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### Secretary Timothy F. Geithner Written Testimony Congressional Oversight Panel

Timothy F. Geithner

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Secretary Timothy F. Geithner  
Written Testimony  
Congressional Oversight Panel  
December 16, 2010

## **Introduction**

Chairman Kaufman, members McWatters, Neiman, Silvers, and Troske, thank you for the opportunity to testify about government policies in response to the financial crisis, particularly the Troubled Asset Relief Program (TARP).

At the suggestion of the panel, I would like to take this opportunity to provide a broad overview of the impact of the government strategy to repair the damage caused by the financial crisis. In this context, I will also provide an update on the status of our efforts to return the financial system to private hands, recover government investments with the highest possible returns to taxpayers, and support the housing market.

As the financial crisis spread in 2008, the previous Administration and the Federal Reserve took a series of unprecedented actions, through TARP and other programs, to help stabilize a financial system that was at the edge of collapse. Those actions included:

- Support for the Government-Sponsored Enterprises (GSEs), through the Preferred Stock Purchase Agreements authorized under the Housing and Economic Recovery Act;
- Providing capital to financial institutions through the Capital Purchase Program;
- Providing broad-based guarantees to the financial system, through programs such as the FDIC's Temporary Liquidity Guarantee Program and the Treasury Money Market Fund guarantee program;
- Support for the auto industry, in order to prevent massive additional unemployment and further disruption to the financial markets;
- Initiation of extraordinary facilities, through the Federal Reserve, to support liquidity across the financial system.

The combined effect of the actions taken by the Federal Reserve and the previous Administration helped stop the panic and slow the momentum of the financial crisis. But despite these extraordinary actions, when President Obama took office in early 2009, the financial system was still paralyzed and the economy was contracting at an accelerating rate.

Banks could not operate without government assistance, and businesses were unable to raise capital. Foreclosures were increasing and home prices were falling, and they were expected to fall by as much as an additional 30 percent. For individual families who needed credit – who wanted to buy a house or a new car, or put a child through college – it was more difficult to borrow money than any time since the Great Depression.

Against this background, the Obama Administration, working alongside the Federal Reserve, put in place a broad strategy to restore economic growth, free up credit, and return private capital to the financial system. The Administration's strategy combined the American Recovery and Reinvestment Act, a powerful mix of targeted tax measures and investments, with a comprehensive plan to repair the financial system.

This plan represented an important shift in strategy. The Financial Stability Plan shifted the focus away from broad support of individual institutions to restarting the broad markets for capital and credit that are critical for economic growth. We designed a plan that would maximize the chance that private capital bore the burden of solving the problems of the crisis. We provided support for the housing market and for homeowners in order to facilitate broader economic recovery. And when we did provide extraordinary assistance to individual firms, our assistance came with tough conditions.

## **Actions**

Our Financial Stability Plan had three central components:

- first, to recapitalize the banking system.
- second, to restart the credit markets that are critical to borrowing for businesses, individuals, and state and local governments; and
- third, to help stabilize the crisis in the housing market.

The first piece of the Administration's strategy was to recapitalize the financial system. Towards this end, we conducted a stress test of the nation's nineteen largest bank holding companies. The test forced these banks to disclose significant amounts of information about the risks they faced, so that private investors could differentiate among them and assess the underlying financial strength of each institution.

A test of this scale and stringency was unprecedented, and it required a level of transparency and disclosure that no country has adopted before or since. Banks were forced to raise enough capital to meet the exacting conditions of the stress test, with the knowledge that if they were unable to raise that capital from the private markets, they would be forced to take capital from the government. And that capital, in keeping with this Administration's commitment to accountability, would come with tough conditions.

Our comprehensive strategy proved effective. In the spring of 2009, the Recovery Act had begun to turn the economy around. The improvement in macroeconomic conditions, combined with the government's explicit capital backstop of tested institutions, bolstered market confidence and facilitated investment in major U.S. financial companies. The test itself provided the necessary impetus for banks not only to begin raising private capital, but also to repay TARP investments. Banks were able to raise \$150 billion in private capital at a very early stage of the crisis, saving hundreds of billions of taxpayer dollars, helping restore market confidence, reopen credit markets, and restart economic growth.

The second key aspect of the Financial Stability Plan was committing resources in order to restart key channels of credit to households and businesses.

