

U.S. House of Representatives
Committee on Financial Services
2129 Rayburn House Office Building
Washington, DC 20515

October 14, 2008

Dear Republican Colleague:

As you know, earlier today, the Treasury Department announced that it will use its authority under the recently enacted Emergency Economic Stabilization Act (EESA) to inject some \$250 billion in equity capital directly into U.S. financial institutions. No Republican who believes in free markets is happy to see the Federal government having to take these extraordinary measures to stabilize our economy. Like most of you, I have deep philosophical concerns about the government's recent interventions in our financial markets. Having said that, however, I want to take this opportunity to explain why I believe that direct capital injections represent a better and less intrusive use of taxpayer dollars than the large-scale purchase and management of toxic mortgage-backed securities that was the centerpiece of Treasury's original proposal.

When Secretary Paulson and Chairman Bernanke first briefed the congressional leadership on September 18th on the turmoil in the credit markets and the need for Federal intervention to address it, I asked them whether a better use of taxpayer money might be the injection of capital directly into the banking system. Such an approach would avoid the difficulties inherent in pricing, purchasing and managing complex assets whose market valuations are largely unknown, in addition to being a quicker and more direct means of infusing capital into the banking system. Moreover, having the government assume non-voting equity stakes in banks and allowing the market to set the value of those interests through continuous trading on public exchanges is arguably a less intrusive – and far more transparent – form of government intervention than the purchase of hard-to-value securities through arrangements with private asset managers that are rife with possibilities for conflicts of interest.

Direct capital contributions are also a much safer use of the taxpayers' money and there is a well-defined exit strategy. In return for the capital contributed, the government will receive preferred stock in companies that are widely believed to be under-valued now. As the market crisis of confidence clears, values will rise and the taxpayers will benefit through the increase in value of these preferred shares. When markets stabilize, the government can sell the preferred stock and exit in an orderly way from its involvement in private business.

Finally, while the purchase of troubled mortgage-related securities runs the risk of rewarding firms seeking to avoid the consequences of their bad decisions, the primary beneficiaries of direct capital injections will be healthy institutions that are more likely to use this assistance to keep credit flowing to businesses and consumers so that our economy can begin to emerge from its recent downturn.

We will soon be headed into a period during which the causes of the economic crisis will be extensively examined, along with legislative proposals to address them. Indeed, Chairman Frank has scheduled a hearing of the Financial Services Committee on October 21st to begin this process.

Clearly, there have been failures, including regulatory inaction that contributed to the situation we are working to alleviate. More than three years ago, I advocated for subprime lending reforms that would have stopped some of the loans in 2006 and 2007 that now make up the "illiquid assets" that are creating havoc in the markets. We must be prepared to adopt reasonable reforms in keeping with our free market system. But we must not allow this crisis to lead to attempts to undermine our fundamental reliance on free market capitalism. The Financial Services Committee will work to keep Republican Members informed as this process moves forward.

Please do not hesitate to contact me or have your staff contact the Financial Services Committee Republican staff with any questions about this matter.

Sincerely,


SPENCER BACHUS
Ranking Member