ADDRESSING THE NEED FOR COMPREHENSIVE REGULATORY REFORM

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ADDRESSING THE NEED FOR COMPREHENSIVE REGULATORY REFORM

Thursday, March 26, 2009

U.S. House of Representatives,
Committee on Financial Services,
Washington, D.C.

The committee met, pursuant to notice, at 11 a.m., in room 2128, Rayburn House Office Building, Hon. Barney Frank [chairman of the committee] presiding.

Members present: Representatives Frank, Kanjorski, Maloney, Gutierrez, Velazquez, Watt, Ackerman, Sherman, Meeks, Moore of Kansas, Capuano, McCarthy of New York, Baca, Lynch, Miller of North Carolina, Scott, Green, Cleaver, Bean, Moore of Wisconsin, Hodes, Ellison, Klein, Wilson, Perlmutter, Donnelly, Foster, Carson, Speier, Childers, Minnick, Adler, Kilroy, Driehaus, Grayson, Himes, Peters, Maffei; Bachus, Castle, King, Royce, Lucas, Paul, Manzullo, Jones, Biggert, Capito, Hensarling, Garrett, Barrett, Gerlach, Neugebauer, Price, McHenry, Campbell, Bachmann, Marchant, McCotter, Posey, Jenkins, Lee, Paulsen, and Lance.

The Chairman. The Committee on Financial Services will now convene for the purpose of the hearing with Secretary Geithner. I have an announcement to make regarding the order on the Democratic side when Mr. Geithner and Mr. Bernanke were here the day before yesterday; and, I apologize for not having Mr. Geithner here on Wednesday, but sometimes we have to do other things.

The following Members on the Democratic side were here at a time when he and Mr. Bernanke had to leave, and I said at the time that they would get priority in questioning. After myself and the chairman of the subcommittee, we would go to the following Democrats:

Let me just read them in the normal, seniority order: Mr. Ellison; Mr. Scott; Mr. Green; Ms. Kilroy; Mr. Donnelly; Mr. Klein; and Mr. Grayson. They will be the first ones to ask questions. .

We will now proceed to the opening statements using the rules for hearings with a Cabinet member. The rules are 5 minutes for the chair and the ranking member; 3 minutes for the chair and ranking members of the subcommittee, and I apologize for the disruption of the transition. We will now begin. I think the announcements are over.

We have before us the job of dealing with whether or not there is existing in the Federal Government today sufficient authority to deal with systemic risk. There are several aspects to that. We talked considerably about one of them on Tuesday with the Chairman of the Federal Reserve and the Secretary of the Treasury;

namely, the need to have somewhere in the Federal Government the ability to use the bankruptcy authority given by the U.S. Constitution to wind down an important, non-bank, financial institution.

We have long had in our laws an adaptation to bankruptcy to wind down banks; and, when banks have failed, while it has been sometimes painful, it has not been as disruptive as when the non-bank financial institutions have failed. The two glaring examples are Lehman Brothers, where nothing was done, and AIG, where everything was done. I believe we are looking for an alternative method to avoid those two polar extremes. That is, a bankruptcy authority which can honor some and not honor others. It has some discretion.

The question of compensation is part of that, as is the question of whether or not people should continue to be allowed to securitize 100 percent of loans. Today—although obviously members are free to bring up whatever they wish—our focus will be on whether we need to increase the authority of some entity or entities in the Federal Government to restrict excessive leverage.

We are talking in the resolving authority about what happens when there is a failure on the part of an institution that is so heavily indebted to so many parties that simply allowing it to fail without intervention could cause magnifying, negative effects. But, obviously, the preferential situation would be to keep that from happening, and this subsumes a lot of other issues, whether or not people are too-big-to-fail, or too-interconnected-to-fail.

The goal should be—and obviously no system is going to prevent all failures, because it would then be too restrictive—to minimize the likelihood that entities will get so heavily indebted, so heavily leveraged with inadequate resources in case there is a need to make the payments, that their lack of success threatens the whole system.

I believe that we are in a third phase here of a set of phenomena we have seen in American economic history. It is a phenomenon in which the private sector innovates. Innovations which have no real value die of their own weight, but innovations that add value thrive as they should, because we are dependent on the dynamism of the private sector to increase our wealth.

But, by definition, when this comes from significant innovation, there aren't rules that contained abuses. The goal of public policy is to come up with rules that set a fair playing field that constrains abuses, and that protects legitimate and responsible entities from irresponsible competition, that can draw them away from good practices, while having as little effect as possible on diminishing the value. Thus, in the late 19th Century, the trusts were created, and they were very important.

We would not have industrialized without those large enterprises such as oil, coal, and steel, and a number of other areas. But because they were new, the operated without restraint, so Theodore Roosevelt and Woodrow Wilson were more help, I think, than they get credit for from William Howard Taft. Set rules, the Antitrust Act, the Federal Trade Commission, the creation of the Federal Reserve, those were rules that tried to preserve the large industrial enterprises.

Indeed, they were people who tried to get Woodrow Wilson to break them up. And he said, "No." They gave a valuator that we need, but we need rules. That led to a great increase in the importance of the stock market, because you now had enterprises that could not be financed individually. And the job of Franklin Roosevelt and his colleagues during the 1930's was to set rules that allowed us to get the benefit of the finance capitalism, the stock market, but curtailed some of the abuses.

I believe that securitization and the great increase in the ability to send money around the world that comes from both the pools of liquidity and the technology, CDOs and credit default swaps, these are a set of innovations on a par with the earlier set, and they have had great value. Securitization, which allows money to be relent and relent and relent without it all having to be repaid, greatly magnifies the value of money; but, there are problems, as there were with the trusts or with the stock market when there are no rules. Our job is to craft rules as did Theodore Roosevelt, Woodrow Wilson and Franklin Roosevelt that allow the society to get the benefit of these wonderful, value-added financial innovations while curtailing some of the abuses.

The gentleman from Alabama.

Mr. BACHUS. Secretary Geithner, earlier this week, we had a hearing on AIG's bailout, and at that hearing, you acknowledged that AIG fully met its obligations to foreign banks and certain U.S. banks, our financial companies. In fact, at that time, you said that throughout this period of time, and this is critically important to the stability of the system, we wanted to make sure AIG was able to meet its commitments.

I said to you—pensioners and retirees—and your response was also to municipalities and banks, and that you considered they had met the full range of their obligations. Since that time, I have been informed that AIG is now attempting to force many of its U.S. bank creditors to accept severe haircuts of more than 70 percent on the total debt owed to them. This disparity and the treatment of foreign banks, which, as you said in your response to my question, were paid dollar-for-dollar within hours of the bailout, and U.S. banks have yet to receive any payment and are being asked to accept 70 and 80 percent haircuts.

This disparity in treatment between foreign banks and U.S. banks is very concerning to me. This morning, I sent a letter to the chairman regarding this development and a hearing will be scheduled so that the committee can get to the bottom of this. And he has assured me that he will fully cooperate and I think agrees with my concern.

Now, let me talk about this hearing. In the last year we have witnessed unprecedented interventions by the government to commit trillions of taxpayer dollars to save too-big-to-fail institutions. The taxpayer continues to be given the bill as the government continues a cycle of bailouts. One way to end the cycle would be to allow for an orderly liquidation of complex financial institutions that are not subject to the statutory regime for resolving banks administered by the FDIC.

At a hearing last July, I stated that our regulators must strive for a system where financial firms can succeed or fail without threatening the whole financial system and placing taxpayers at risk. By creating this process of which non-banks whose failures would have systemic consequences could be unwound in an orderly fashion, we would restore balance and force firms to face the consequences of their actions. It is essential that any new regime for resolving or liquidating non-banks not rely on taxpayer funding. However, the Treasury legislative proposal released yesterday suggests the Administration is considering using taxpayer funding to pay the cost of resolving these failed financial firms. This to me is unacceptable and would serve only to promote moral hazard and perpetrate a too-big-to-fail doctrine that the American people have squarely rejected.

The proposal also leaves it to the Secretary and the FDIC to decide whether the firm will receive financial assistance or be placed in conservatorship. This empowers Federal regulators with incredible discretion. And some of the past experience that I have witnessed in the case that this discretion is not always administered fairly or evenhandedly. If the goal of the resolution process is to end the too-big-to-fail premise, why is the potential taxpayer subsidy part of the Administration's solution?

Mr. Chairman, there are many more unanswered questions, like which firms will be designated as systemically important, and why? When will a liquidation be triggered? What happens if there is a disagreement between regulators on the need for a conservatorship? How will the regulators determine whether to provide financial assistance or place a firm in conservatorship? The details are important, even more important is that we develop the right solution and not rush poorly vetted legislation.

I do commend you and agree with you that we do need a resolution process. The modernization of our regulatory structure will be the most important task this committee undertakes this Congress. The complex and interconnected nature of our financial markets require us to engage in thorough analysis with all the major stakeholders.

I conclude by saying I hope that the committee will have additional hearings on this proposal so that we can hear from the stakeholders and regulators on their views, identify any unintended consequences in advance, and take a look at some past resolutions which have caused real questions and issues, which I think have not been resolved.

So I appreciate your attendance today.

The CHAIRMAN. The gentleman from Pennsylvania.

Mr. KANJORSKI. Good morning, Mr. Chairman.

The committee will today consider the Treasury Secretary's ideas related to regulatory reform, focusing in particular on his legislative proposal vesting the Executive Branch with a new power to wind down troubled financial institutions. Specifically, this resolution authority would permit the Administration to place into receivership or conservatorship failing non-bank entities that pose systemic risk to the broader economy.

During the last 7 months, the entire global economy has often stood in the balance as our government resorted to erratic 11th hour efforts to prevent a catastrophic economic collapse. Without a guidebook, policymakers could only rely on hurried, ad hoc solutions. Such options, however, are inherently flawed and regularly produce unintended consequences. As we deal with the current financial crisis, we find ourselves facing the very difficult task of fixing a leaky regulatory roof while it is raining.

We therefore need to provide the Administration with a bigger hammer, a larger tarp, and the other tools needed to step in sooner when institutions are unhealthy, but not as close to death. Establishing resolution authority for all players in our financial markets has the potential to help lessen the severity of not only the present crisis, but also to prepare us for as yet unknown calamities down the road.

Today's forum must also include a discussion of what to do about those entities that presently operate in the shadows of the financial system. Hedge funds, private equity pools, and other unregulated bodies have the potential to unleash devastating consequences on our broader economy. Long-term capital management and AIG financial products are two obvious examples here; and, while the extent of regulation required is debatable, we must begin this crucial examination today and we must include them in the resolution authority.

We must also consider how the creation of a new Federal power to wind down troubled financial institutions will affect insurance, which is currently only regulated at the State level. Insurance is part of our financial services system, and is increasingly part of the global market, especially when it comes to products like reinsurance.

Because insurance is a piece of the puzzle that we must have in order to complete the picture, I am very interested in discerning how the Treasury Secretary currently envisions the resolution authority working in this market. In sum, we now expect regulatory reform to play with at least three acts: establish a resolution authority; create a system of risk regulator; and overhaul our regulatory authority. The gravity of this situation requires that the Congress deliberate and exercise patience so that we lay a thoughtful regulatory structure that will establish the basis of a strong economy for many years to come.

The CHAIRMAN. The gentleman from New Jersey, the ranking member of the subcommittee.

Mr. GARRETT. Thank you, Mr. Chairman.

And before I begin, Mr. Secretary, in light of the comments by both Russia and China with regard for a new reserved currency, I would think today might be a good opportunity for your issue just a clarification on your past marks.

Today's hearing, though, is on the issue of addressing the need for comprehensive regulatory reform. And I think it's important that we keep this in mind that it's a comprehensive approach as opposed to a piecemeal approach, because both the Chairman and the Secretary have expressed support for a new systemic regulator for our markets. But I really think that before we move forward on such a proposal on a separate track, we really need to have a comprehensive reform in place, because they are really linked together.

How could we possibly assign powers to a systemic regulator if we haven't fully examined the appropriate roles for the existing regulators? And, even more fundamentally than that, before we get too far down the road of fixing certain problems, how do we do so before we actually identify what those problems are?

I think we should be mindful of advice offered by one of the President's other economic advisors, and that's Paul Volcker. He stated in reference to financial regulatory reforms, "All this will take time if the necessary consensus is to be achieved in a comprehensive, rather than a piecemeal approach is to be taken."

And, Mr. Secretary, I know you have talked about the need for an FDIC-like resolution authority for large, non-bank, financial institutions. And I look forward to trying to delve into that a little bit more, but I think this authority needs to be really carefully structured to avoid a lot of unintended consequences. Because if the entities which are a subject of this authority were seen to be as too-big-to-fail without clear signals indicating what the consequences are for the creditors and the counterparties, we could really end up doing a heck of a lot more harm than good.

Getting back to the systemic regulator, time after time in history we have heard the promise that, oh, if we had more regulation, we wouldn't find ourselves in the situation that we are in today. In fact, in your testimony the other day you said, "We must ensure that our country never faces this situation again."

We all agree with that. But, you know, the Federal Reserve itself was created to ensure that acid bubbles and panics, like we have right now, don't happen, but they do. And, more recently, we had FISA, which was passed in 1990–91, I think, and that was supposed to tighten regulations after the savings and loan situation and they said it was never supposed to happen again, but it does.

So, forgive me if I'm still a skeptic when I hear, if we only have a systemic regulator, this will never happen again, especially, if moral hazard is instutionalized with an entire new designation of systemically risky institutions, that it will never happen again. We will only be encouraging that it will happen again in some future time.

I thank you and I yield back.

The CHAIRMAN. Mr. Secretary, please begin your testimony.

STATEMENT OF THE HONORABLE TIMOTHY GEITHNER, SECRETARY, U.S. DEPARTMENT OF THE TREASURY

Secretary GEITHNER. Thank you, Mr. Chairman, Ranking Member Bachus, and other members of the committee. I am pleased to be here before you today, again, and to testify about this critical topic of financial regulatory reform.

Now, over the past 18 months, we faced the most severe global financial crisis in generations. Some of the world's largest institutions have failed. Confidence in the overall system has eroded dramatically. As in any financial crisis, the damage falls principally on Main Street. It affects those who are conservative and responsible, not just those who took too much risk.

Our system today is wrapped in extraordinary complexity, but beneath it all, financial systems serve an essential and basic function. Institutions and markets transform the earnings and savings of American workers into the loans that finance a first home, a new car, a college education, or a growing business. They exist to allocate savings and investment to their most productive uses.

Our financial system still does this better than any financial system in the world, but still our system failed in basic fundamental ways. Compensation practices rewarded short-term profits over long-term return. Pervasive failures in consumer protection left many Americans with obligations they did not understand and could not sustain. The huge, apparent returns to financial activity attracted fraud on a dramatic scale.

Market discipline failed to constrain dangerous levels of risk-taking throughout the system. New financial products were created to meet demand from investors, but the complexity out-matched the risk management capabilities of even the most sophisticated institutions in the world.

Financial activity migrated outside the banking system, relying on the assumption that liquidity would always be available. Regulated institutions held too little capital relative to their exposure to risk. Supervision and regulation failed to prevent these problems. There were failures where regulation was extensive and failures where it was weak and absent.

Now, while supervision and regulation failed to constrain the build-up in leverage and risk, the United States came into this crisis without adequate tools to manage it effectively; and, as I discussed before this committee on Tuesday, U.S. law left regulators without good options for managing the failure of systemically important, large, complex financial institutions.

