the Consumer Business Lending Initiative. The TALF is designed to jumpstart the securitization markets, which in turn will increase lending throughout the economy. Under the TALF, the Federal Reserve extends loans to investors who purchased newly issued ABS. Treasury has committed funds under the TARP program to provide a degree of credit protection for the Federal Reserve's TALF loans. The program was initially proposed in November 2008, with a focus on highly-rated ABS backed by student loans, auto loans, credit card loans, and loans guaranteed by the Small Business

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[3] See http://www.fdic.gov/regulations/resources/TLGP/index.html.

[4] See "Treasury Announces Extension of Temporary Guarantee Program for Money Market Funds," Treasury Press Release, March 31, 2009. http://www.treas.gov/press/releases/tg76.htm

Administration (SBA). As part of President Obama's FSP, we announced an expansion of the size and scope of the program, increasing the scale of potential ABS funding under TALF.

In March, the first transactions – Four deals, including three auto securitizations and one credit card securitization, were brought to the market. These transactions totaled approximately $8.5 billion, with just under $5 billion financed through TALF. Recently, Treasury and the Federal Reserve expanded TALF to include newly or recently issued AAA-rated ABS backed by four additional types of consumer and business loans – mortgage servicing advances, loans or leases relating to business equipment, leases of vehicle fleets, and floor plan loans.

The terms of the funding provided under TALF, including fees, are set in a way that is designed to limit the risks faced by U.S. taxpayers while still meeting the objective of encouraging lending to consumers and small businesses. The amount and cost of funding that is provided varies depending on the perceived riskiness of the assets being financed. Treasury and the Federal Reserve used conservative assumptions when calibrating the limits on the funding provided given the uncertain economic environment.

In recent years, securitization has supported over 40 percent of lending guaranteed by the Small Business Administration. As a result of the severe dislocations in the credit markets that began in October 2008, however, both lenders that originate loans under SBA programs and the "pool assemblers" that package such loans for securitization have experienced significant difficulty in selling those loans or securities in the secondary market. This, in turn, has significantly reduced the ability of lenders and pool assemblers to make new small business loans. As a result, while the SBA typically guarantees about $20 billion in loans annually, new lending was trending below $10 billion earlier this year.

On March 16, 2009, Treasury announced a program to unlock credit for small businesses as part of the Consumer and Business Lending Initiative. As part of the program, Treasury will make up to $15 billion in TARP funds available to make direct purchases to unlock the secondary market for the government-guaranteed portion of SBA 7(a) loans as well as first-lien mortgages made through the 504 program. These purchases, combined with higher loan guarantees and reduced fees implemented under the American Recovery and Reinvestment Act of 2009, will help provide lenders with the confidence that they need to extend credit, knowing that if they make an SBA loan, they will be able to sell it and access the liquidity necessary to do further lending.

Public Private Investment Program

A variety of troubled legacy assets is congesting the U.S. financial system. The vicious cycle of deleveraging has pushed some asset prices to low levels. The difficulty of obtaining private financing on reasonable terms to purchase these assets has reduced secondary market liquidity and disrupted normal price discovery. While economic fundamentals have deteriorated substantially in this crisis, there is ample evidence that current market prices for many legacy

assets include substantial liquidity discounts.[5] Such discounts constrain the economic capital of U.S. financial institutions, reducing their ability to provide new credit. Moreover, uncertainty about the value of legacy assets is constraining the ability of financial intuitions to raise private capital.

The Public Private Investment Program (PPIP) is intended to restart the market for these assets while also restoring bank balance sheets as these devalued loans and securities are sold. Using $75 to $100 billion in capital from EESA and capital from private investors – as well as funding enabled by the Federal Reserve and FDIC – PPIP will generate $500 billion in purchasing power to buy legacy assets, with the potential to expand to $1 trillion over time. By providing a market for these assets, PPIP will help improve asset values, increase lending capacity for banks, and reduce uncertainty about the scale of losses on bank balance sheets – making it easier for banks to raise private capital and replace the capital investments made by Treasury.

