Section Two: Additional Views

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The report issued today by the Congressional Oversight Panel identifies central issues that should frame the public policy debate on financial stability, including the importance of asset valuation, the extent to which the current crisis is being driven by liquidity as well as credit factors, and the proper relationship between the public and private sectors.

These issues are complex, however, and the Panel did not reach an agreement on either the economic assumptions underlying strategic choices or on the optimal strategy to pursue. Further, we are concerned that the prominence of alternate approaches presented in the report, particularly reorganization through nationalization, could incorrectly imply both that the banking system is insolvent and that the new Administration does not have a workable plan. The stakes for the American people are too high to permit any such misapprehensions to develop and intrude on successful outcomes that affect our national financial security.

Therefore, we have issued this Statement of Separate Views, to highlight what we consider to be the key points and to provide Congress and the public with a fuller context in which to consider the Panel's report.

1. The Primary Mission of the Panel is to Evaluate the Effectiveness of Treasury's Actions

First and foremost, the Panel is charged with evaluating the effectiveness of Treasury's use of the new authority granted it under the Emergency Economic Stabilization Act. It is not our role to design or approve Treasury's strategy, nor should the Panel's mission be expanded to encroach on that authority.

Advocating an alternative strategy comes within the scope of our mission only if Treasury either offers no plan, or attempts to proceed with a plan that the Panel determines cannot reasonably be expected to succeed. As we will describe, neither of these conditions exists at present. Therefore, to the extent that the Panel report focuses more on alternatives and less on evaluation of current activities through objective metrics, we have missed an opportunity to closely engage with our primary task.

2. The Current Treasury Strategy Aligns with Congressional Intent

The new Administration has set forth a comprehensive plan, in particular through the Capital Assistance Program (CAP) and the Public-Private Investment Program (PPIP). Collectively, these programs deal with the need for banks to engage in controlled deleveraging by addressing both the equity and the asset challenges to the balance sheet. The combination of these two approaches provides a more comprehensive strategy than either capital infusions or asset purchases alone. The Treasury has further allocated funds to directly address mortgage modification and foreclosure mitigation efforts for homeowners.

Taken together, these programs comprise a strategy that aligns with the Congressional intent in passing the TARP legislation. They return to the original concept of asset purchases and address the housing crisis. Furthermore, they embody a preference for maintaining a private banking system via temporary public support or partnership, which is consistent with this country's tradition of private rather than government control of business. Congress passed the EESA to protect the American public from financial chaos, and preventing collapse also avoids the subsequent need for more extensive forms of government intervention in the markets- forms less consistent with our American experience of democratic capitalism.

3. The Current Treasury Strategy is Reasonable and Viable

Much of the Panel's report is premised upon the tension between subsidization and reorganization through nationalization, in considering which options are preferable. Embedded within this tension are profound differences in assumptions, both on the origins of the crisis and on the optimal shape of the financial services industry that emerges post-crisis.

Some still question the viability of any plan involving public support that does not first divest private ownership; however, less drastic options such as public-private sector solutions are based on very reasonable assumptions.

The debate turns on whether current prices, particularly for mortgage-related assets, reflect fundamental values or whether prices are being artificially depressed by a liquidity discount due to the market strain. As stated in the report, one school of thought focuses on the liquidity factor:

> *"If the liquidity discount is real, approaches such as Treasury's Public Private Investment Partnership (PPIP) are more likely to succeed. Current prices may, in fact, prove not to be explainable without the liquidity factor. Even in areas of the country where home prices have declined precipitously, the collateral behind mortgage-related assets still retains substantial value."*

We affirm that it is entirely reasonable to assume that a liquidity discount is impairing these assets, and thus that the Treasury has adopted a viable plan based on this valid assumption. Further, we believe that a viable plan should be given the opportunity to work. Speculation on alternatives runs the risk of distracting our energy from implementation of a viable plan and needlessly eroding market confidence. Market prices are being partially subjected to a downward self-reinforcing cycle that could be exacerbated by unwarranted consideration of more radical solutions such as nationalization.

This positive assessment of Treasury's view on the underlying causes of the financial crisis is not meant to suggest that the housing bubble should be re-inflated. But we do admit to being confident that the long-term values of mortgage-related assets secured by American homes remain a good investment.

4. Restoring Financial Stability During an Emergency Takes Precedence over Other Policy Goals

In thinking long-term, other issues remain to be considered. The financial crisis has revealed underlying weaknesses in our regulatory system, and a reform effort will contribute to preventing future crises. Regulatory reform is a process, however, and we should not withhold access to existing tools for restoring financial stability while that reform process is in progress.

Two examples of broader issues that should be addressed in the context of financial stability are 1) the role of securitization in reviving markets, and 2) the need for prudence in setting the degree of transparency for stress-testing of the major banks in connection with the CAP.

Reforms are certainly necessary in securitization and secondary markets, as the Panel has noted on previous occasions. We need to improve the credit quality of securities issued and better manage risk going forward, but this does not mean that securitization should be abandoned in the interim.

The Panel's report presents a variety of views on the role of securitization both in a reformed regulatory structure and as a potential tool in reviving markets. We agree with the perspective which acknowledges that economic recovery depends upon the existence of a functioning secondary market, to re-cycle capital and support credit access for consumers and businesses.

That is why the Federal Reserve has developed the Term Asset-Backed Securities Loan Facility (TALF), in which the Treasury has chosen to invest limited TARP funds. The secondary market has been largely frozen for a wide class of assets, including student loans, auto loans, credit cards, and small businesses credit. An added safeguard is that the TALF will not accept the more exotic forms of securitized structures.

On the issue of transparency, specifically in the stress-testing that federal banking regulators will be performing under the CAP, results should be held confidential. We believe that government agencies and officials who monitor the industry have a public trust and should be held accountable for their oversight. But there is also a critical difference between public information and confidential information, and respecting this distinction is in our national interest. Regulatory examination findings for banks are confidential, and this rule should extend to the results of stress-tests to prevent misuse of information and rumors that could place depositors' funds at risk.

5. The Panel's Mission Remains of Critical Importance

There is much serious and constructive work for the Panel to contribute in evaluating the Treasury's existing initiatives, including the structure of both the TALF and PPIP, and we should be zealous in pursuit of our mission. Open issues that need to be addressed in-depth in future Panel reports include:

- Treasury's decision to limit the number of fund managers for the PPIP, and the eligibility criteria for fund managers;
- The impact of new FASB rules on mark-to-market accounting;
- The implications of redemptions of TARP funds on the design and goals of the program; and,
- Additional metrics to quantify the health of the financial system.

Congress would be much better served by those lines of inquiry, which we believe will identify ways in which to maximize the opportunities for success.

And success is achievable. We have the wherewithal not only to restore financial stability, but to emerge from this crisis in an even stronger position. Prosperity is not a zero-sum game. It is not the case that one person or group necessarily prospers at another's expense. If we stand together in investing in our common future, as individual and as corporate citizens, we continue in our country's tradition of pragmatic optimism and lay the most enduring foundation of all for our lasting economic stability.