To address this will require comprehensive reform, not modest repairs at the margin, but new rules of the game. And the new rules must be simpler and more effectively enforced. They must produce a more stable system, one that protects consumers and investors, rewards innovation, and is able to adapt and evolve with changes in the structure of our financial system.

Our system, the institutions, and the major centralized markets must be strong enough and resilient enough to withstand very sever shocks and withstand the effects of a failure of one or more of the largest institutions. Financial products in institutions should be regulated for the economic function they provide and the risks they present, not the legal form they take.

We can't allow institutions to cherry-pick among competing regulators and shift risk to where it faces the lowest standards and weakest constraints. And we need to recognize that risk does not respect national borders. Markets are global and high standards at home need to be complemented by strong international standards enforced more evenly and fairly.

Building on these principles, we want to work with Congress to create a more stable system with stronger tools to prevent and manage future crises. And, in this context, my objective today is to concentrate on the substance of reform, rather than the complex and sensitive question of who should be responsible for what.

Now, our framework for reform will cover four broad areas: systemic risk; consumer investor protection; eliminating gaps and streamlining our regulatory framework; and international coordination. But today, I want to discuss in greater detail the need to create tools to identify and mitigate system risk, including tools to protect the financial system from the failure of large, complex, financial institutions.

Before I go into that, though, I just want to briefly touch on the critical need to reform in these other areas. Weakness in consumer and investor protection harm individuals, undermine trust in our system, and can contribute to the kind of systemic crisis that shakes the foundations of the system. We are developing a strong plan for consumer and investor regulation to simplify financial decisions for households and to protect people much better from unfair and deceptive practices.

We have to move to eliminate gaps in coverage, and end the practice of allowing banks and other finance companies to choose the regulator simply by changing their charters. Our regulatory structure must assign clear regulatory authority, resources, and accountability. As I said, we need a simpler, more streamlined, more consolidated, broader supervisory structure; and, to match these increasingly global markets, we must ensure that global standards for regulation are consistent with the highest standards we will be implementing here in the United States.

And we have begun to work with our international counterparts to reform and strengthen the role of the financial stability forum and enhancing sound regulation, strong standards, strengthening transparency, and reinforcing the kind of cooperation and collaboration we need. In addition to this, we are going to launch a new initiative to address prudential supervision, tax savings, and money laundering issues in weekly regulated jurisdictions.

President Obama will underscore in London on April 2nd at the leaders summit the imperative of raising standards globally and encouraging a race to the top, a race to higher standards, rather than a race to the bottom.

Now, on systemic risk, I want to focus on this today, not just because of its obvious importance to our future economic performance, but also because these issues about systemic stability will be at the center of the G–20 summit agenda next week. This crisis has made clear that large, interconnected firms and markets need to be brought within a stronger and more conservative regulatory regime. These standards cannot simply address the soundness of individual institutions, but they must also focus on the stability of the system as a whole.

The key elements of our program to reduce systemic risk in our system have six elements. I am going to summarize these briefly. My written statement goes into them in somewhat greater detail, and then I'll conclude and look forward to responding to your questions.

Let me just go through these quickly, these six key points:

First, we need to establish a single entity with responsibility for systemic stability over the major institutions and critical payment and settlement systems and activities.

Second, we need to establish and enforce substantially more capital requirements for institutions that pose potential risk to the stability of the financial system that are designed to dampen rather than amplify financial cycles.

Third, leveraged private investment funds with assets under-management over a certain threshold should be required to register with the SEC to provide greater capacity for protecting investors and market integrity.

Fourth, we should establish a comprehensive framework of oversight, protections, and disclosure for the OTC derivatives market, moving the standardized parts of those markets to central clearinghouse, and encouraging further use of exchange-traded instruments.

Fifth, the SEC should develop strong requirements for money market funds to reduce the risk of rapid withdrawals of funds that could pose greater risks to market functioning.

And sixth, as we have all discussed, we need to establish a stronger resolution mechanism that gives the government tools to protect the financial system and the broader economy from the potential failure of large complex financial institutions.

Let me just conclude by saying that these are very complicated, very consequential, very difficult sets of questions. You are absolutely right that we have to look at these together. Their interaction is important, and it is very important we have a comprehensive approach.

The President has made it clear that we are going to do what is necessary to stabilize this system to get credit flowing again and restore the conditions for a strong economic recovery. And I look forward to working closely with the Congress to modernize our 20th Century regulatory system and put in place a system that meets the needs of our much more complicated, more risky 21st Century financial system. And, working together, I am confident that we have an opportunity we have not had in generations to put in place a stronger, more resilient system.

Thank you, Mr. Chairman.

[The prepared statement of Secretary Geithner can be found on page 49 of the appendix.]

The CHAIRMAN. In the order of seniority, I'm going to start with the Democrats who were here at the end of the last hearing and did not get to ask a question. The gentleman from Georgia.

Mr. SCOTT. Thank you very much—

The CHAIRMAN. I will also announce, as I did before, with a very full membership, 5 minutes is going to mean 5 minutes. At the conclusion of 5 minutes, whomever is speaking will be allowed to finish a sentence or two, and that will be it.

Mr. SCOTT. Thank you very much, Mr. Chairman. Welcome, Mr. Secretary. It is good to have you back. You have quite a task before you. Let me just ask you this because I think it's very important that we move in a way that we do not—as we rush to save our economy, that we do not suffocate our economy. And I commend you on the move that we have made to, with a private/public partnership, in terms of getting the toxic assets off and getting our credit markets, our credit forces unclogged.

But I do have some questions about this expansion of power, which I think is at the heart and soul of your efforts here. And, as I said before, in our rush to save our economy, we certainly don't want to suffocate it. One example would be, and I want to ask my first question, you use the AIG as an example of why we need this expansion of power. And in AIG, the problem that happened in AIG was not in the insurance area, but it was in the special division that they had set up dealing with sort of the hedge fund-like operations, credit default swaps, and so forth that truly fall beyond the bounds of regulation. And we do need to move on that and I applaud you for that.

But here we come with the insurance companies, and insurance companies are already regulated by the States, so is there a conflict? How are you going to handle that conflict in dealing with the insurance companies, particularly in view of the fact that it is not been insurance that has caused the problem?

Secretary GEITHNER. Excellent question. Let me just start by saying, you know, what we need is better, smarter, tougher regulation. Because we have seen that the costs of these weaknesses and gaps are catastrophic for the system as a whole. And we have an enormously complicated system in the United States with regulation at the Federal and State level, multiple bank supervisors, multiple authorities, and it just didn't work. It did not deliver what it has to deliver.

And I think that we have to start by making sure we have in place effective consolidated supervision over those entities that could pose potential risks to the system. Now, that does not mean that we should supplant and take away the existing authorities that State insurance companies, that State insurance supervisors have over those institutions, or that the bank regulators have over depositories.

And so what we're suggesting is fully compatible with maintaining their important role in supervising insurance companies. But again, for these core institutions, you need to have much stronger, more effective supervision applied on a consolidated basis if you're going to get better results in the future.

Mr. SCOTT. Okay. Well, let me ask you also this, a part of your approach is to rein in the hedge funds in some of these areas that say they are unregulated. How do we respond to hedge fund operations so they are regulated? Could you very briefly explain how it will change from where we are now, in terms of the regulations we have with, say, hedge funds, and how it would be under your plan?

Secretary GEITHNER. Well, this is really the provence of the SEC, but our proposal is built on something that the SEC has considered for some time, which is to require registration for hedge funds, similar institutions, if they get to be above a certain size. And that, we believe, will give the SEC more ability to do what they exist to do, which is to protect investors, contain the risk of fraud, and make sure that they are more able to enforce the rules of the road on market integrity. That's the objective of it.

We are not suggesting that they be regulated like banks are regulated. They are different institutions in this context. And I think it is the right balance.

Mr. SCOTT. And in terms of this power that we are asking for, which is this great expansion of power to seize non-bank companies, where in the Federal Government should that power rest? Should it be with you in Treasury, should it be in the Fed, or perhaps in FDIC?

Secretary GEITHNER. Well, what we're proposing to do is build on the model established for the FDIC for banks and thrifts. That model, we have a lot of experience with it. There's a whole range of important checks and balances in that system to limit discretion so the existence of this does not increase moral hazard, as your colleague said. And we think that model offers a lot of promise. And we're basically suggesting a model that would substantially rely on the FDIC, itself, to run this new regime. But you have to have some checks and balances in the system, like that system has, and so you don't want to vest in any single institution such broad powers.

So the FDIC mechanism, for example, has this great virtue of, an action requires a majority of the Board of the FDIC, a majority of the Board of Governors, and a judgment by the Secretary of the Treasury on behalf of the President. And our suggestion is to build on that basic framework and put in place a similar set of checks and balances to limit discretion, again because of the concern your colleague raised about the risks you create too much uncertainty and moral hazard in putting in place a stronger resolution authority.

The CHAIRMAN. The gentleman from California, Mr. Campbell, on the list provided by the minority.

Mr. CAMPBELL. Thank you, Mr. Chairman, and thank you, Mr. Secretary. On Monday, you released a plan to leverage, bring private capital in to deal with the toxic assets. I'm generally supportive of that plan. The question I have is, it's 6:1 leverage ratio. How did you come up with that number? Why did you come up with that number? As you just stated, a lot of the problem that we had was because there was too much risk-taking too much leverage. It seems to me that that 6:1 ratio encourages more risk-taking, more leverage, and perhaps just moves the problem from bank to non-bank entities but doesn't necessarily help it that much.

Secretary GEITHNER. A very important concern. You're right. That basic concern shaped the proposal we made. And the suggestion for that leverage is really what the FDIC suggested, based on the range of experience they have with their existing mechanism. Now, it is substantially less leverage than banks run with today. And you are right, you want to get the balance carefully right.

What we have put forward was a framework that, we think, leaves the taxpayer much better protected than the alternatives. And we're trying again to stretch taxpayer resources prudently and, you know, use private investment effectively and still limit those risks to the taxpayer.

Mr. CAMPBELL. So you're open to a little less leverage, then?

Secretary GEITHNER. Well, you know, again, we want to get the balance right. We're not suggesting that we got it perfect. We'll try to figure out a program that's going to, again, what we want to do is help free up credit flows in ways that protect the taxpayer the best we can.

Mr. CAMPBELL. Okay. When we talk about the authority, this receivership authority that you have discussed, are you asking for that authority now prior to a new systemic, prior to the comprehensive reform that, I think there is universal agreement we all want, there is not agreement on what it should look like, but is that something, this authority you're asking for, prior to that reform?

Secretary GEITHNER. You're raising a very important question and I think that realistically you need to look at these provisions for better emergency powers for the government, resolution authority for the government, in the context of the proposals we're making for vesting more accountability and authority, responsibility, in a single arm of the government for dealing with systemic risk.

They need to be viewed together, which is why we're presenting these together to you today to evaluate, but we'll work with the committee and with the Congress on what the best legislative vehicle is for looking at this as a whole. I completely understand the judgment many people share, that you can't do this piecemeal. You can't do it just element by element. Everyone's going to look at how they all fit together, but we'll be open to whatever process works best for the committee and the Congress as a whole.

Mr. CAMPBELL. Yes, because my concern, Mr. Secretary, would be that if you have, that's a pretty extreme authority of receivership. And if you have that authority without the complete information and perspective of a full regulatory framework, wrong decisions could be made.

Secretary GEITHNER. We designed this proposal to fit within current law so that, I mean, within the current regulatory structure. So, you could move on this proposal alone and once you do the broader regulatory redesign we're proposing, you could come back and make sure they fit, you could do it that way, but you want to be able to see what we're proposing on the broader framework as you consider this specifically.

Mr. CAMPBELL. Why would you want us to move on it separately and more quickly? Are you expecting some additional non-bank failures? Are you concerned about that?

Secretary GEITHNER. Look, you know, we are, as I said, I think it's a great tragic failure of the country that we came into this crisis without anything like the broad authority governments need to manage financial crises effectively and protect the economy from the trauma that comes. This is not just in the case of resolution authority. You know, until Congress acted in the summer and the fall, the Executive Branch had no meaningful authority to put capital into a financial institution where that was necessary to protect the economy, to provide broad guarantees insurance.

And, you know, we're still in the midst of a very challenging period, and so, I think it would be in the interest of the country for Congress to do everything they can to make sure we get broader tools so we can manage this effectively. You know there is a good, I think as quickly as you can, because, again, this will be less costly for the economy, less costly for the taxpayer if we're able to contain this more effectively now.

Mr. CAMPBELL. Okay, one last really quick question. You have talked about an exchange for CDO's or whatever. Are you talking about for fixed income instruments, in general, which, because of their lack of homogeneity have not had an exchange in the past?

Secretary GEITHNER. No, our proposal is really concentrated on the over-the-counter derivatives market, not just credit derivatives, but a full range of other types of products where there has been a huge amount of sanitization. And we think the system would be safer if those standardized products were moved into clearinghouses. There was greater trading and exchange traded instruments in that context, but that would still preserve the capacity for the more specialized, tailored products which our system relies on to manage risk effectively. You want to have protections for those, too, but I think we're at the moment where we have enough maturation and sanitization that we can get a more stable system by moving these things on to the central counterparties and to exchanges.

Mr. CAMPBELL. Thank you. I yield back my time.

The CHAIRMAN. All right. I thank the gentleman for his precision. And the gentleman from Texas is now recognized for 5 minutes.

Mr. GREEN. Thank you, Mr. Chairman, and I thank the Secretary for appearing today, 2 times in one week. I know that you have many other things to do, but we're grateful that you're here. Mr. Secretary, let me start by saying that you're doing the right thing. You're doing the right thing because the American people understand that, too-big-to-fail is the right size to regulate.

Some things bear repeating. Too-big-to-fail is the right size to regulate. And I'm concerned about a moral hazard, as well. I'm concerned about the moral hazard associated with what Dr. King called the "paralysis of analysis." Analysis of paralysis. And I'm concerned about the notion that we may analyze to the point that we may become paralyzed. I think that we have to consider what happened with long-term capital. Long-term capital was a clear indication that we needed to do something. But the paralysis of analysis prevented us from taking the action that would have prevented AIG.

AIG is, if you will, a prodigy of long-term capital. And if we had taken corrective action with long-term capital, and I remember when the chairman had us, when were at a hearing concerning long-term capital, and I remember one of the comments that I made was that, before there was long-term capital, there was no long-term capital. Because there were many people who wanted to convince us that long-term capital was an aberration. That it was not something that could happen again. That systems were in place. That we didn't need regulation. Well, I'm here to tell you, Mr. Chairman, Mr. Secretary, in a metaphorical sense, the foxes have raided the AIG henhouse.

And the foxes don't want us to secure the henhouse. Now, I know a fox when I see one, and I want to let you know, that there are no foxes in this room. No foxes in the room, but the foxes that exist don't want us to secure this henhouse. Mr. Chairman, Mr. Secretary, I'm elevating you to a lofty position, I assume, but Mr. Secretary, it's our job to secure the AIG henhouses of the world. We cannot allow the financial order to become disrupted when we had it within our power to make a difference and we did not.

It is time for us to act. Don't allow the moral hazard associated with the paralysis of analysis to prevent us from acting. More specifically, when it comes to these hedge funds, many of the employees are owners of the hedge funds. How are they acting in the best interests of persons who are non-employees who have an interest in the hedge funds, when they have to take actions with regard to the hedge funds? We have to deal with that. Many of these hedge funds have pensions in them. Hedge funds were designed for sophisticated investors. Many people who have their monies in pensions are not sophisticated investors. I'm not sure that they understand, in toto, what it means to have their monies associated with a hedge fund.