By following three basic principles, PPIP is designed as part of an overall strategy to resolve the crisis as quickly as possible with the least cost to the taxpayer. First, by partnering with the FDIC, the Federal Reserve, and private sector investors, we will make the most of taxpayer resources under TARP. Second, PPIP will ensure that private sector participants invest alongside the government, with the private sector investors standing to lose their entire investment in a downside scenario and the taxpayer sharing in profitable returns. Third, the program will use competing private sector investors to engage in price discovery, reducing the likelihood that the government will overpay for these assets. By contrast, if the government alone purchased these legacy assets from banks, it would assume the entire share of the losses and risk overpaying. Alternatively, if we simply hoped that banks would work off these assets over time, we would be prolonging the economic crisis, which in turn would cost more to the taxpayer over time. PPIP strikes the right balance, making the most of taxpayer dollars, sharing risk with the private sector, and taking advantage of private sector competition to set market prices for currently illiquid assets.

The program has two major components, one each for securities and loans. The Legacy Securities Program initially will target commercial mortgage-backed securities and residential mortgage-backed securities. Treasury will partner with approved asset managers. Pre-approved asset managers will have an opportunity to raise private capital for a public-private investment fund ("PPIF"). Treasury will invest equity capital from the TARP in the PPIF on a dollar-for-dollar basis with participating private investors.[6] Additional funding will be available either

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[5] See "White Paper: Public Private Investment Program," U.S. Treasury, March 23, 2009, http://www.treas.gov/press/releases/reports/ppip_whitepaper_032309.pdf

[6] Additional information on the terms and conditions of the Legacy Securities Program are available at: http://www.treas.gov/press/releases/reports/legacy_securities_terms.pdf

directly from Treasury or through TALF. The program is designed to encourage participation by a wide range of investors, and we extended the application deadline to facilitate that objective.

The Legacy Loans Program is designed to attract private capital to purchase eligible legacy loans and other assets from participating banks through the availability of FDIC debt guarantees and Treasury equity co-investments. Under the program, PPIFs will be formed – with up to 50 percent equity participation by Treasury – to purchase and manage pools of legacy loans and other assets purchased from U.S. banks and savings associations. The FDIC will provide a guarantee of debts issued by PPIFs and collect a guarantee fee. The FDIC will be responsible for overseeing the formation, funding, and operation of legacy loan PPIFs and for overseeing and managing the debt guarantees it provides to the PPIFs.[7]

The terms of the funding provided under both parts of PPIP, including fees, will be set in a way that is designed to limit the risks faced by U.S. taxpayers while still meeting the objective of generating new demand for legacy assets. In addition, those participating in the program will be subject to a significant degree of oversight to ensure that their actions are consistent with the objectives of the program.

HOUSING

As we are all painfully aware, the collapse of the housing price bubble, and the sharp reversal in lending standards that helped fuel that bubble, has had a devastating effect on the financial sector and on homeowners alike, with dire consequences for the economy overall. In addition to reducing household wealth across the country, and thereby further intensifying the economic contraction, falling home prices and extraordinarily tight lending standards have trapped homeowners in their old mortgages. Even many homeowners who made what seemed to be conservative financial decisions three, four, or five years ago find themselves unable to benefit from the low interest rates available to unencumbered borrowers today. At the same time, increases in unemployment and other recessionary pressures have continued to impair the ability of some otherwise responsible families to stay current on mortgage payments.

As a result, as many as 6 million families are expected to face foreclosure in the next several years. Foreclosures have massive negative externalities – such as reducing surrounding home values, and increasing vacancies, homelessness, and violent crime. In some studies, foreclosure on a home has been found to reduce the prices of nearby homes by as much as 9 percent.