- Through the Term Asset-Backed Securities Loan Facility (TALF), a joint program with the Federal Reserve, we helped restart the asset-backed securitization markets that provide credit to consumers and small businesses. Since TALF was launched in March 2009, new issuances of asset-backed securities have averaged \$12 billion per month, compared to less than \$2 billion per month during the height of the crisis.
- Through the Public-Private Investment Program (PPIP) for legacy securities, we matched TARP funds with private capital to purchase legacy mortgage-related securities. This program helped return liquidity to key markets for financial assets and clean up the balance sheets of major financial institutions. Since the announcement of PPIP in March 2009, prices for eligible residential and commercial mortgage-backed securities have increased by as much as 75 percent.
- We also launched the SBA 7(a) Securities Purchase Program, in which we committed to help unlock credit for small business by purchasing securities backed by small business loans.

Finally, the Administration took a series of actions to help address the crisis in housing markets. The focus of our strategy has been to provide stability to housing prices and to give Americans who can afford to stay in their homes a chance to do. By reducing mortgage rates, and reducing foreclosures that could be avoided with sensible incentives, these policies helped put a floor under housing prices, helped bring stability to house prices nationally on average, and have given a chance to millions of Americans, a chance to stay in their homes.

The Home Affordable Modification Program (HAMP) has helped catalyze the market to provide millions of loan modifications. More than 3.73 million modifications were started between April 2009 and the end of August 2010 – more than double the number of foreclosure completions during that time. These modifications include nearly 1.4 million trial HAMP modification starts, more than 600,000 Federal Housing Administration loss mitigation and early delinquency interventions, and nearly 1.8 million proprietary modifications reported through HOPE Now data.

### **The Economic Impact of Our Policies**

In any assessment of the response to a financial crisis, there are several important measures of success. What was the response's effect on the availability of credit and economic growth? How quickly is the government able to return the financial system to private hands? What was the direct financial cost of the interventions? And, finally, has the response left the financial system able to support rather than impede economic growth?

#### *Macroeconomic Impact*

At the peak of the crisis, banks were not making new loans to businesses, or even to one another. Businesses could not get financing in our capital markets. Municipalities and state governments could not issue bonds at reasonable rates. The securitization markets, which provide financing for credit cards, student loans, auto loans and other consumer financing, had stopped functioning. And where credit was available, it was prohibitively expensive.

In response to the combined actions of the President, the Congress, and the Federal Reserve, the cost of credit has since fallen dramatically. For businesses, the cost of long-term investment grade borrowing has fallen from a peak of roughly 600 basis points over benchmark Treasury securities to just 320 basis points over Treasuries today. American families are spending less each month on mortgage payments. At the peak of the crisis, a family with an average 30-year mortgage was borrowing at almost 6 percent. Today, that family is borrowing at approximately 4.5 percent, saving more than \$2,500 each year.

As early as the middle of 2009, due to the combined impact of the government's financial programs, borrowing rates fell sharply for businesses, individuals, and state and local governments. Companies were able to fund themselves in private markets by issuing equity and long-term debt. Housing prices began to stabilize. The value of the savings of American workers began to recover and the economy began to grow again.

The economy as a whole has made substantial progress since the recession ended last year. Real GDP has risen for five straight quarters, and private sector firms have started to hire again. The housing market remains weak, but there are signs that it is beginning to stabilize.

Our strategy to force a fundamental restructuring of the auto companies has not only helped save a million jobs across the country, but has restored these institutions to profitability. Since GM and Chrysler emerged from bankruptcy, the industry has created 75,000 jobs, and for the first time in six years, Ford, GM, and Chrysler are all operating at a profit.

Although we can never know with certainty where we would be today without these emergency policies, one of the most comprehensive independent analyses of the overall impact of our response, by economists Mark Zandi and Alan Blinder, concluded that without the Recovery Act, TARP, and other government actions, GDP would still be contracting in 2010 – at the astonishing rate of 3.7 percent – unemployment would have reached 16.5 percent; and we would be experiencing deflation.

#### *Exit and Wind-Down*

We have moved very quickly to reduce the dependence of the financial system on emergency support and to return these institutions to private hands as quickly as possible. Federal agencies moved aggressively to reduce the market's dependence on programs by allowing them to expire, including the Temporary Liquidity Guarantee Program and the Temporary Guarantee Program for Money Market Funds. Through the stress test, we provided confidence to the market and helped private capital return to the system. And Treasury has exited from its investments as quickly as practicable.

When President Obama took office, the U.S. government had made investments in banks representing 75 percent of the entire banking system by assets. Today, the remaining investments are in banks representing roughly ten percent of the banking system. We have recovered \$229 billion of the funds invested in banks and other institutions to date, and over the last month, there has been significant progress in exiting our remaining investments.