We have to make some decisions about how pensions are going to be a part of hedge funds such as they are safe and secure. And again, I want it done such that we don't allow the paralysis of analysis to prevent us from acting.

Finally, I share this with you, Mr. Secretary. When we have this opportunity to make a difference, there will be naysayers. We need naysayers. There is safety in the counsel of the multitudes. The naysayers are part of the multitudes. But we cannot allow the naysayers to prevent us from doing what we know is the right thing for the American people and what the American people know is the right thing for this country.

Mr. Secretary, I salute you for what you're doing. God bless you, and I yield back the balance of my time.

Mr. CHAIRMAN. Mr. Secretary, do you have any response?

Secretary GEITHNER. Well, I do want to underscore, we have a moment of opportunity now. We don't want to waste this opportunity. And I do think we need to act. But, this is a complicated set of question. We're going to do it carefully, but we need to move.

Mr. CHAIRMAN. I thank you. I would just say, the gentleman has 13 seconds left, so I'll take his time to say that when he says, the foxes don't want us to protect the henhouse, I have been watching television some and I think that's right. Now, the other gentleman from New Jersey, on the list given to me by the Republicans.

Mr. LANCE. Thank you, Mr. Chairman. Good morning to you, Mr. Secretary. Let me say from my perspective, I wish the President well, and I wish you well in your incredibly responsible positions and I certainly wish you well next week in London. My questioning regards two matters in your testimony, credit default swaps and other OTC derivatives and money market mutual funds.

You indicate, regarding credit default swaps, that in our proposed regulatory system, the government will regulate the markets for credit default swaps and over-the-counter derivatives for the first time. Mr. Secretary, can that be done by regulation, or will that require statutory change, and does it also require regulation or statutory change in London and in Asia and in other places in the world?

Secretary GEITHNER. We're examining right now the questions about what requires legislation in this area, what we can do with existing authority. We actually can do quite a lot with existing authority. But, right now, broad authority for the centralized parts of our payment systems are segmented and separated. No one is really accountable for looking at the whole thing and that's something we have to fix.

I do think it's very important that in these markets, which are global markets, you want to have a global solution. You don't want to have separate nationalist solutions—

Mr. LANCE. I agree completely.

Secretary GEITHNER. And our hope is that we can work with Europeans on a global framework, a global infrastructure which has appropriate global oversights so we don't have a balkanized system at the global level like we had at the national level.

Mr. LANCE. My concern, of course, is that if we engage in regulation or statutory change here and this does not occur in London and in Asia, that money will go to those centers of commerce and we will be back in the situation where we have found ourself.

Secretary GEITHNER. I completely agree with you, and at the center of our agenda is, again, a recognition that we can move here alone.

Mr. LANCE. And then regarding money market mutual funds which I had thought were safe, and I think the American people felt safe regarding that instrument, clearly different from the sophistication of credit default swaps, after the collapse of Lehman Brothers, we discovered, and certainly I discovered for the first time, that they could not be safe.

And you indicate in your testimony that we believe that the SEC should strengthen the regulatory framework regarding money market mutual funds and my question there is, can we do that alone or does this also have to occur in London and in Asia?

Secretary GEITHNER. Excellent question. My sense is that we can do a lot here that would leave our system more protected, but of course, as in every area of this, on the capital requirements and everything else, we'll look at whether there would need to be complementary changes elsewhere.

Mr. LANCE. And you will be discussing this, I assume, Mr. Secretary, next week when you are in London?

Secretary GEITHNER. Well, I'm not sure how detailed in each of these provisions we're going to go, but absolutely we're going to be discussing with our colleagues a common approach to efforts at the global level that focus on the stability of our national systems.

Mr. LANCE. Thank you very much, Mr. Secretary, I yield back the balance of my time.

The CHAIRMAN. The gentleman from Minnesota, Mr. Ellison.

Mr. ELLISON. Thank you, Mr. Chairman. Mr. Secretary, thank you for your testimony and your work today. Will the stress test that the Treasury plan is considering be a way to effectively require banks without adequate capital to sell their troubled assets into the Administration's public/private investment program?

Secretary GEITHNER. No, I wouldn't frame it that way. Could I step back and frame the broad objective? You know, right now, we have a very resilient, diverse financial system. Parts of the system have a lot of capital. Parts of the system, in the eyes of the market, need some more capital. And what this assessment is designed to do, and this assessment is run by the Fed, not by the Treasury, is to assess what potential losses these institutions might face in the event we faced a deeper recession.

And to make sure the government's willing to give, able to provide capital to help backstop the system through this period of time. Most institutions want to go raise any additional capital they may need from the markets, but we're going to make sure that the markets understand that the government will be there with capital if that's necessary.

In our judgment, that will help reduce the risk that the system pulls back more from providing the credit that recovery needs. We don't want the system sucking more oxygen out of the economy just as we're trying to lay the foundation for recovery and providing capital to the system is an important part of that.

Giving these banks a chance to sell assets into a market will be helpful to restoring confidence in their financial soundness and make it easier, in our judgment, for them to go out and raise private capital, as well.

Mr. ELLISON. In your testimony, you indicated that capital requirements for systemically important firms must be more robust than other firms. How many systemic entities like hedge funds currently face no capital requirements whatsoever? Could you discuss in greater detail how a capital adequacy regime would work for these firms?

Secretary GEITHNER. We did not propose to establish capital requirements for hedge funds. What we are saying, though, is that the large institutions, principally the banks and the major large complex regulated financial institutions, are held to a set of requirements on capital liquidity reserves risk management, which are commensurate with the risks they pose. And because their risks are greater, and because the consequences of their failure is greater, they need to be subject to a higher set of standards and greater constraints on leverage.

But we're not proposing to establish capital requirements for the broad universe of hedge funds and private pools of capital that exist in our markets. We want them to register with the SEC if they reach a certain scale, and in the future, if some of them individually reach a size where they may be systemic, then at that point, we believe they should be brought within a regulatory framework that's similar to that which exists for banks.

Mr. ELLISON. Thank you. Could you explain how you think that consumer protection should be incorporated into comprehensive regulatory reform?

Secretary GEITHNER. You know, we're not at the position today where we want to lay out any details on the consumer side. I just want to underscore that will be a critical part of our reform agenda. You know, the failures there were very consequential, not just for the lives of millions of Americans, but for the whole system. They will be a critical part of what we propose.

Mr. ELLISON. Are you familiar with Elizabeth Warren's concept of a financial product safety board?

Secretary GEITHNER. I am. And I think that's a—

Mr. ELLISON. Could you offer us your thoughts on it?

Secretary GEITHNER. I think it's an interesting proposal. That's one of the many things we're looking at.

Mr. ELLISON. Could you tell me why the Treasury would be given resolution authority over systemically significant financial institutions such as bank holding companies, hedge funds, and large insurance firms? Why would the Treasury be given such resolution authority?

Secretary GEITHNER. We're actually proposing a structure in which the FDIC would have a central role in managing this regime, but as is true now, in the existing process for banks and thrifts, the judgment by the Treasury is necessary. The concurrence of the Treasury is necessary for a range of actions, as you would expect because, you know, the Treasury is responsible in some sense for guarding the interest of the taxpayer.

Mr. ELLISON. But why not an independent regulatory authority for those things?

Secretary GEITHNER. Well, again, in our structure, like in the structure of our banks now, there's a complicated set of checks and balances. So, there's an important role for the independent regulatory authority supervisor and for the FDIC and the Fed but that's not authority that the Executive Branch can delegate or separate because ultimately it relates to hugely important consequential judgments about the risks the taxpayers are exposed to and the degree of moral hazard in the financial system. And the Treasury has to be responsible for those judgments.

Mr. ELLISON. Well, given that the FDIC already has resolution authority, wouldn't such authority be better suited for that—

Secretary GEITHNER. Well, as I said, what we're proposing to do is to expand the role they would play with respect to a broader range of institutions and within its set of checks and balances that are similar to what now exists for banks.

Mr. ELLISON. Okay. I think I am about out of time. Thank you, Mr. Secretary.

The CHAIRMAN. The gentleman from Texas, Mr. Marchant.

Mr. MARCHANT. Thank you, Mr. Chairman. Secretary Geithner, I would like to spend my time talking about the new public-private partnerships you have announced, which I am generally in favor of. My concerns are that as it has been discussed, it has been announced now that PIMCO and I think Black Rock and several of the large institutional money managers are now emerging as some of the people who will be managing those funds.

Secretary GEITHNER. Not yet. They have expressed interest, but we haven't made any of those judgments yet.

Mr. MARCHANT. My concern is that given the ratios of leverage involved here, my concern is that the actual investors have more skin in the game than is proposed here, because if they in fact just take their hedge fund partners out in America and put all of their money in, and then they pull management fees off of that, then they—they don't have, in my opinion, don't have adequate incentive to make sure that those funds—they don't have enough skin in the game if you absolutely follow the hedge fund model and putting this money in. I'm very concerned about that.

Secretary GEITHNER. We have the same concern, and we want them to have enough skin in the game that their interests are aligned with our interests. But we have the objective, recognize that we have to find the right balance. But I think this is a better way of protecting the taxpayer than the alternatives.

Mr. MARCHANT. The concept I agree with. I'm concerned about how the money gets raised for the equity partner. The second thing I'm concerned about is the potential gap that is created if indeed once the auctions begin to take place and you begin to discover prices that you—that there will be gaps created between bid and ask. And when those gaps are created in those banks, and those deals are made, then you're going to have losses. You might have some gains to the banks. But I suspect we'll read more about the losses, and that those banks will then immediately have to put monies into the loan loss reserve, and so they're going to have immediate needs for capital.

Now is it in the plan, is there enough TARP money if necessary to plug that hole? And are you going to allow, if a gap in fact is created, are you going to allow there to be a response time between the bank and the FDIC or the regulating entity to where that bank then says, okay, if I sell this at this, I have a buyer, then it's going to create this gap, are you going to close me down instantaneously, or are you going to give me—or can we give you a plan as to whether we can raise additional capital or whether we're going to get TARP money? Because if we do this, we can't do the deal, and you may end up freezing the whole system up.

Secretary GEITHNER. Right. A very important concern, and you said it exactly right. So we're going to establish a 6-month window in which these institutions will have the ability to go raise capital from the markets or take capital from the government. Throughout that period of time, they would have the ability, if they choose, to sell assets into, both loans and securities, into these type of new funds. And so they would have the ability to make a choice about what mix of asset sales with what implications for capital and how they would meet the capital needs created by that. So that is how we would work. And you're right that you need to—any institution looking at this would have to do the—make those judgments together at the same time.

Mr. MARCHANT. And the last concern is, will you have the ability—will the market have the ability to take a look back and say—will the regulator have any ability to say this sale can't take place? This sale is—this auction, this is too devastating to the government or the FDIC fund. I mean, the FDIC is going to be insurer here. Does the FDIC have function in saying this is a sale that we can't bear the loss of in the fund? This is not—because the FDIC fund actually, insurance fund, is going to actually be the ultimate insurer here, right?

The CHAIRMAN. Could I say, if the gentleman wants an answer, probably we ought to end the question. It's an important question. I want to make sure we have time for the answer.

Secretary GEITHNER. I think this probably requires a bit more thought and care in responding to, and we would be happy to have our staff with the FDIC come up and walk you or your colleagues through the details of this. And your concerns are right in this case. But the FDIC will manage and operate the auction process for the loan piece of this. They have had a lot of experience in doing this. They have a huge interest in making sure they're not too exposed, just as I have a huge interest in making sure they're not too exposed. And we'll try to work out the right balance in this case. But your questions are good questions, thoughtful concerns. We share those concerns. We would be happy to walk you through it in more detail how we manage those concerns.

The CHAIRMAN. If the gentleman would permit me, and the Secretary had suggested this to me, because the gentleman from Texas has a very important point. This clearly calls for the cooperation and participation of all of the regulators. And on his suggestion, I will be consulting with the minority about having a hearing when we come back with all of those who will have a piece of the action here, so that we don't want anyone to think that one agency is being left out or being committed over its objection. That was the Secretary's suggestion. It will be consulting, and we'll have them all here precisely for the purpose of making sure that no agency's specific mission will be in any way impinged upon by this. So I appreciate the gentleman's question.

Next, the gentleman from Florida, Mr. Klein.

Mr. KLEIN. Thank you, Mr. Chairman. Thank you, Mr. Secretary. Good morning. First I want to join the gentleman from Texas in his comments about the interrelationship between the markets overseas. A number of us in a few weeks are going to be meeting with the TransAtlantic dialogue with European Union countries, so as we progress through this, I would like to make sure we're all up to speed and can have those conversations with them so that we can obviously get at the rate we want to get at, but at the same time, they're not doing something inconsistent.

We're obviously talking today about the importance of handling the insolvency of non-bank and financial institutions, and I fully support first of all the notion of an integrated system that looks at a systemic way of doing this, but I also note that, as I think you're correctly presenting, every day that passes and we don't do—take the necessary action or have the clear authority for agencies to take the necessary action, more money is being spent, more—or less confidence is in place, and those are the things that need to happen as quickly as possible. We want to get it right, and I think we want to get a systemic point in place, but I fully support the notion of working quickly to get this organized.

One of the points I want to make is, as we get into the breaking down, the merger or the acquisition, the selling off and liquidating, I want to make sure that—there's been some criticism in the past that sometimes no-bid contracts were used. Certain organizations were given priority.

It is very important to the American people in terms of confidence that there is an open, competitive bidding process; there are a lot of qualified companies around the United States that can help assist in this area, and if you can make it absolutely clear that will happen, and if you can comment on that.

Secretary GEITHNER. Oh, I completely agree, and I think that you're right. Confidence in the basic integrity of that process is critically important. And again, I really think the FDIC has great experience in designing procedures that meet that test. They are very sensitive to that concern, too. We want to build on that model, and of course are open to any suggestions of how we can do a better job of assuring that.

Mr. KLEIN. I appreciate that. And secondly, I think from a taxpayer point of view, everyone in the United States is concerned. They heard about the AIG payouts. It was—yes, it was the amount of money, but it was also the principle of fairness.

Secretary GEITHNER. Yes, it was.

Mr. KLEIN. This just struck people as totally unfair. They're struggling in their own businesses and their own personal lives, yet these payments took place. It's very important that these contractors, these parties that will assist us in helping this orderly liquidation, which in time will save taxpayer money. It's also important that, yes, there will be fees paid to these organizations. They should get a reasonable compensation, but the taxpayers have to feel there is an upside in the sale and liquidation of these assets so they don't see money getting paid to a private, you know, organization, which they're entitled to, but at the same time, taxpayers feel it's on our dime. We're not getting anything out of this. Assets don't have zero value. They have some value. We need to make sure that taxpayers feel like they're getting their fair share on the upside.

Secretary GEITHNER. I agree with you completely, and that's why in our proposal there's a dollar of taxpayer capital alongside a dollar of private investment, and so the taxpayer will share in any gains that come from the purchase of these assets management over time.

Mr. KLEIN. And if we can make sure that's very clearly articulated every step of the way. The next step I would like to bring up is the whole notion of too-big-to-fail, which is nauseating to most Americans, this idea that businesses were allowed to get so big they couldn't fail, and yet you have smaller banks, for example, that can't get TARP money, can't get assistance, and they're on the edge. And yet other companies just on the click of a dime, they get a huge check.