Since January, the Administration has made significant progress in developing and implementing a comprehensive plan for stabilizing our housing market, the centerpiece of which is the Making

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[7] Additional information on the Legacy Loans Program is available at: http://www.treas.gov/press/releases/reports/legacy_loans_terms.pdf

Home Affordable Program (MHA). By reducing foreclosures around the country, the average homeowner could see their house price bolstered by as much as $6,000 as a result of this plan, and up to 9 million homeowners may increase the affordability of their mortgages and avoid preventable foreclosures.

MHA targets the root causes of the foreclosure crisis directly. First, the refinancing program expands access to refinancing for families whose homes have lost value. Second, the modification plan commits $75 billion to loan modifications that will provide sustainably affordable mortgage payments for borrowers. The focus of the plan is affordability because providing borrowers with payments they can afford, including those with negative equity, will keep millions from being foreclosed on in a way that is most effective for taxpayers. A third part of the plan supports refinancing more generally by increasing confidence in the GSEs.

MHA's design centers on two key ideas. First, MHA creates detailed standard industry guidelines for loan modifications, with the goal of helping to transform the industry standard to a product better for all borrowers, both within and outside of MHA. In the past, a lack of common standards has limited loan modifications, even when they are likely to both reduce the chance of foreclosure and raise the value of the securities owned by investors. Second, the innovative pay for success structure of the program aligns the incentives of servicers, investors, and borrowers to voluntarily modify mortgages in a way that will be affordable for borrowers in the long-term, cost-effective for taxpayers, and profitable for lenders. In addition, when Hope for Homeowners has been expanded and improved, we also intend to position this program as a critical part of MHA.

Our progress in implementing MHA to date has been substantial. We have introduced detailed guidelines for loan modifications which will establish a new standard practice for affordable modifications in the industry. We have already signed contracts with the top servicers covering a majority of loans nationwide for our loan modification program. Servicers have begun executing refinancings and modifications under our program, and our program has helped push interest rates to historic lows, increasing refinancing nationwide. For example, Fannie Mae did $77 billion in refinancings in March, its largest one-month volume since 2003.

We have launched MakingHomeAffordable.gov, a consumer website for the program, which has had 11.2 million page views in less than a month. These are just a few of the many steps that have been taken to implement these programs.

We have also expanded the efforts of the federal government to combat mortgage rescue fraud and put scammers on notice that we will not stand by while they prey on homeowners seeking help under our program.

We are also supporting or are working on additional measures to stabilize housing, all of which are aimed at supporting the success of MHA in keeping homeowners in their homes or in finding

alternative and less damaging “exit strategies” for borrowers who own homes that they are clearly unable to afford, even under favorable mortgage terms. These measures include reform of the bankruptcy code to allow judicial modifications of home mortgages, a second lien program under MHA, further details on a short sales and deeds-in-lieu program, and, as noted, the strengthening of Hope for Homeowners.

We will continue to explore additional ways to help the housing market and report on ongoing progress as we push forward.

Regulatory Reform

The programs outlined above are designed to help rehabilitate our financial sector and, as quickly as possible, turn it into a source of support for our economy rather than a drag on it. But this effort will not be fully successful unless a broader set of reforms is put in place. Our regulatory and market infrastructure has to catch up to significant changes that have occurred in our financial sector in recent decades.

The rapid growth of the largest financial institutions, and their increasing interconnections through securities markets, have heightened systemic risk in the system. In response, we need to expand our capacity to contain systemic risk. This crisis – and the cases of firms like Lehman Brothers and AIG – has made clear that certain large, interconnected firms and markets need to be under a more consistent and more conservative regulatory regime. It is not enough to address the potential insolvency of individual institutions – we must also ensure the stability of the system itself.

Financial innovation has expanded the financial products and services that are available to consumers. These changes have brought many benefits. But we have to make sure that when households make choices to borrow, or to invest their savings, there are clear and fair rules of the road that prevent manipulation, deception, and abuse. Lax regulation has left too many households exposed to deception and abuse. While outright fraud like that perpetrated by Bernie Madoff is already illegal, these cases highlight the need to strengthen supervision and enforcement across the financial sector. We need meaningful disclosures that actual consumers and investors can understand. We need to promote simplicity, so that financial choices offered to consumers are clear, reasonable, and appropriate. Further, there needs to be clear accountability for protecting consumers and investors alike.