Treasury received \$13.5 billion in the GM IPO. We have now recovered about half of our \$50 billion investment and have reduced our stake in GM by roughly half, from 60.8 percent to 33.3 percent. On December 6, Treasury sold its remaining 2.4 billion shares of Citigroup common stock for \$10.5 billion, which resulted in a \$12 billion profit on our overall investment of \$45 billion in the company. And last week, we entered into definitive agreements for the restructuring of AIG. The restructuring will accelerate the government's exit on terms that are likely to lead to an overall profit on the government's support for AIG, including the value of Treasury's interests in AIG held outside of TARP.

#### *Cost*

In terms of direct financial cost, TARP will rank as one of the most effective crisis response programs ever implemented. Independent observers, such as the Congressional Budget Office (CBO), estimated early on that TARP would cost \$350 billion or more. Now, because of the success of the program, TARP is likely to cost a fraction of that amount. CBO today estimates the cost of the program to be as low as \$25 billion.

The cost of TARP is likely to be no greater than the amount spent on the program's housing initiatives. The remainder of the investment programs under TARP – in banks, AIG, credit markets, and the auto industry – will likely, in the aggregate, ultimately yield a positive return for taxpayers.

Furthermore, the cost of the government's broader response efforts is remarkably low when compared to past systemic crises. An IMF study found that the average net fiscal cost of resolving roughly 40 banking crises since 1970 was 13 percent of GDP. The GAO estimates that the cost of the U.S. Savings and Loan Crisis was 2.4 percent of GDP. In contrast, the direct fiscal cost of all our interventions, including the actions of the Federal Reserve, the FDIC, and our efforts to support the GSEs is likely to be less than one percent of GDP. The true cost of this crisis to the economy, however – the jobs, wealth and growth that it erased – is much higher, but that damage would have been far worse without the government's emergency response.

#### *Restructuring of the System*

Our response to the crisis has brought about a fundamental restructuring of the system. The weakest parts of the financial system no longer exist. The firms that remain were subject to a stress test that demonstrated their viability without government assistance. Our financial system today has substantially higher levels of capital relative to risk than before the crisis and are also better capitalized than their international competitors. And the Dodd-Frank Act has provided the government with critical tools it did not have during the crisis – including the ability to wind down firms that pose a significant threat to our financial system.

## **Remaining Challenges**

Even with the progress I have identified, we are still living with the scars of this crisis, and both our financial system and the economy as a whole continue to show signs of significant damage. Although the economy has been growing for more than a year, unemployment remains close to ten percent. Although household wealth has begun to recover, many families are still struggling to regain financial security. And although many businesses are growing again, others, particularly, small businesses, continue to encounter difficulties accessing credit.

Outside of TARP, we are working to help these businesses access credit through the Small Business Lending Fund (SBLF) and the State Small Business Credit Initiative (SSBCI). The SBLF will provide up to \$30 billion in capital to small banks with incentives to increase their lending to small businesses. Second, the SSBCI strengthens state small businesses initiatives threatened by budget cuts and is designed to spur \$15 billion in lending.

The housing market also remains weak. We are continuing to support new housing credit and apply downward pressure to mortgage rates through agreements with Fannie Mae and Freddie Mac. Our goal remains to help as many eligible homeowners as possible, and along with improvements to HAMP, we are implementing a range of additional programs, including Treasury's second lien program, which provides a simultaneous modification of the second lien when a first lien is modified; a foreclosure alternatives program for borrowers who don't qualify for a modification; a principal reduction program; and a forbearance program for unemployed borrowers. Treasury has also allocated \$7.6 billion to 18 states and the District of Columbia to tailor localized solutions for borrowers facing unemployment and negative equity.

On October 3, Treasury's ability to make new commitments under TARP expired. We are well on the way to fully winding down the exceptional actions the government has taken over the past two years. These actions have been remarkably successful in helping repair the damage caused by the financial crisis.

We have brought stability to the financial system and the economy at a fraction of the expected costs. We have returned the financial system to private hands far more quickly than anyone would have thought possible. And in doing so, we have returned hundreds of billions of dollars of unused TARP authority to Congress. As we manage our exit and confront any remaining difficulties, we will continue to be aggressive in protecting taxpayer dollars. But today, thanks to a comprehensive and careful strategy to address the financial crisis, we are in a much stronger position to address our still very substantial remaining economic challenges.