This notion probably goes back to the chairman's comments about antitrust laws were created many years ago based on consolidation of economic power which drove anticompetitive activity. Antitrust laws by and large, many of them, have not been as enforced as many people would like to see, and that allowed for large consolidations to occur, which in free enterprise we understand is fine, as long as there aren't adverse consequences. Adverse consequences to anticompetitive activity, in this case adverse consequences was this notion of a disaster that we have to put money into.

As we move forward with the systematic regulation, there has to be a notion of definition of how we avoid organizations getting to the too-big-to-fail category. Do you have some thoughts on how we're going to integrate that into our law and the regulation?

Secretary GEITHNER. We are a nation of 8,000 to 9,000 banks. We're a much stronger country because of the hundreds and thousands of smaller institutions that operate in our communities across the country. This is—they were not, mostly not part of the problem. They're going to be part of the solution going forward. It's very important they have access to capital on the same terms the large institutions do, and we're moving very, very quickly since we came into office to try to make sure that we're accelerating the procedures at the Treasury to make sure they can have access to capital.

Now in our proposal, as you saw, we want to hold the large institutions to stronger, tougher, more rigorous standards, tougher constraints on leverage. That will help counteract this risk that we have further consolidation over time to leave the system more risky. But you're absolutely right to underscore the importance of effective antitrust enforcement, and we have significant—we have these caps now on the scale of share of deposits that any single institution can have across the United States. We want to keep those in place, because we want to have a system that still relies on not just a few large institutions, but hundreds and thousands of smaller institutions across the country.

And, again, if you look at what's happening across the country, they're bearing a lot of the burden for filling the gap left by those institutions that have to pull back now and get smaller because they took too many risks.

Mr. KLEIN. Well, I look forward to working with you on that notion to make sure we don't have another too-big-to-fail scenario, but we allow a free enterprise system that is healthy and allows banks and others to thrive. I thank you, Mr. Chairman.

The CHAIRMAN. The gentleman from Alabama.

Mr. BACHUS. Thank you. Secretary Geithner, Mr. Klein talked to you about too-big-to-fail, and you want to get away from that as quickly as possible?

Secretary GEITHNER. I do. And I think that, again, the critical test for any system should be, is our system strong enough that we can handle failure, even of the largest institutions? That is a critical objective that's to underpin everything we do.

Mr. BACHUS. Thank you. Your draft legislation authorizes the FDIC to spend an unlimited amount of money, of taxpayers' cash, to prop up or unwind a supposedly systemically important firm. Or actually the words are "such sums as are necessary." Isn't that what we have been doing that the taxpayers and American citizens are so upset about?

Secretary GEITHNER. You said in your opening remarks, and you're saying again now that this question about who bears the losses, how you pay for these things, is very important and complicated. And we are going to have to look carefully at how the costs of these interventions are shared across the system.

Right now, in the current system, it is fundamentally unfair, because smaller banks are forced to absorb a disproportionate cost of interventions needed to protect the system from often mistakes made by larger institutions. We would like to change that and put in place a fee structure that is a bit more just and fair in that context.

Mr. BACHUS. But wouldn't a fair structure be not to prop them up with any taxpayer money?

Secretary GEITHNER. Well, I think, again, is as this crisis reveals and as the crisis of the thrift and loan crisis, the S&L crisis in the early 1990's revealed, there are circumstances in which it is cheaper for the taxpayer over time and less damaging for the country over time for the government to take some risk in preventing greater cost not just to the deposit insurance fund, but to the rest of the system. That's the balance we have to strike.

Mr. BACHUS. Well, I'm talking about, is there really no alternative than saddling future generations of Americans with perhaps hundreds of billions of dollars worth of losses for the mistakes of a few institutions that grow too large or too complex?

Secretary GEITHNER. What has to guide what we do is how do we protect the system at least cost to the taxpayer? And in emergencies, in extremis, as we have seen, letting institutions fail can cause far greater damage. You know, acute, catastrophic damage to the fortunes of all Americans.

Mr. BACHUS. All right. But—

Secretary GEITHNER. And so there may be circumstances in which with carefully designed constraints that it is more effective for the country and for the taxpayer for there to be carefully designed emergency authority to step in and prevent failure.

Mr. BACHUS. I would submit to you that "such sums as are necessary" is too open-ended, but Secretary Geithner, in my opening statement, I talked about that within hours—you said within minutes of the AIG intervention, billions of dollars went to the foreign banks.

Secretary GEITHNER. But—can I just clarify that?

Mr. BACHUS. Yes.

Secretary GEITHNER. What I said is, the purpose of the action was to ensure they can meet their commitments, and therefore that had impacted immediately—

Mr. BACHUS. AIG?

Secretary GEITHNER. Immediately on their ability to meet their commitments. I don't actually—didn't mean to say in minutes, they were making payments, but—

Mr. BACHUS. Sure. Okay. Within minutes they were—or, you know—

Secretary GEITHNER. —they were able.

Mr. BACHUS. I said hours, and you said minutes, but, you know, even if it was a few days, it was to allow them to not default on their obligations.

Secretary GEITHNER. That was the purpose of the action.

Mr. BACHUS. Right. Now they have obligations to a lot of American banks. In fact, you know, I said pensioners and retirees, you added municipalities and banks. How about the U.S. banks that their obligation of AIG, they're in default today, they were in default then?

Secretary GEITHNER. Mr. Bachus, I heard your question, and I need to understand a little more the precise examples you're referring to. I would be happy to look at that and get back to you.

Mr. BACHUS. Sure. Well—

Secretary GEITHNER. I understand if it seems unfair, we'll have to fix it, but I want to take a more careful look at what you're suggesting.

Mr. BACHUS. Sure. And what I'm talking about, let me tell you. What was paid off dollar-for-dollar were these risky credit default swaps agreement in most cases, which were the financial products subsidiary that wrote those. That's what you paid off dollar-for-dollar. What is still not being paid off is the more traditional loans to AIG of actual money. And do you not—do you understand my concern?

Secretary GEITHNER. I completely understand your concern, but I want to look in more detail at the precise examples you're speaking of. Because they don't—I need to understand those better, and I'll give you a thoughtful response.

Mr. BACHUS. Yes. And I'm talking about U.S. banks, federally insured U.S. banks, that made secured loans to a subsidiary of AIG, and they're being told—they're being offered 20 or 30 cents on the dollar, U.S. companies doing business in Florida, Alabama, Tennessee.

Secretary GEITHNER. As I said, I'll work with the chairman. We'll come back to you and give you a detailed response.

The CHAIRMAN. Thank you, Mr. Secretary. The gentleman from Indiana, Mr. Donnelly.

Mr. DONNELLY. Thank you, Mr. Chairman. Mr. Secretary, thank you for being here. When you read the papers today, you see there is continued work on getting General Motors and Chrysler squared away, trying to get across the finish line. And as I'm sure you know, if the dealers aren't working, nobody's working. And so that brings up the issue of floor plan financing, and I know the Treasury has been working on a solution. Could you, for all the dealers out there, whether they're RV or marine or automotive, could you tell us where you are and if there's a ray of hope for us?

Secretary GEITHNER. As I said, we're working on it. We have been looking at this very carefully over the last several weeks. We're exploring a range of options. I can't tell you today whether we have found a way to solve it, but we agree it's important. We think it would be helpful as a part of the overall solution, and I certainly will be able to tell you and your colleagues in the next couple of days what we think is possible and what is not possible.

Mr. DONNELLY. Okay. Because, as I said, and I know I'm repeating myself, but if the dealers can't get floor plan financing, the whole point of General Motors and Chrysler working their way through this and other companies, there's no point to that if we can't fix this portion of it.

Secretary GEITHNER. Right. And as you have seen, you know, we have tried to—we found something we could do on the supplier side. There are other things we need to do to make this work. But, again, we want there to be—we want to take our best shot at trying to see if there's a basis for a broader restructuring would leave these firms viable in the future without government assistance.

Mr. DONNELLY. When the chairman gave his opening statement, one of the things he said was that we want to have innovations with value added. We saw naked credit default swaps cause extraordinary devastation to our economy. And I know regulation is coming. Do these naked credit default swaps provide any value added, or is this simply just gambling?

Secretary GEITHNER. I know there are strong opinions on this issue, so I say this with some trepidation. My own sense is that banning naked default is not necessary and wouldn't help fundamentally in this case. It's too hard to distinguish what's a legitimate hedge that has some economic value from what people might just feel is a speculative bet on some future outcome.

If we could find a way to separate those two types of transactions from each other, we could do that—we would have done that a long time ago across a whole range of financial innovations. But it is terribly hard to do, and—but we will listen carefully to any ideas in this area and understand why people feel so strongly about this.

Mr. DONNELLY. I would love to see if there is something we can do in regulation in this area, because to me, those are just simple bets. And the American people have been required to take money out of our truck drivers' pockets, our waitresses' pockets, to pay off bets on Wall Street. And it's not that there was any real product there. It was simple, at least to me, from the Midwest on Main Street, it just seems like gambling.

Secretary GEITHNER. Well, our issue is not whether we want to protect the American economy from these things in the future, which we do. The only question is how best to do that. And our view is that the absolutely essential thing is to make sure there is more capital held against those positions so that we never again face a situation where those type of judgments could imperil the system and therefore leave Americans in the position where they're facing, you know, much lower pension values, higher borrowing costs, much greater risk of losing their job.

That is our basic objective. The only question is whether alongside what we do for capital and margin and these broad efforts to bring these things into central clearinghouses, whether we need also to look at banning certain instruments. And my own judgment is that we don't need to do that, very, very hard to do that, but understand there are other views on that and would be happy to listen to any suggestions.

Mr. DONNELLY. And we have seen IRA and 401(k) amounts significantly affected. People open their envelopes at the end of the quarter, and it takes their breath away. With the steps we're moving forward with, from what I understand and what I have read, mutual funds will be allowed to participate. Is that correct? Because that gives every one of the people in our country a chance to try to get back some of the money that they have lost. And so if mutual funds can participate in the programs that you have as opposed to just hedge funds and such, then actually the American people are part of it, and it should go in their pockets first.

Secretary GEITHNER. Absolutely.

Mr. DONNELLY. Okay. Thank you.

The CHAIRMAN. The gentleman from New Jersey, Mr. Garrett. At the conclusion of Mr. Garrett's questions, we will break for the votes. There are a lot of votes, but we will do the best we can in coming back. Mr. Garrett.

Mr. GARRETT. Great. Thanks. And I appreciate your comment with regard to the need for the comprehensive regulator going forward. I'm just sitting here thinking, if we had something like that in place, a systemic regulator, and also this idea of being able to wind things down as well, prior to what happened with the GSEs and the problems that we have today with them, would we be here where we are? Would they have done something different or what have you with the GSEs?

Secretary GEITHNER. GSEs were allowed—talk about moral hazard.

Mr. GARRETT. Right.

Secretary GEITHNER. GSEs were allowed to build up huge exposure to risk with inadequate oversight of their risk-taking. We got the balance of moral hazard and constraints completely wrong in that context.

Mr. GARRETT. Right. I agree.

Secretary GEITHNER. And that's one reason why Congress acted to put in place a stronger framework of supervision going forward with a stronger conservatorship authority. And I think that like in many things, and I think it's true in lots of other parts of the system, I believe it would have been better for the country for that to happen sooner.

Mr. GARRETT. Right. And—now there's a case where I give credit where credit is due to the Federal Reserve was here many times, past Administrations, this Administration, and this chairman as well, worked as well, tried—we didn't get it done as quickly as some of us would like, but we did work together to try to get that done, but it didn't happen soon enough. So you're saying that had we had what you're looking for in place 10 years ago, this new entity, whether it's the Federal Reserve or this, I'll call it an uber regulator, or what have you, they could have taken some sort of action and put it into receivership or done something else to get us not where we are today?

Secretary GEITHNER. I see where you're going, but let me just make a broader point. Across the financial system—

Mr. GARRETT. I'm just looking at that.

Secretary GEITHNER. No, I understand. But it is a bigger issue.

Mr. GARRETT. I know. But I'm just looking at that.

Secretary GEITHNER. Right.

Mr. GARRETT. Would they have done something different than what Congress did with regard to the GSEs?

Secretary GEITHNER. You know, this is kind of a hard question to answer in some sense.

Mr. GARRETT. Okay.

Secretary GEITHNER. Because it's easy with hindsight to go back and say that if only "X," then "Y."

Mr. GARRETT. They should have. But you can say that they probably should have?

Secretary GEITHNER. More generally, I would say that, again, this country, our Nation, did not have effective means to prevent the buildup of risk that would be threatening to the system nor to protect the economy from the consequences of the unwinding of those big bubbles.

Mr. GARRETT. Okay. Let me just go to a second area, and I always apologize, but the time is short. With regard to setting up something like FDIC, FDIC has a set class of people you're trying to protect, the depositors, right? Here you're trying to do something else.

It's really not a set class of depositors for these other institutions. It could be the equity holders, bond holders, what have you, that are not just like them, so you have a situation there where it's not so clear who exactly it is that we're trying to protect, it's the systemic risk. If that's the case, when it's not so clear which values or who you're going to weigh over, doesn't that potentially create some inverse or perverse incentives and create even more moral hazard? I'll just throw one last little twinge to that, too.

Secretary GEITHNER. Right. Okay.

Mr. GARRETT. And that—I'll watch my time—is this. Someone over there said we regulate hedge funds now. I don't think we do. But if you set up a system like that and they come into it, right, even if it is to regulate them, and even if you regulate just the big guys, again, don't you say now we create an inverse, perverse incentives there because now there may be the same GSE implicit guarantee, which is now explicit?

Secretary GEITHNER. Yes. I completely agree. There is real risk that if you identify some class of institutions as systemic, imply they're too-big-to-fail, imply they will get support in extremis, that would create a huge amount of moral hazard, perhaps leaving our system more vulnerable even than it is today.

Mr. GARRETT. Right.

Secretary GEITHNER. So we need to make sure we design this in a way that mitigates that risk. On the other hand, and I think you're right to be worried about that. The question is how we balance that. On the other hand, it is true that, as we have seen, firms can develop to the point where their fate—

Mr. GARRETT. I understand that.

Secretary GEITHNER. —could threaten systemic stability. And I think—and that creates moral hazard itself.

Mr. GARRETT. Right.

Secretary GEITHNER. And so what we have to do is to make sure that those institutions are subject to a more effective set of constraints on leverage and risk-taking. I don't see any other way to do it, because market discipline alone is not going to protect a system from that. But you're exactly right that you can do this in ways that will make the problem worse.

Mr. GARRETT. One really quick question. And moving too quickly on this, yes—AIG—with regard to AIG, that's a company that has foreign subsidiaries, right?

Secretary GEITHNER. Right.

Mr. GARRETT. And if we today set up a situation that says we're going to have to have a way to wind down companies where they have foreign subsidiaries, might it be—I know you want to go global, but if we don't do the global thing at the same time, might the other countries look at it and say, wait a minute. We're going to wind down these companies that are in the United States but they're over here in other foreign countries, those countries might say we're going to seize these assets here before the United States does—

Secretary GEITHNER. Part of the international agenda is a more effective globally coordinated approach to resolution of globally active firms.

Mr. GARRETT. So we have to do that at this exact same time before we have a wind down system, don't we?

Secretary GEITHNER. Well, you know, we don't want to leave our country vulnerable because of the time it takes to build consensus globally. So we need to do these things together. But ultimately, we have interests as a country we have to protect, and we can't be hostage to the difficulty of getting the rest of the world to move. We need to move as much as we can in this case, but an important part of the international agenda is more effective cooperation around the resolution of large, globally active financial institutions.