The rapid pace of development in the financial sector in recent decades has meant that gaps and inconsistencies in our regulatory system have become more meaningful and problematic. Financial activity has tended to gravitate to parts of the system that are regulated least effectively. Looking ahead, our regulatory structure must assign clear authority, resources, and accountability for each of its key functions.

The financial landscape has become ever more global in recent years. Advances in information technology have made it easier to invest abroad, which has expanded and accelerated cross-border capital flows. Greater global macroeconomic stability has also helped to accelerate financial development around the world. To keep pace with these trends, we must ensure that international rules for financial regulation are consistent with the high standards we will be implementing in the United States. Additionally, we must seek to materially improve prudential supervision, tax compliance, and restrictions on money laundering in weakly-regulated jurisdictions.

Finally, the recent financial crisis has shown that the largest financial institutions can pose special risks to the financial system as a whole. In addition to regulating these institutions differently, we must give the Federal government new tools for dealing with situations where their solvency is called into question. Treasury has proposed legislation for a resolution authority that would grant additional tools to avoid the disorderly liquidation of systemically significant financial institutions that fall outside of the existing resolution regime for banks under the FDIC.

STATUS OF TARP

TARP, established under EESA, has been a vital part of our efforts to rehabilitate the financial sector. Since the Congress released the second half of the $700 billion allocated to Treasury through EESA, we have unveiled our FSP in an effort to use the full range of tools at our disposal to create the foundations for an economic recovery. Table 1 below summarizes current projections concerning the remaining funds available as part of the FSP.

When President Obama took office, Treasury had already committed over half of the funds allocated for the Troubled Assets Relief Program. Today, Treasury estimates that there is at least $134.6 billion in resources authorized under EESA still available. This figure assumes – as reported by the Government Accountability Office – that the projected amount committed to existing programs will be $590.4 billion (of which $355.4 billion was committed under the previous administration), but also anticipates that $25 billion will be paid back under the CPP over the next year. Because the most relevant consideration is what funds will remain available for new programs, we believe that our estimates are conservative for two reasons. First, our estimates assume 100 percent take-up of the $220 billion made available for our housing and liquidity programs, which require significant voluntary participation from financial participants. If any of those programs experience less than full take-up, additional funds will be available. Secondly, our projections anticipate only $25 billion will be paid back under CPP over the next year, a figure lower than many private analysts expect.

In the attached table, we have broken down our commitment of EESA funds under four categories:

- Exceptional Relief: Funds committed for exceptional relief to specific financial institutions and the auto industry.
- Capital Purchase Program.
- Housing and Liquidity Initiatives: New initiatives directed towards addressing weaknesses in the housing and credit markets.
- Paybacks.

In addition to the programs discussed above, Treasury has stated its intention to provide additional support to the auto industry – contingent on an acceptable restructuring – as well as capital under the Capital Assistance Program. We believe that even under the conservative estimate of available funds described here, we have the resources to move forward in implementing all aspects of our FSP.

Indicators on interbank lending, corporate issuance, and credit spreads generally suggest that credit conditions have improved significantly in the past few months. The LIBOR-OIS spread, an indicator of major banks' willingness to lend, has fallen to about 90 basis points, down from its October peak of 365. Additionally, corporate bond issuance and issuance of asset back securities both rose in March after grinding to a halt in October and November.

However, reports on bank lending show significant declines in consumer loans, including credit card loans, and commercial and industrial loans. It is also important to point out that the cost of credit and terms of credit, even where they have recently declined, are still elevated.

TRANSPARENCY

Upon taking office, President Obama committed to increased transparency, accountability, and oversight in our government's approach to stabilizing the financial system. Treasury is committed to an open and transparent program with appropriate oversight.

We have launched a reinvigorated public communications initiative designed to more directly communicate how our policies will stabilize the financial system and restore the flow of credit to consumers and businesses. A key element to this enhanced public outreach effort is providing user-friendly resources online. Last month, Treasury launched a new website, FinancialStability.gov, that details financial stability programs in a simplified format. In addition, Treasury has taken a number of steps to better measure whether financial stability programs are increasing the flow of credit to consumers and businesses. In January, we launched a monthly lending and intermediation survey to better gauge, in a way readily accessible to the public, the performance of banks participating in the CPP. The most recent results, covering February 2009, demonstrate that the largest CPP banks continue to lend and refinance despite the increasingly severe headwinds posed by this economic downturn. Absent Treasury capital provided through the CPP, lending levels would likely have been substantially lower.

Treasury announced on January 28, 2009, that it would begin posting all of its investment contracts on our website within ten business days of each transaction's closing. Treasury is in the process of posting all the contracts signed prior to January 28 to the website as well.

Treasury looks forward to continuing to work with our four oversight bodies – the Financial Stability Oversight Board, the Inspector General, the Comptroller General, and the Congressional Oversight Panel. Transparency will not only give the American people comfort in our stewardship of these funds, it will give the markets confidence that we are stabilizing and strengthening the financial system.

EXECUTIVE COMPENSATION

Compensation systems in many financial institutions played a material role in creating this financial crisis. They gave individuals incentives to focus on short-term profits at the expense of long-term value. In many institutions they did not reward sound risk management. Going forward, it is important that everyone in financial institutions – from traders to executives – have compensation that is closely and tightly aligned with sound risk management and long-term value for their financial institution and the economy as a whole. We have to be careful, however, not to destroy beneficial forms of incentive compensation or to restrict financial firm compensation packages so severely as to drive the most talented people out of the U.S. financial sector. We will engage in a thorough review of this issue, and we want to hear the ideas and analysis of experts throughout the country. I anticipate that we will look for ways to orient compensation towards long-term performance. Had this been done earlier, I think a certain amount of the pain caused by this financial crisis and the resulting loss of public trust that has resulted could have been mitigated.

In accordance with ARRA provisions, Treasury will be conducting a review of TARP recipient compensation for the 25 most highly-compensated employees. In addition, the Administration is currently working to develop an Interim Final Rule (IFR) that will set clear standards of acceptable compensation for recipients of federal assistance under EESA. While the IFR will be effective immediately upon publication, Treasury will invite public comment during a sixty-day period and will consider all comments in developing a final rule.

Table 1:
Projected Use of TARP/Financial Stability Plan Funds

($U.S., billions)

Exceptional Relief	**152.4**
Of which:	
AIG	70
Citigroup/Bank of America (Targeted Investment Program and Guarantees)	52.5
Autos	24.9
Auto Suppliers	5
Capital Purchase Program	**218**
Housing and Liquidity Initiatives	**220**
Of which:	
Housing	50
Consumer and Business Lending Initiative	
TALF 1.0	20
TALF Asset Expansion (New Issuance)	35
TALF for Legacy Securities	25
Unlocking SBA Lending Markets	15
Public Private Investment Program (Net $75.0)	100
Conservative Estimate of Paybacks	**-25**
Total	**565.4**
Total Remaining	**134.6**
Additional Funding	
Autos:	-
(To be determined)	
Capital Assistance Program:	-
(Ability to convert existing preferred stock from CPP, plus mandatory convertible capital to be determined)	

MAJOR INITIATIVES

February 10, 2009: Treasury Introduced the Financial Stability Plan (FSP)

To address the financial crisis – a crisis of confidence, of capital, of credit, and of consumer and business demand - FSP is designed to attack the credit crisis on all fronts. Restarting our economy and creating jobs requires ensuring that businesses with good ideas have the credit to grow and expand, and working families can get the affordable loans they need to meet their economic needs. To protect taxpayers and ensure that every dollar is directed toward lending and economic revitalization, FSP will institute a new era of accountability, transparency and conditions on the financial institutions receiving funds.