Mr. GARRETT. Thanks for squeezing in that one.

The CHAIRMAN. The gentlewoman from Ohio.

Ms. KILROY. Thank you, Mr. Chairman, and thank you, Mr. Secretary, for returning here. You know, certainly we have talked a little bit about what happened last fall and whether or not things could have—what you're proposing now could have prevented what happened then.

And certainly at that time, you know, I was not here. Along with other citizens, we sort of watched and listened to the issues with Lehman, the failure with Lehman, Bear Stearns, and AIG, and we saw government officials scrambling to try to prevent collapse. So, you know, what seemed to me is that Treasury at that time had no Plan B, had no preparation for what to do in that sense, and were winging it, were scrambling.

So I appreciate the fact that you are engaging in this kind of process, taking a bigger picture look at it about what we need to do so that we don't get into a situation of housing bubbles and egregious credit default swaps and overleveraged institutions, and even fraud on a dramatic scale, as you said in your earlier remarks. And I certainly look forward to working with you on these issues of systemic risk and capital requirements and over-the-counter oversight, and like some of my colleagues here, take a stronger view on credit default swaps.

And I also appreciate the public-private partnership that you announced with addressing the issue of toxic assets and cleaning up that mess. But I think as we heard from Mr. Klein, you know, the AIG bonus uproar did offend a sense of justice that's ingrained in the American people, that those who broke their own company, broke the system and caused such anguish and real hurt out there on Main Street, are also continuing to benefit from that. And what I think we need to hear a lot more is how this will help the taxpayer, how this will help Main Street; the car dealer, the restaurant owner, the dry cleaners, and the hardworking people here who are planning to retire and seeing their 401(k)s that they had hoped to use in a couple of years disappear.

So what would you say to them, that this is going to benefit them?

Secretary GEITHNER. "This" being the program of reforms we're announcing today?

Ms. KILROY. Right.

Secretary GEITHNER. This will make our system more stable in the future, with better protection for consumers and for investors. So it's much less—we want to make it much less likely in the future that a working family, in your district or anywhere else, could be taken advantage of by a mortgage broker, could be sold a mortgage loan or some other type of financial product which they did not understand, and could not afford to meet in a sense, leaving them vulnerable to losing their house, that we have to prevent. We have a deep moral obligation to prevent that more effectively in the future. We won't be able to save all people from making bad judgments about their financial health, but we can try to do a better job of making sure they're not taken advantage of by predatory behavior at the basic level of the mortgage consumer lending market.

That is necessary, but it's not sufficient. Because even if we did that well, but we still had large institutions taking on such risk that when we go into a recession, they suck the oxygen out of the overall economy, and pushing smaller businesses to the brink of failure, then we'll still leave the system as a whole more vulnerable in the future. So we have to prevent that, too, and that's going to require smarter, tougher, better designed constraints on risk taking at the core of the financial system as well. You need both of those two things.

And just finally, because we won't be able to prevent all financial crises, nothing we do here today over the next 6 months will offer the prospect of preventing all future financial crises, we can make sure that when they happen in the future, we can act more quickly, more effectively to contain the damage, to put a firebreak around the most weaker parts of the system, to not allow the fire to jump that firebreak and spread to parts of the economy that were more prudent and careful in their decisions. That's the core objectives that have to guide what we do.

Ms. KILROY. One of the issues that arose in the wake of our financial distress in terms of getting the toxic assets off of banks' books was the issue of pricing them. And the proposal that you made earlier this week has had some criticism that we could be overpricing some of the toxic assets and that it would be a windfall for some of the hedge funds. Would you address that issue for us, please?

Secretary GEITHNER. There are two tests of concerns people raise: One is this is going to be too generous to the bank; and the other is that it is too generous to the investor. Both can't be true. So you could design a proposal which is very generous to the bank, has the government overpaying for these assets, leaving the taxpayer bearing all the risk. We're not going to do that.

You could also design a proposal that leaves the investors out there, private investors, getting more reward than we're going to give the taxpayer. We're not going to do that. So our proposal has a balance, leaves the taxpayer better protected, makes sure that private investors are taking risks alongside the taxpayer, and that we share in those returns. We think that's the better approach, better balance.

The CHAIRMAN. We will reconvene after the votes.

[recess]

The CHAIRMAN. Would someone please close that door?

Mr. Secretary, thank you. And I now recognize for 5 minutes the gentleman from Delaware, Mr. Castle.

Mr. CASTLE. Thank you, Mr. Chairman. And thank you, Mr. Secretary, for being here and for your judgment on all this. And let me say that I by and large agree with what you have stated.

But I want to talk about what you didn't talk about a little bit, and that is what you referred to as the complex and sensitive questions on who should be responsible for what. I am not trying to pin you down; I am trying to sell you something, actually.

You may—I am sure you probably did see or read about Senator Collins' proposal, which I have also introduced here in the House, forming a Financial Stability Council. And I am not suggesting that is magic. Who knows. But I have looked at this issue, and I am very concerned about where this all may rest.

I think there is majority agreement, if not unanimous agreement, we need to do something. And the question then becomes, who is going to do it, and I think what you have outlined substantively is about what we have to do. But I am worried about the powers we are going to give to any one entity in doing this.

And I thought that this council, which would have an outside chairman but would bring in the different agencies that do the regulating now, would be a good way to go. And the word in the media is that the Federal Reserve is the natural entity to run this. And that is fine, and I have a lot of respect for Mr. Bernanke and the Federal Reserve.

But they have some regulatory authority now in a certain aspect of the economy. They also have other responsibilities for the economy. And I just worry about potential conflicts there. On the other hand, having them at the table, having the other regulatory entities, including Treasury and FDIC and the others, I think is important.

So I would hope that when we get down to that important question of how this is going to be organized, that careful thought is given—and for all I know, you have already given careful thought to this—but careful thought is given to being inclusive, even having an advisory council, perhaps some of the entities that are going to be regulated to help with this. I mean, after all, you know, the AIG people may have been a little more thoughtful if they had been at the table hearing some of this.

So there is a variety of things perhaps we can do. And I just don't want it to be so closed that all of a sudden you have that iron-fisted hand making all these decisions, perhaps without consultation with other people or groups, and maybe unintentionally, but in conflict with itself in terms of other things that they may have to do.

So I pose all that to you, and I would be interested in your comments on it. Again, I am not asking you to reveal something that you are not ready for yet. But I just want to make sure that the Administration is paying attention to the breadth of this issue as well as the substance of it in terms of how we are going to manage it.

Secretary GEITHNER. Thank you. I think there are three different issues involved here. One is the division of labor and the checks and balances on this resolution authority.

And as I said in response to earlier questions from your colleagues, I think in that context, as is now the case under FDICIA with respect to the FDIC, the decisions involved are of such consequence to the system that you can't vest authority for that within one entity.

And I think, again, as FDICIA reflects now, it requires a judgment by the Majority Board of the FDIC, the Majority Board of Governors of the Fed, as well as the Secretaries—the President has designated me in this context. And I think there is a lot in that basic structure that is similar to what you might think a board might do.

There is another set of issues, which is just trying to make sure there is cooperation across regulatory authorities, so that we are doing more even, more evenly enforced, more economically sensible, incentives and constraints across financial advisory.

So it is very, very important, particularly given how balkanized and segmented and siloed our system is today, that we have much more integration brought to bear across setting the rules of the game and enforcing them across those systems. And we do not want to design a system where we are going to invest all that authority in one place, one concentrated agency.

Can I go on to one—

Mr. CASTLE. Yes. Please do.

Secretary GEITHNER. There is a third question about who should be responsible for what we are calling here the systemic, core responsibilities in the system. And as I said in my opening statement, there are a range of issues we are going to have to look at to deliver a more streamlined consolidated financial oversight framework.

And we want to make sure that we have the right division of labor. There is clarity about responsibility. The responsibility is matched with authority. And the guys who are responsible are competent to execute that.

We are open to looking at a range of suggestions for how that authority should be framed and where that should be lodged in the system. But let me just give you a few basic principles. And this is, again, the authority we are calling the Systemic Risk Authority.

It should not be the Treasury. It needs to be vested in an independent supervisory authority. I do not believe it should be pulled together in one independent agency. I think too much concentrated power for all that regulatory authority would be not a sensible thing for the country. I think it is probably best to build on the existing authorities that we have for holding companies under the current statute.

And I want to end with just one basic example, which is that, you know, in a fire, the fire station needs to understand the neighborhood. It needs to know the neighborhood it is operating in. And you don't want to have to convene a committee before it can get the engines out of the station.

So it has to be able to move very, very quickly in extremis with the knowledge so it can make sensible judgments. And there is a good pragmatic case, I believe, looking at the lessons of crises in our country and around the world, to try to have that authority for crisis management matched with the authority for mitigating systemic risk.

Not too much concentration. Not vested within the Treasury. Appropriate checks and balances. But there is a range of those three different areas we have to make some judgments about responsibility.

The CHAIRMAN. Thank you. That was obviously a very important question, so we let it go on a little bit.

The gentleman from Florida.

Mr. GRAYSON. Thank you, Mr. Chairman.

Thank you, Mr. Secretary. I think we all understand how difficult the decisions are that need to be made these days. And these are not decisions that we ever wanted to make. Sometimes we are probably afraid to know if we are right or wrong. But in any case, I have to ask you a few questions.

On the balance sheet of AIG that was submitted earlier this month in their 10-K–, the balance sheet showed that AIG had an exposure to the yield curve of $500 billion, which is 5 times greater than it ever had in equity. At what point is enough, enough? Why didn't anybody stop AIG from accumulating that kind of risk and then turning it over to the taxpayers?

Secretary GEITHNER. Well, that is the great question. I mean, under the laws of the land, AIG was allowed to build up, through a variety of complex structures, huge amounts of risk relative to the capital they put up. And there was really no accountable competent authority overseeing that broad process. And that is what put us to the point where, again, the government had no choice but to come in and try to unwind this in a sort of carefully measured way.

Mr. GRAYSON. Well, if you look at the last 10–Q that Fannie Mae filed, the last 10–Q shows that Fannie Mae accumulated just in the last 6 months before that 10–Q, from the beginning of last year to the beginning of last year, over $250 billion in exposure to derivatives.

Again, at what point do people say enough is enough? This is too dangerous for the system to be allowed?

Secretary GEITHNER. Well, but again, this is not something I could respond to carefully and thoughtfully without looking at the particular issues in this context.

In the context of Fannie and Freddie, now, they are very large institutions. They have a very complicated set of risks they have to hedge. They have an elaborate risk management framework over them with a much more powerful supervisor now looking over those basic judgments.

But I wouldn't infer from looking at that one piece of their 10–K whether that set of risks are leaving—they are designed to make them safer, not more risky.

Mr. GRAYSON. Well, in fact, the total exposure at that point, in June of last year, for Fannie Mae was over a trillion dollars, about $1.5 trillion of exposure to derivatives.

Is it fair to say that contributed to its failure? And if so, at what point should someone have said, enough is enough?

Secretary GEITHNER. Again, Fannie and Freddie were also not under an appropriately sophisticated oversight framework with adequate powers prior to the legislation Congress passed last summer. But again, I don't think you can measure the risk and their exposure by looking at that piece of the balance sheet.

Mr. GRAYSON. If one's priority at this point were to say there should be no more need for taxpayer bailouts, that the way to deal with systemic risk is to prevent that risk from happening in the first place, what kind of substantive rules would you see being imposed on these kinds of institutions to prevent the taxpayer from being on the hook?

Secretary GEITHNER. That is our objective. Again, the most simple way to frame it is capital. Capital. Capital. Capital sets the amount of risk you can take overall. Capital ensures you have big enough cushions to absorb extreme shocks.

You want capital requirements to be designed so that, given how uncertain we are about the future of the world, given how much ignorance we fundamentally have about some elements of risk, that there is a much greater cushion to absorb loss and to save us from the consequence of mistakes in judgment and uncertainty in the world.

In a simple way, that is the best solution to these things. And that is not going to be something the market is going to provide on its own. That is something we have to impose through standards set in regulation.

Mr. GRAYSON. Is it fair to say that if an organization like AIG had been subject to margin calls, things never would have gotten as far along as they did and we wouldn't have had this kind of exposure today?

Secretary GEITHNER. I am not quite sure that is fair. But you are right, you want to make sure that the margin regime, too—margin is like capital, just to use a simple thing. You want to make sure that institutions like AIG hold much more capital against the risks they are underwriting and are exposed to. And you want to have—in derivatives in particular, you want to have a margin regime that is also much more conservative.

Mr. GRAYSON. Give us some idea of the substantive rules that you see being put in place for, let's say, hedge funds if hedge funds reach the size of posing systemic risk.

Secretary GEITHNER. If an entity that is not now a bank were to rise to the point in the future where, because of its structure, because of how connected it is to the system, because of its relationships and role in these markets it could pose systemic risk, then in our judgment they should be brought within a framework similar to what we are going to impose on large, complex, regulated financial institutions.

And that means a fully elaborated set of capital requirements, requirements on liquidity, on risk management, that are applied and enforced on a consolidated basis by a competent authority.

Mr. GRAYSON. And does enforcement really mean that at some point, somebody is going to say to an institution like AIG, enough is enough?

Secretary GEITHNER. Absolutely. That is what the—the great virtue of a capital requirement is it does constrain the amount of risk you can take. And the great virtue of the elaborate structure we have in place for banks in FDICIA is it forces intervention if they get to the point where capital erodes.

Mr. GRAYSON. Thank you, Mr. Secretary, and Mr. Chairman.

The CHAIRMAN. The gentleman from California, Mr. Royce.

Mr. ROYCE. Thank you, Mr. Chairman.

Yes, Mr. Geithner, I think part of the issue here is the wind-down power, the sheer enormity of it, that would be given here because actually, you would be able to take over any firm, any large firm. You would have basically permanent TARP authority. I wasn't a fan of TARP; I didn't vote for it.

But if you would have had this authority, let's say, in New York when Lehman or AIG were an issue, what would you have done differently at that time? Because what we are doing here is setting the rules, presumably for many, many years to come. We have to be very clear so people would know what to expect.

So how would you have handled, let's say, the creditors, the counterparties at AIG? Would you have bailed out AIG? Would you have done specific actions? Because if you just would have guaranteed it, you would have done the same thing that basically was done anyway.

Secretary GEITHNER. Exactly.

Mr. ROYCE. Go ahead with your analysis on that for a minute, if you will.

Secretary GEITHNER. You are raising a very important point, which is that the resolution authority we are proposing, like what exists for banks under FDICIA, gives you two types of authorities.

One is to intervene, wind down the entity, separate the good business from the bad, and figure out the best way to absorb losses, allocate those losses across the parts of the capital structure. But in the event default would cause systemic consequences, under FDICIA, FDIC also has the authority, subject to the set of constraints I outlined earlier, to take actions to put in capital to guarantee liabilities, to protect all creditors.

But that judgment has to be made as a very, very high threshold. You have to be able to demonstrate that the consequences of default would be systemic.

Mr. ROYCE. Right. And—

Secretary GEITHNER. So in any of those cases, like Lehman or AIG or Bear Stearns or any large, complex institution, you would have to look at the state of the world at that point. You would have to look at whether the costs to the economy as a whole would be so severe in the event of default that it was cheaper for the taxpayer ultimately to intervene to protect creditors from the consequences of default.

Mr. ROYCE. And of course, the one thing the economists have really been fretting about in terms of the scheme is all of the moral hazard that goes with it, the overleveraging that could occur, all the borrowing that would be presumed in the market that any large institution could suddenly obtain because the concept would be, hey, at the end of the day, this is going to, you know, be under the auspices of this systemic risk regulator.

And so at the end of the day, part of our investment here is going to be guaranteed, or our loan. And so they are going to be borrowing at a lower rate. They are not going to have the market discipline, as you said. They are going to be overleveraging. So it makes things more complex.

Let's take GE, you know, GE Capital, if you have a problem. They own NBC, CNBC, MSNBC. Just to discuss for a minute the consequences of this becoming a political issue over at Treasury, and now you do have this power. You have this power over any large firm. You have this permanent TARP authority.

How do you handle—have you thought through how you handle these decisions should this arise?

Secretary GEITHNER. You are exactly right. These are very complicated situations, and we have to be very careful that what we are doing is not going to add to moral hazard in the system.

So the regime has to come with clearly established rules for prompt corrective action, like what exists for banks, so you constrain the discretion of the supervisor to let an institution slip towards the edge of the cliff without intervention.

You have to have very high thresholds for judgment that would allow the government to put in capital. It requires, you know, elaborate checks and balances to limit discretion there, too. And you have to look at this alongside what we are proposing, to raise, fundamentally, capital requirements and leverage constraints on the system as a whole.

But you are right that you have to be very careful that this mechanism does not add to moral hazard. And I think that—but the virtues of this is exactly that, that we are reducing moral hazard in the system because we are giving ourselves more choices. The system we have today has the opposite risk because today, people fear that with no resolution authority, our only choice if it is systemic is to come in and guarantee.

Mr. ROYCE. I understand how you perceive this, but I don't think the market will perceive it the same way. And my presumption is that, instead, what we are going to do is guarantee basically that large firms borrow at a lower price than their competitors. I think that the consequence is going to be that they are going to crowd them out of the market.

But in any event, let's move to a different issue I wanted to ask you quickly about because in the text of the bill, you have the FDIC as the appropriate Federal regulator for insurance companies. However, the FDIC has very little authority over the insurance market. As you know, the regulatory structure overseeing the market is comprised now of 50-plus State regulators focused on their individual jurisdictions.

Would it make sense to establish a single Federal regulatory alternative for insurance to coordinate with when it comes to unwinding these institutions?

The CHAIRMAN. That question is going to have to be answered in writing since we started right at the limit. So, Mr. Secretary, please answer that one in writing for the record.

The gentleman from Idaho.

Mr. MINNICK. Mr. Secretary, two questions.

As you are aware, the House Agriculture Committee passed H.R. 977, which conveys to the Commodities Futures Trading Commission, the SEC, and other qualified regulatory authorities some of the oversight, the clearing, and the regulatory authority that you were talking about that would be subordinate to those exercised guidelines from a systemic regulator.

Do you think that the regimen proposed by that legislation would be consistent with the regimen you are attempting to—that the Administration will be attempting to implement?

Secretary GEITHNER. I would have to take a careful look and get back to you in writing. But what we are trying to do is to provide a delicate balance, which preserves the existing SEC and CFTC authority over those centralized markets, but still provides, in an entity with broader systemic responsibility, the capacity to look across these entities, make sure there is a level playing field, and that we are protecting the system as a whole by ensuring there are stronger safeguards in place where those risks are concentrated.

But as I said in my remarks, there are a lot of complicated jurisdictional issues we will have to sort through, and we wanted to start by proposing things that will guide the substance of regulation. We will have to step back at the end of this process and look at what the right division of labor is across the existing functional authorities.

Mr. MINNICK. Yes. Please do because there is an attempt, I think, to give you tools that would accomplish what I heard you say this morning.

My second question is, with respect to the new mechanism for creating liquidity of asset-backed securities that you have discussed yesterday and will continue to discuss, I am concerned that given the need for capital, which financial institutions of all types—a critical need right now if they're going to become functional, that this regime not underprice these assets. They need to be fairly priced but not underpriced.

And the question I had for you: Under this regulatory scheme, if your initial auctions produce prices that in your judgment are at the low end of fair market value in a freely functioning market, are you prepared to provide additional leverage into the system which would have the impact, I think, of increasing bid prices to a point where the solution to the problem doesn't exacerbate the situation we have today, where these institutions tend to be badly undercapitalized, if they are going to perform effectively?

Secretary GEITHNER. You are right. Providing more leverage would help against that risk. But we have to worry about the other risk, that we are not leaving the taxpayer too exposed in this context.

But this—like about alternatives, you have to think about this relative to the alternatives. This proposal is better than what exists today because today, you have a market where there is a very stark absence of financing, absence of leverage from private sources, and that is leaving at least some of these markets with a large liquidity risk premium. And this will make that substantially better.

Mr. MINNICK. Yes. We all want to make sure the taxpayer is treated fairly.

Secretary GEITHNER. Right.

Mr. MINNICK. But to the extent that the taxpayer—the desire to ensure the taxpayer receives maximum price leads to the financial institutions receiving less than a fair price. It will increase the need for you to induce capital directly.

Secretary GEITHNER. Right.

Mr. MINNICK. And I think the taxpayer is going to be stuck with that alternative as well. And this strikes me as a better balanced and market-tested vehicle for providing the capital than a direct subsidy, and it has the advantage you are not nationalizing the system.

And I would encourage you to look at your leverage and the experience of these initial auctions to see if it is yielding a fair to the taxpayers but nevertheless full price to the institutions.

Secretary GEITHNER. Well, you have the tradeoffs right. I mean, you exactly understand it. And we have to figure out a delicate balance for those things. But you have it exactly right.

Mr. MINNICK. Thank you, Mr. Secretary.

The CHAIRMAN. The gentleman from Texas.

Dr. PAUL. Thank you, Mr. Chairman.

The chairman in his opening statement talked about the problem being excessive leverage, and I certainly agree with that. And others refer to that as pyramiding of debt. And then we run into trouble, and we come up with the idea that regulations will solve this without asking the question: where did all this leveraging come from and how much of it was related to easy money from the Federal Reserve and artificially low interest rates?

So I am very skeptical of regulations per se because I don't think that solves the problem. And of course, everybody knows I am a proponent of the free market, and this is not certainly free markets that got us into this trouble, and this certainly won't solve it.

But, you know, in other areas we never automatically resort to regulations. When it comes to the press, if we had regulations on the press, we would call it prior restraint and we would be outraged. If we wanted to regulate personal behavior, we would be outraged and call this legislating morality.

But when it comes to economics, it seems like we have been conditioned to say, oh, that is okay because that is good economic policy. I accept it in the first two but not in the third, and therefore I challenge the whole system.

And it hasn't been that way forever. It has really been that way since the 1930's, about 75 years, that we in the Congress have deferred to the Executive Branch to write regulations, which are essentially laws. And yet the Constitution is very clear. All legislative power shall be vested in the Congress.

So we write laws and we transfer this power. So essentially—we have done this for years—we have reneged on our responsibility. We have not met our prerogatives. And therefore, we participate in this.

But in your position, you have been trained throughout your life to be a regulator, and that is something I know you can't deal with. But there is one area that I think that you might be able to shed some light on and work toward the rule of law because, you know, traditionally under common law—our system has always assumed that we are innocent until proven guilty.

And yet when it comes to regulations, first we allow the Executive Branch to legislate as well as the court. But in the administrative courts, we are assumed to be guilty until proven innocent. You are in charge of the IRS.

So this is someplace where, if there were a reasonable respect for the rule of law, that we could change that tone and assume that the taxpayer and the person that is on the receiving end of these regulations could say, hey, at least now the burden of proof is on the government to prove that somebody broke these regulations. And yet look at what we are doing endlessly. And yet I see that as the real culprit in all this because we are assuming the citizen is guilty.

Could you comment on that and tell me what you might be able to do in changing the direction?

Secretary GEITHNER. That was a very thoughtful set of questions. I just want to correct one thing. I have never been a regulator, for better or worse. And I think you are right to say that we have to be very skeptical that regulation can solve all these problems.

We have parts of the system which are overwhelmed by regulation, overwhelmed by regulation. It wasn't the absence of regulation that was a problem. It was, despite the presence of regulation, you got huge risks built up.

But in banks, because banks by definition take on leverage and transform short-term liabilities into long-term assets for the good of the system as a whole, they are vulnerable to runs. Because they are vulnerable to runs, governments around the world have put in place insurance protections to protect against that risk.

Because of the existence of those protections, you have to impose standards on them on leverage to protect against the moral hazard created by the insurance. That is a good economic case for regulation—

Dr. PAUL. Excuse me, but I only have a couple of seconds left. But see if you can address the subject of giving more respect to that individual who is accused of a crime. Can't we assume that the government has the burden of proof?

Secretary GEITHNER. You are talking in the criminal context?

Dr. PAUL. Well, any way. I mean, any time a regulator comes in and says that you are guilty of something, why doesn't the government have to prove he is guilty? Why can't we assume—

Secretary GEITHNER. Guilty of a criminal violation or of a—

Dr. PAUL. Civil or criminal. Why not? I mean, that is a principle that has been around for more than 1,000 years, or at least 800 years.

Secretary GEITHNER. I am neither a regulator nor a lawyer, unfortunately, so I am not sure I can give you an adequate answer to that. But I would be happy to think about it a little bit and get back to you with a view on—

Dr. PAUL. Well, I don't think it is complicated to think about the principle of innocent until proven guilty. How about the IRS? Can't you advise the IRS and say, don't assume anything until you prove these guys did something wrong before we prosecute them and say that they owe $500,000? I mean—

Secretary GEITHNER. Mr. Chairman, again, if this is about the IRS, I would be happy to come talk to you about that.

The CHAIRMAN. The gentleman's time has expired.

The gentleman from Pennsylvania, the chairman of the subcommittee.

Mr. KANJORSKI. Thank you, Mr. Chairman.

Mr. Secretary, I am going to actually give you an opportunity to answer Mr. Royce's question. But I just want to preface it a little bit.

One, I want to congratulate you on your resolution authority suggestion here. Of course, it will need some work and whatnot. But I think there is no question in my mind it is a tool that is necessary in this convoluted world that we live in, and certainly will be in the future, maybe the immediate future.

Unfortunately, there are some gaps in there, and I think I see the gaps because there has been a decision made that it is going to be publicly announced, I guess, April 30th, when you come back with a Blueprint.

But in your news release announcing the proposed legislation, you talked about covered institutions. And insurance companies were one of those add-ons, but not quite clearly defined. And then when we go over to your proposed legislation, you again use insurance as an add-on.

And the suggestion in the legislation is that it will not significantly change from what the present status is because you are not giving us the idea of what you propose in terms of maintaining State jurisdiction or Federal jurisdiction, whether it be optional, whether it be involuntary, whether it be determined by size or product or location or amount.

And if you do have the opportunity, I would appreciate the answer to Mr. Royce's question.

Secretary GEITHNER. Let me make sure I understand the question. This is with respect to, are we proposing through this to change the existing regulatory treatment of insurance companies?

Mr. KANJORSKI. Will you have a position on the Federal treatment of insurance companies? And if so, when, and what do you see as the likely parameters of that question? Simply because we are going to be undertaking hearings now and preparing, and I would like to have some understanding of where Treasury will be.

Secretary GEITHNER. We will come back soon in the context of the more detailed proposals around the rest of the complicated issues that matter in this case. I think there is a good case for introducing an optional Federal charter for insurance companies. But we have to look at each of these things in the context of the broader whole, and I would welcome a chance to talk to you about those sets of questions in as much detail as you would like.

Mr. KANJORSKI. Okay. Is there anyone in the Department now who is designated to handle the questions of insurance, or are we still in a hiatus there?

Secretary GEITHNER. Oh, right now we have a terrific team of people working on all these kind of questions. We are trying to fill out our team. But I would be happy to give you an individual you can talk to directly about not just the insurance questions, but how they fit into this broader structure.

Mr. KANJORSKI. In the last Congress, we almost succeeded in getting through the House a piece of legislation which would have established the Office of Insurance Information. And it would be needless to do that if we are going to be able to get to insurance legislation very quickly, but I doubt we are going to get to it that quickly.

Would you be opposed to our pushing that legislation now, early, so we have some repository of insurance information to deal with? Or would that—

Secretary GEITHNER. Would that be in the Treasury, that office?

Mr. KANJORSKI. Yes. In Treasury.

Secretary GEITHNER. We would not be opposed to that. Anything you can do to help us get more resources and talent in this area would be terrific.

Mr. KANJORSKI. Very good.

The CHAIRMAN. If the gentleman would yield, can I just ask—because that is something we talked about, how you respond to these important questions. I would also be interested if you think there is any difference as to how we deal with life insurance on the one hand and property and casualty on the other because that would be helpful. I thank the gentleman.

The gentlewoman from Illinois, by process of elimination.

Mrs. BIGGERT. Thank you, Mr. Chairman. Last, but not least, right?

Mr. Secretary, I want to go back to the legacy loans for a minute, and then I have another question. But the FDIC, as I understand your plan, is going to have the five or six groups set up, you know, for managing the loans?

Secretary GEITHNER. Well, this program has a program for loans on bank balance sheets, and it has a program for securities that are held across a range of market participants.

Mrs. BIGGERT. Right.

Secretary GEITHNER. There are different models for each of those because of the complex issues involved. But the proposal you are referring to, which is to have five asset managers raise equity income is on the securities—

Mrs. BIGGERT. This is with the FDIC?

Secretary GEITHNER. That is on the securities side. On the loan side, we are going to use an existing mechanism the FDIC now runs as part of the resolution process, where they would give a bank the right to identify a pool of loans and to sell that into a fund. And the FDIC would run an auction process to give a chance for investors to come in and participate in taking an equity stake in that pool of loans.

Mrs. BIGGERT. Okay. Then the bidding, would that be—how would the competition work? Would there be—would these investors have to have an ability to successfully manage the legacy loan or the legacy—

Secretary GEITHNER. Congresswoman, I think it would probably be best—this is a very complicated set of questions. I think the best thing for me to do is to maybe, as the chairman suggested, is we get the range of entities that are going to be responsible for managing and designing this process to come before you in whatever session you would like and walk you through the details.

Mrs. BIGGERT. Okay. All right.

Secretary GEITHNER. Because these are very complicated. Consequently, they are hard to do in 5 minutes.

Mrs. BIGGERT. Okay. And I don't even have 5 minutes left, so I will move on to the next question.

I think that Mr. Castle mentioned the council rather than just having the regulator for the systemic risk over that. I would wonder if—it seems like so much of our problem was the fact that the regulators didn't really catch it, and it could have been a lot of regulators, and they didn't communicate with each other. And so I think it is a failure of communication.

But we have seen sort of the same thing in Homeland Security. We saw it in Hurricane Katrina with—I know that we had—I was involved with FLEC, and we asked all of the agencies—with the Treasury, to ask all of the agencies come together. And they discovered that there was a lot of duplication in what they were doing, and how important the communication was.

How about having, rather than just the agencies in a council, also having—making it a private-public partnership, where you would have representatives from, let's say, the large financial institutions, and then maybe the small financial institutions and the insurance, and have it be where they rotate representatives in there?

Because it seems to me when we have asked the questions, like of Chairman Greenspan, we didn't get the answers. And he really, you know, didn't know, and he said he didn't know, everything that was going on.

And these are the people who are really in the industry and dealing with that. And it is not—you know, it is set up so that they can bring their concerns, and then that can be addressed. And maybe there are a lot of others who realize that, under different regulation, that they are having the same concerns.