February 18, 2009: Treasury Introduced the Making Home Affordable Plan (MHA)

The collapse in home prices served as the catalyst for the current financial crisis, harming both household balance sheets as well as much of the financial sector. MHA includes a refinancing program that provides the opportunity for 4 to 5 million homeowners to refinance their mortgages and reduce their monthly payments, a $75 billion loan modification program that keeps 3 to 4 million families in their homes, and provides support for low mortgage rates by strengthening confidence in Fannie Mae and Freddie Mac.

Since the introduction of MHA, consumers have seen record low interest rates helping to alleviate pressure on homeowners. Also, the first loan modification contracts have already been signed in an effort to bring monthly payments to sustainable levels.

February 25, 2009: Treasury Introduced the Capital Assistance Program (CAP) and Measuring Capital Needs

Treasury launched CAP in order to ensure that institutions have enough capital to lend - even during tougher economic times. CAP requires that banks maintain a capital buffer as an insurance policy against worse-than-expected economic conditions. The country's largest banks are undergoing a forward looking "stress test" designed to determine how large a capital buffer is necessary to ensure that those banks would be well capitalized in even a severe economic scenario. The results of this exercise are expected to be released during the first week of May.. Many banks will not need additional capital, but in cases where an additional buffer is needed, Treasury is making government capital available as a bridge to private capital through CAP. In order to ensure transparency, over the last several months bank supervisors have been conducting forward looking assessments of the balance sheets of the 19 largest banks to determine the strength of their capital and capital needs.

March 3, 2009: Treasury Introduced the Consumer and Business Lending Initiative

Treasury announced the Consumer and Business Lending Initiative (CBLI) including a significant expansion of the Term Asset Backed Securities Loan Facility (TALF) - a program

developed to help improve credit market conditions by addressing the securitization markets. TALF was expanded in collaboration with the Federal Reserve to ease the pressure on credit markets. New asset classes expanded from credit cards, auto loans, student loans, and SBA loans to rental, commercial and governmental vehicle fleet leases, small ticket equipment and heavy equipment leases, agricultural equipment loans and leases and commercial mortgage backed and older securities.

March 16, 2009: Treasury Introduced the SBA Loan Purchase Program

Treasury announced a program to unlock credit for small businesses as part of the Consumer and Business Lending Initiative. As part of the program, Treasury will make up to $15 billion in TARP funds available to make direct purchases to unlock the secondary market for the government-guaranteed portion of SBA 7(a) loans as well as first-lien mortgages made through the 504 program. These purchases, combined with higher loan guarantees and reduced fees implemented under the American Recovery and Reinvestment Act of 2009, will help provide lenders with the confidence that they need to extend credit, knowing that if they make an SBA loan, they will be able to sell it and access the liquidity necessary to do further lending.

March 23, 2009: Treasury Introduced the Public-Private Investment Program (PPIP)

Treasury introduced PPIP in order to address the vicious market cycle and troubled assets clogging the balance sheets of financial institutions. By using government financing in partnership with the FDIC and the Federal Reserve and co-investment with private sector investors, PPIP will create substantial purchasing power to create a new market for legacy assets and make the most of taxpayer resources. PPIP ensures that private sector participants invest alongside the taxpayer, with the private sector investors standing to lose their entire investment in a downside scenario and the taxpayer sharing in profitable returns. To reduce the likelihood that the government will overpay for these assets, private sector investors competing with one another will establish the price of the loans and securities purchased under the program.

In order to accommodate increased participation in the Legacy Securities Program, the deadline for asset manager applications was extended to Friday April 24th, 2009.

March 31, 2009: Treasury Extended the Federal Guarantee of Money Fund Assets

Treasury extended the money market fund guarantee in order to support ongoing stability in financial markets. As a result of this extension, the temporary guarantee program will continue to provide coverage to shareholders up to the amount held in participating money market funds as of the close of business on September 19, 2008. All money market funds that currently participate in the Program and meet the extension requirements under the Guarantee Agreements are eligible to continue to participate in the program.