Secretary GEITHNER. Mr. Chairman, do I have time to respond to that question?

The CHAIRMAN. Yes. You have actually 57 seconds.

Secretary GEITHNER. Fifty-seven seconds? Excellent.

The CHAIRMAN. And a little extra.

Secretary GEITHNER. I don't think you can let the regulated be part of the regulation, which is not quite what you are suggesting. But you can't put in a body that is designed to set the regulatory standards in which these companies operate and have people who are regulated part of that body. I do think, though—

Mrs. BIGGERT. What about an advisory council that would then work with the regulators? But to have that communication that is lacking?

Secretary GEITHNER. Well, I don't think our problem is a lack of communication between the regulators and the regulated, although I am sure people can do better in this context.

But let me just come back to emphasize one thing which I agree with you on. And maybe I agree with you on this, too, but just I am sure that I agree with the basic premise that you need these regulatory agencies working together. You need somebody who is responsible for looking at the whole, not just the pieces, because a big part of our system was nobody was really looking at the whole and pulling it together.

And there is a very strong case for trying to make sure there is better coordination and cooperation across the people who have expertise and experience that they could bring to bear in this process.

The CHAIRMAN. I thank the Secretary. I would just add to the gentlewoman: If anybody suffers from an absence of communication with those people who are regulated, I envy them. I wish I suffered from a lack of communication with them.

We are going to be able to—because the Secretary has agreed to give us an extra 15 minutes—hear from the gentlewoman from California and the gentleman from Missouri. To my other colleagues, the gentlewoman from California, somehow things have worked out. She will be first with—

Mrs. BIGGERT. Mr. Chairman?

The CHAIRMAN. Yes?

Mrs. BIGGERT. If I could just have 1 minute to—

The CHAIRMAN. Certainly.

Mrs. BIGGERT. I think it was a lack of communication among the regulators that I was talking about, not—

The CHAIRMAN. Oh, I apologize. Among the regulators. Yes. Well, as a matter of fact, one of the things I mentioned, I think that is absolutely right. And, you know, and I think it is not—people get busy and they just do the wrong stuff.

That is why the Secretary suggested, and I think it is a very good idea, when we come back, we will have all the regulators who will have a piece either of the resolution or of the impaired assets or the—all of them here so that we can start out that conversation. That was a good suggestion by the Secretary.

The gentlewoman from California will then be able to question—

Ms. WATERS. Thank you very much, Mr. Chairman.

The CHAIRMAN. Well, I meant the other gentlewoman will be first when we come back because we are going to lose him at 1:15. So the gentlewoman from California.

Ms. WATERS. Thank you, Mr. Chairman, for all the hard work that you are putting in all of these hearings. They are so very important. And I would like to thank the Secretary for coming back. He is holding up well. And we are appreciative for the time that you are putting in.

I want to ask about the products that are on the market, in the various markets. I don't quite understand why it is we don't talk about the elimination of certain products. We talk about regulation. Whatever product somebody can dream up, we say, okay, we will regulate it.

Why don't we talk about Alt-A? Why is Alt-A a good product? Why are credit default swaps good products? Is there such a thing as elimination of products, or not allowing certain products to come on the market after careful scrutiny, rather than saying, anything can come on the market and we will regulate it?

Secretary GEITHNER. Well, I think it is a very good question. I think that, you know, people will always innovate around what the government prohibits. And you will always be chasing the next thing which is designed to get around just that new piece of legislation designed to ban some particular product.

So probably the more effective way to regulate, in some sense, is again to make sure the institutions are strong enough to survive a very bad storm, and that people are protected from predatory behavior, because the predation can come in all sorts of forms. People will be endlessly innovative in how to take advantage of people if they think there is some gain at stake.

So I think that you need to have, you know, clearer standards regulated and enforced much more effectively across our country, and not allow people to come and get around those standards and offer people products that don't meet with those broad regulatory standards. But if you just do it by banning specific things, you will always be chasing the next innovation.

Ms. WATERS. Well, I am not so sure that we shouldn't look at opportunities to give more scrutiny to products before they come on the market, and really disclose to consumers that this is particular maybe as it relates to your economic health.

So let me go to the next one on asset management. I started out the other day talking about the five firms that are indicated in the plan. I am concerned about women-owned and minority-owned businesses. You know, we are dumping a lot of money out into the economy, and we want everybody who has something to offer that is legitimate and competent to participate in all of this money that we are putting into the economy to create jobs and opportunities.

Why can't we look at this a little bit closer and figure out how we can get more women and small firms and minority firms involved in this asset management, rather than having to go and knock on the doors and beg the five?

Secretary GEITHNER. We can look at it, and I will commit to look at it more carefully and come talk to you and your staff about how best we can do that.

Ms. WATERS. Okay. All right. One other thing that I would like to ask about is in terms of how the dollars have been put out there. FDIC has a guarantee program, and the banks are doing their own underwriting.

Is that unusual? Rather than putting that out there for the firms, all of the small firms, to get a crack at underwriting with this guarantee that comes from FDIC?

Secretary GEITHNER. You know, there is a lot I don't understand about how the FDIC operates. But I would be happy to pass on that request to Chairwoman Bair and ask her to come back and walk you and your staff through their basic approaches in that area.

Ms. WATERS. And lastly, let me just ask about credit default swaps. Why can't we just eliminate them?

Secretary GEITHNER. We could, but I don't think it would help anything. And I think it would deprive people from the ability to do things that are probably going to make the system safer.

What we are proposing to do is to bring them within a framework of oversight, to put them onto clearinghouses and exchanges, which will help contain the risk, help people manage their risk better, provide much more transparency and disclosure about those risks. And we think that will do a lot to make the system safer.

I am not sure this is worth going into, but if you just ban them, something else will develop like that. The better approach is to try to bring them into a framework where their risks are better managed.

Ms. WATERS. Well, Mr. Secretary, I wish that in the thinking that goes on about all of these markets, I wish that some deeper thought would go into not allowing some products to come on the market rather than talking about regulating everything because I think even though you talk about how creative people can be and how innovative and they will come with something else, it is better that you look at that than let something get out there that causes us a lot of pain that we haven't been able to control. Thank you.

The CHAIRMAN. Two more. We have time for two more. The gentleman from Illinois and the gentleman from Missouri, Mr. Cleaver, who has been through and got our commitment to go. Members who were here will get priority the next time around, as we have done before.

The gentleman from Missouri—no, I am sorry. The gentleman from Illinois and the gentleman from Missouri. And we will hold to a very strict 5 minutes, Mr. Secretary. Thank you.

Mr. MANZULLO. Thank you, Mr. Chairman.

Mr. Secretary, would you agree that the Fed's authority to government mortgage instruments and to govern the documents that would be necessary to prove the income of an individual applicant are extremely important powers?

Secretary GEITHNER. The Federal Government's or the Federal Reserve's?

Mr. MANZULLO. The Federal Reserve.

Secretary GEITHNER. I guess I believe they're important, although I'm not—I'm the Secretary of the Treasury, not the Chairman of the Fed. But I agree they are important powers.

Mr. MANZULLO. Okay. Thank you. They do have those powers. They did that by regulation, and the reason I bring that up is that here we have a very powerful Federal agency that could have curbed a lot of the subprime abuse by eliminating the 3/27 and the 3/28 teaser mortgages and by eliminating the so-called "cheater" mortgages by requiring proof that a person has the income that he states on his mortgage application, yet they did not act.

And the reason I bring that up is you are wanting to start yet another large powerful Federal agency and give it additional powers and yet I just gave an example of a situation where a Federal agency with the powers to have stopped a lot of the subprime bleeding had the power but simply did not act.

Secretary GEITHNER. You are right across this regulatory framework.

Mr. MANZULLO. So I'm not asking for an answer because it's—

Secretary GEITHNER. Okay. All right.

Mr. MANZULLO. —more of a comment. But it leads into the next question, is that now you want to set up this super regulatory system, give it the additional powers to even seize institutions.

My question to you is, is how many entities or companies would you—can you envision having to be at a—in a position where they could be seized because of their size? Would it be 100, 1,000, 10,000? Do you have any idea?

Secretary GEITHNER. No answer. I have no answer to that question, again because as we lead out in this suggestion, the Congress would have to establish broad standards that would describe—

Mr. MANZULLO. Right.

Secretary GEITHNER. —what type of institute would impose these type of risk.

Mr. MANZULLO. But you're talking about generally all insurance companies, all large insurance companies?

Secretary GEITHNER. Well, no. Again, what we're trying to do is to make sure that those largest institutions or those that are so connected or pose grave risks—

Mr. MANZULLO. Right.

Secretary GEITHNER. —are subject to a framework which protects the economy from those risks.

Mr. MANZULLO. So you're going to have to go through company by company—

Secretary GEITHNER. No.

Mr. MANZULLO. —to see if they're important enough—

Secretary GEITHNER. No.

Mr. MANZULLO. —as to whether or not they should—they could be seized because you want to set their executive compensation, so you already have your eyes on them?

Secretary GEITHNER. Congressman, we have to do better. The system we have today—

Mr. MANZULLO. No. I—

Secretary GEITHNER. —does not work.

Mr. MANZULLO. I understand that, but what I'm—what I'm trying to ask you is how many new companies would be involved in this, how intimate would be the relationship that's so intimate that you're going to determine what the executive compensation is?

So I would think that before you came out with this plan you would have some idea of the number of companies that would be subject to this new regulation.

Secretary GEITHNER. We laid out a broad set of proposals in the legislation and a broad set of principle standards for determining what a systemic risk authority would cover—

Mr. MANZULLO. No.

Secretary GEITHNER. —in that context and those are things that we'll have to work out in consultation with the Congress.

Mr. MANZULLO. No. No. I understand that, but, I mean, you realize how radical your proposal is?

Secretary GEITHNER. It's not a radical proposal.

Mr. MANZULLO. Oh, it's just absolutely—you're talking about seizing private business—

Secretary GEITHNER. No, it's not.

Mr. MANZULLO. —and you don't consider that to be radical?

Secretary GEITHNER. No. This is a prudent, carefully-designed proposal to protect our financial system from the—

Mr. MANZULLO. If it's prudent and carefully designed, Mr. Secretary, then you would have the answers to some of my questions, such as what size business would be subject to this.

I'm not giving you a hard time because I appreciate the fact that you came out with—with a guideline, with a framework and it's a discussion framework and—and those are good points. I'm just raising the concern that so many people in America have because of more intrusion.

Illinois does not regulate insurance rates. We are terrified, terrified that the Federal Government will get involved and so mess up Illinois insurance, that we will have to go with some grand scheme, perhaps worldwide, as to what the insurance rates should be. That's the big concern of the people that I have and—and I want to thank you for your time. It doesn't require an answer, but I just wanted to share the concerns with you.

Did you have a response to that? It's not necessary.

Secretary GEITHNER. I was going to say the great strength of our legislative process is we'll together be able to work through those concerns. We don't get to decide. We'll have to work through those concerns with you.

Mr. MANZULLO. Okay. Thank you. I yield back.

The CHAIRMAN. I will take the remaining time to reassure the gentleman that I think I'm due to be chairman until at least December of next year, and there will be no legislation empowering anybody to regulate the insurance rates while I'm the chairman of the committee.

I will say to the gentleman, having been in the Massachusetts Legislature, I have a particular aversion to being responsible for the driving habits of my fellow citizens in Massachusetts and as long as I'm here, we never will.

The gentleman from Missouri will be the final questioner.

Mr. CLEAVER. Mr. Secretary, the day has been long. I have one question.

Earlier, someone said they were reading from the legislation. I just want to make sure that people who are watching this understand that there is no legislation. They were reading from a document, probably either your speech or something else. There is no legislation.

The other—there have been pieces—people have asked pieces of this and to the degree that you can answer this question, understanding that you don't have the—the specifics at this moment that—that some would like to see, as specifically as you can, can you let me know about the PDIF process of pricing the assets in each asset pool and—and whether or not the bid process can be conducted in a way that—that is arbitrable and verifiable and fair?

And then, secondly, how—how do we handle the settlement process in a way that makes it transparent?

Secretary GEITHNER. Again, this is an issue where the best thing is to have the FDIC come up and walk you through all that. You know, they do this for a living.

Mr. CLEAVER. Yes.

Secretary GEITHNER. They have a lot of experience doing it. They have an established mechanism, and I really should let them walk you through that.

Mr. CLEAVER. That's good enough for me.

Secretary GEITHNER. Okay.

Mr. CLEAVER. Let's go to lunch.

[laughter]

The CHAIRMAN. The hearing is adjourned, and the members who are here at the end will be given priority.

Mr. SHERMAN. Mr. Chairman, can members submit questions for the record?

The CHAIRMAN. Members may always submit questions for the record and members may always submit documents for the record.

[Whereupon, at 12:20 p.m., the hearing was adjourned.]

A P P E N D I X

March 26, 2009

ANDRÉ CARSON
7TH DISTRICT, INDIANA

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OFFICE OF CONGRESSMAN CARSON

Financial Services Committee Hearing
"Addressing the Need for Comprehensive Regulatory Reform"

March 26, 2009

Mr. Secretary, I want to ask you about Treasury's efforts on behalf of small community banks. As you know, our nation's small businesses receive a large percentage of their loans from community banks. So it is extremely important that parity exists in the assistance that we give to our nation's financial institutions, both big and small.

Treasury recently announced a public-private partnership to buy bad assets from banks in order for them to clean their balance sheets and increase lending. However, there are concerns that selling these assets at a loss will create a capital hole for many of these banks. While you have capital programs readily available to the largest banks, smaller banks contend their access to such programs is restricted. Such restrictions put undue burdens on smaller banks.

So I would like to know if Treasury is working on an initiative to help small community banks raise the capital they need to participate in your trouble asset program and benefit from the public-private investment plan.

Thank you.

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Statement by

Timothy F. Geithner

U.S. Secretary of the Treasury

before the

Committee on Financial Services

U.S. House of Representatives

March 26, 2009

Introduction

Thank you Chairman Frank, Ranking Member Bachus, and other members of the Committee. I appreciate the opportunity to testify about the critical topic of financial regulatory reform.

Over the past 18 months, we have faced the most severe global financial crisis in generations. Some of the world's largest financial institutions have failed. Equity and real estate prices have fallen sharply, eroding the value of our savings. The supply of credit has tightened dramatically. Confidence in the overall financial system, in the protections it is supposed to afford for investors and consumers, has eroded. These financial pressures have intensified the recession now underway around the world.

And as in any financial crisis, the damage falls on Main Street. It affects the vulnerable. It affects those who were conservative and responsible, not just those who took too much risk.

Our system is wrapped today in extraordinary complexity, but beneath all that, financial systems serve an essential and basic function. Financial institutions and markets transform the earnings and savings of American workers into the loans that finance a home, a new car or a college education. They exist to allocate savings and investment to their most productive uses.

Our financial system does this better than any other financial system in the world, but our system failed in basic fundamental ways. The system proved too unstable and fragile, subject to significant crises every few years, periodic booms in real estate markets and in credit, followed by busts and contraction. Innovation and complexity overwhelmed the checks and balances in the system. Compensation practices rewarded short-term profits over long-term return. We saw huge gains in increased access to credit for large parts of the American economy, but those gains were overshadowed by pervasive failures in consumer protection, leaving many Americans with obligations they did not understand and could not sustain. The huge apparent returns to financial activity attracted fraud on a dramatic scale. Large amounts of leverage and risk were created both within and outside the regulated part of the financial system.

These failures have caused a great loss of confidence in the basic fabric of our financial system, a system that over time has been a tremendous asset for the American economy.

To address this will require comprehensive reform. Not modest repairs at the margin, but new rules of the game. The new rules must be simpler and more effectively enforced and produce a more stable system, that protects consumers and investors, that rewards innovation and that is able to adapt and evolve with changes in the financial market.

On February 25, after meeting with the banking and financial services leadership from Congress, President Obama directed his economic team to develop recommendations for financial regulatory reform and to begin the process of working with the Congress on new legislation. The Treasury Department has been working with the President's Working Group on Financial Markets (PWG) to develop a comprehensive plan of reform. This effort has been and will be guided by principles the President set forth earlier this year and in his speech as a candidate at Cooper Union in March 2008.

Financial institutions and markets that are critical to the functioning of the financial system and that could pose serious risks to the stability of the financial system need to be subject to strong oversight by the government. Our financial system and the major centralized markets must be strong and resilient enough to withstand very severe shocks and the failure of one or more large institutions. We need much stronger standards for openness, transparency, and plain, common sense language throughout the financial system. And we need strong and uniform supervision for all financial products marketed to consumers and investors, and tough enforcement of the rules to ensure full accountability for those who violate the public trust.

Financial products and institutions should be regulated for the economic function they provide and the risks they present, not the legal form they take. We can't allow institutions to cherry pick among competing regulators, and shift risk to where it faces the lowest standards and constraints.

And we need to recognize that risk does not respect national borders. We need to prevent national competition to reduce standards and encourage a race to higher standards. Markets are global and high standards at home need to be complemented by strong international standards enforced more evenly and fairly. These are global markets and challenges. Building on these principles, we want to work with Congress to put in place fundamental reforms that create a stronger, more stable system, with much stronger protections for consumers and investors, and a more streamlined, consolidated, and simple oversight framework.

I want to begin that process today by focusing on proposals that are essential to creating a more stable system, with stronger tools to prevent and manage future crises. In this context, my objective is to concentrate on the substance of the reform agenda, rather than the complex and sensitive questions of who should be responsible for what.
Over the next few weeks we will outline proposals in the areas of consumer and investor protection and for reform of regulatory oversight arrangements.

We start with systemic risk, not just because of its obvious importance to our future economic performance, but also because these issues require more cooperation globally, and they will be at the center of the agenda at the upcoming Leaders' Summit of the G-20 in London on April 2.

These proposals reflect a range of complex and consequential policy choices. They will require careful work and drafting. It is important that we get this right. We recognize there will be many alternative models put forth to achieve the objective we all share of creating a more stable system. And we look forward to working with the Federal

Reserve, with the agencies that make up the President's Working Group on Financial Markets, and with the Congress on a package of reforms that we can all support.

The Crisis and Its Fundamental Causes

The current crisis had many causes.

Two decades of sustained economic growth bred widespread complacency among financial intermediaries and investors, lowering borrowing costs and weakening lending standards.

A global boom in savings resulted in large flows of capital into the United States and other markets, pushing down long-term interest rates and pushing up asset prices. The rising market hid Ponzi schemes and other flagrant abuses that should have been detected and eliminated.

In that environment, institutions and investors looked for higher returns by taking on greater exposure to the risk of infrequent but severe losses.

A long period of home price appreciation encouraged borrowers, lenders, and investors to make choices that could only succeed if home prices continued to appreciate. We had a system under which firms encouraged people to take unwise risks on complicated products, with ruinous results for them and for our financial system.

Market discipline failed to constrain dangerous levels of risk-taking throughout the financial system. New financial products were created to meet demand from investors, and the complexity outmatched the risk-management capabilities of even the most sophisticated financial institutions. Financial activity migrated outside the banking system, relying on the assumption that liquidity would always be available.

Regulated institutions held too little capital relative to the risks to which they were exposed. And the combined effects of the requirements for capital, reserves and liquidity amplified rather than dampened financial cycles. This worked to intensify the boom and magnify the bust.

Supervision and regulation failed to prevent these problems. There were failures where regulation was extensive and failures where it was absent.

Regulators were aware that a large share of loans made by banks and other lenders were being originated for distribution to investors through securitizations, but they did not identify the risks caused by explosive growth in complex products based on these products.

Investment banks, large insurance companies, finance companies, and the GSEs were subject to only limited oversight on a consolidated basis, despite the fact that many of those companies owned federally insured depository institutions or had other access to explicit or implicit forms of support from the government. Federal law allowed many institutions to choose among regulatory regimes for consolidated supervision and, not surprisingly, they avoided the stronger regulatory authority applicable to bank holding companies. Those companies and others were highly leveraged or used short-term borrowing to buy long-term assets, yet lacked strong federal prudential regulation and routine access to central bank liquidity.

And while supervision and regulation failed to constrain the build up of leverage and risk, the United States came into this crisis without adequate tools to manage it effectively. Until the Housing and Economic Recovery Act and the Emergency Economic Stabilization Act were passed in the summer and fall of 2008, the executive branch had effectively no ability to provide the capital or guarantees necessary to contain the damage caused by the crisis.

And as I discussed before this committee on Tuesday, U.S. law left regulators without good options for managing failures of systemically important non-bank financial institutions.

Regulation of a financial system as complex and dynamic as our system is inherently difficult and challenging. But that difficulty has been compounded by a U.S. regulatory structure that is unnecessarily complex and fragmented. The complexity has sometimes resulted in a failure to assign clear responsibility for achievement of some public policy objectives, notably for financial stability.

Toward a More Stable and Resilient Financial System

Our comprehensive framework for regulatory reform will cover four broad areas: systemic risk, consumer and investor protection, eliminating gaps in our regulatory structure; and international coordination.

In the coming weeks, I will present detailed frameworks for each of these areas. Today, I will discuss in greater detail the need to create tools to identify and mitigate systemic risk, including tools to protect the financial system from the failure of systemically important financial institutions.

Second, weaknesses in our consumer and investor protections harm individuals, undermine trust in our financial system, and can contribute to systemic crises that shake the very foundations of our financial system. The choice of what home mortgage to get or how to save for retirement are some of the most important financial decisions that households make. It is crucial that when households make choices we have clear rules of the road that prevent manipulation and abuse. We must restore integrity to our financial system and strengthen these protections. Consumer and investor protection is a critical component of the President's regulatory reform plan. We are developing a strong, comprehensive plan for consumer and investor regulation to simplify financial decisions for households and to protect people from unfair and deceptive practices.

We must end the practice of allowing banks and other financial companies to choose their regulator simply by changing their charters; regulators must choose who to regulate. Moreover, our regulatory system must be comprehensive and eliminate gaps in coverage. Our regulatory structure must assign clear regulatory authority, resources, and accountability for each of the key regulatory functions. We must not let turf wars or concerns about the shape of organizational charts prevent us from establishing a substantive system of regulation that meets the needs of the American people.
To match the increasing global markets, we must ensure that global standards for financial regulation are consistent with the high standards we will be implementing in the United States.

The Financial Stability Forum (FSF) has played an essential role in the effort, working with the world's standard - setting bodies to study the underlying causes of the crises and address these weaknesses. Much progress is being made to enhance sound regulation, strengthen transparency, and reinforce international collaboration.

We have begun to work with international colleagues to reform and strengthen the FSF so that it can play a more effective role alongside the original Bretton Woods institutions in strengthening the financial system. We have already gotten agreement to expand the membership to include all G-20 countries, giving it a stronger mandate for promoting more robust standards consistent with the principles above, and working with the IMF and the World Bank to monitor the implementation of those standards.

In addition, we will launch a new, initiative to address prudential supervision, tax havens, and money laundering issues in weakly regulated jurisdictions. President Obama will underscore in London on April 2 at the Leaders' Summit the imperative of raising standards across the globe and encouraging a race to the top rather than a race to the bottom.

Reducing Systemic Risk

The crisis of the past 18 months has exposed critical gaps and weaknesses in our regulatory system. As risks built up, internal risk management systems, rating agencies and regulators simply did not understand or address critical behaviors until they had already resulted in catastrophic losses.

This crisis has made clear that certain large, interconnected firms and markets need to be under a more consistent, and more conservative regulatory regime. These standards cannot simply address the soundness of individual institutions, but must also ensure the stability of the system itself. We need to strengthen our system of prudential supervision across the financial sector. We must require that firms build up capital during good economic times so that they have a more robust protection against losses in down times – and can continue to lend to America's households and businesses big and small. We need to examine our accounting rules to see whether, consistent with investor protection, we can require firms to build up loan loss reserves that look forward and account for losses in downturns.

In addition, regulators must issue standards for executive compensation practices across all financial firms. These guidelines should encourage prudent risk-taking, incent a focus on long-term performance of the firm rather than short-term profits, and should not otherwise create incentives that overwhelm risk management frameworks.
The key elements of our plan to address systemic risk are:

First, we need to establish a single entity with responsibility for systemic stability over the major institutions and critical payment and settlement systems and activities.

Second, we need to establish and enforce substantially more conservative capital requirements for institutions that pose potential risk to the stability of the financial system, that are designed to dampen rather than amplify financial cycles.

Third, we should require that leveraged private investment funds with assets under management over a certain threshold register with the SEC to provide greater capacity for protecting investors and market integrity.

Fourth, we should establish a comprehensive framework of oversight, protections and disclosure for the OTC derivatives market, moving the standardized parts of those markets to central clearinghouse, and encouraging further use of exchange-traded instruments.

Fifth, the SEC should develop strong requirements for money market funds to reduce the risk of rapid withdrawals of funds that could pose greater risks to market functioning.
And sixth, we need to establish a stronger resolution mechanism that gives the government tools to protect the financial system and the broader economy from the potential failure of large complex financial institutions.

Systemically Important Financial Firms and Markets

To ensure appropriate focus and accountability for financial stability we need to establish a single entity with responsibility for consolidated supervision of systemically important firms and for systemically important payment and settlement systems and activities.
We can no longer allow major financial institutions to choose among consolidated supervision regimes and regulators or to avoid consolidated supervision entirely. That means we must create higher standards for all systemically important financial firms regardless of whether they own a depository institution, to account for the risk that the distress or failure of such a firm could impose on the financial system and the economy.
We will work with Congress to enact legislation that defines the characteristics of covered firms, sets objectives and principles for their oversight, and assigns responsibility for regulating these firms.

In identifying systemically important firms, we believe that the characteristics to be considered should include: the financial system's interdependence with the firm, the firm's size, leverage (including off-balance sheet exposures), and degree of reliance on short-term funding, and the firm's the importance of the firm as a source of credit for households, businesses, and governments and as a source of liquidity for the financial system.

In general, the design and degree of conservatism of the prudential requirements applicable to such firms should take into account the inherent inability of regulators to predict future outcomes.

Capital requirements for these firms must be sufficiently robust to be effective farther into the tails of potential outcomes than capital requirements for other financial firms. And they must be less pro-cyclical, requiring firms to build up substantial capital buffers in good economic times so that they can avoid deleveraging in cyclical downturns.

The single systemic regulator will also need to impose liquidity, counterparty, and credit risk management requirements that are more stringent than for other financial firms. For instance, supervisors should apply more demanding liquidity constraints; and require that these firms are able to aggregate counterparty risk exposures on an enterprise basis within a matter of hours.

The regulator of these entities will also need a prompt, corrective action regime that would allow the regulator to force protective actions as regulatory capital levels decline, similar to that of the FDIC with respect to its covered agencies.

Payment and Settlement Activities

Weaknesses in the settlement systems for key funding and risk transfer markets, notably overnight and short-term lending markets (such as those for tri-party repurchase agreements) and OTC derivatives, have been highlighted as a key mechanism that could spread financial distress between institutions and across borders. While some progress was made in the markets for CDS and other OTC derivatives while I was at the New York Fed, federal authority over such arrangements is incomplete and fragmented, and we have been forced to rely heavily on moral suasion to encourage market participants to strengthen these markets.

We need to give a single entity broad and clear authority over systemically important payment and settlement systems and activities. Where such systems or their participants are already federally regulated, the authority of those federal regulators should be preserved and the single entity should consult and coordinate with those regulators.

Hedge Funds and Other Private Pools of Capital

U. S. law generally does not require hedge funds or other private pools of capital to register with a federal financial regulator, although some funds that trade commodity derivatives must register with the CFTC and many funds register voluntarily with the SEC. As a result, there are no reliable, comprehensive data available to assess whether such funds individually or collectively pose a threat to financial stability. However, in the wake of the Madoff episode it is clear that, in order to protect investors, we must close gaps and weaknesses in regulation of investment advisors and the funds they manage.

Accordingly, we recommend that all advisers to hedge funds (and other private pools of capital, including private equity funds and venture capital funds) with assets under management over a certain threshold be required to register with the SEC. All such funds advised by an SEC-registered investment adviser should be subject to investor and counterparty disclosure requirements and regulatory reporting requirements. The regulatory reporting requirements for such funds should require reporting, on a confidential basis, information necessary to assess whether the fund or fund family is so large or highly leveraged that it poses a threat to financial stability. The SEC should share the reports that it receives from the funds with the entity responsible for oversight of systemically important firms, which would then determine whether any hedge funds could pose a systemic threat and should be subjected to the prudential standards outlined above.

Credit Default Swaps and Other OTC Derivatives

The current financial crisis has been amplified by excessive risk-taking by certain insurance companies and poor counterparty credit risk management by many banks trading Credit Default Swaps (CDS) on asset-backed securities. These complex instruments were poorly understood by counterparties, and the implication that they could threaten the entire financial system or bring down a company of the size and scope of AIG was not identified by regulators, in part because the CDS markets lacked transparency.

Let me be clear: the days when a major insurance company could bet the house on credit default swaps with no one watching and no credible backing to protect the company or taxpayers from losses must end.

In our proposed regulatory system, the government will regulate the markets for credit default swaps and over-the-counter derivatives for the first time.

We will subject all dealers in OTC derivative markets and any other firms whose activities in those markets pose a systemic threat to a strong regulatory and supervisory regime as systemically important firms.

We will force all standardized OTC derivative contracts to be cleared through appropriately designed central counterparties (CCPs). We will also encourage greater use of exchange-traded instruments.

The CCPs will be subject to comprehensive settlement systems supervision and oversight, consistent with the authority outlined above.

We will require that all non-standardized derivatives contracts be reported to trade repositories and be subject to robust standards for documentation and confirmation of trades, netting, collateral and margin practices, and close-out practices.

We will bring unparalleled transparency to the OTC derivatives markets by requiring CCPs and trade repositories to make aggregate data on trading volumes and positions available to the public and make individual counterparty trade and position data available on a confidential basis to federal regulators, including those with responsibilities for market integrity.

Finally, we will strengthen participant eligibility requirements and, where appropriate, introduce disclosure or suitability requirements, and we will require all market participants to meet recordkeeping and reporting requirements.

Money Market Mutual Funds (MMFs)

In the wake of Lehman Brothers' bankruptcy, we learned that even one of the most stable and least risky investment vehicles - money market mutual funds - was not safe from the failure of a systemically important institution. These funds are subject to strict regulation by the SEC and are billed as having a stable asset value - a dollar invested will always return the same amount. But when a major prime MMF "broke the buck" - lost money - the event sparked sharp withdrawals across the entire prime MMF industry. Those withdrawals resulted in severe liquidity pressures, not only on prime MMFs but also on financial and non-financial companies that relied significantly on MMFs for funding. The vulnerability of MMFs to breaking the buck and the susceptibility of the entire prime MMF industry to sharp withdrawals in such circumstances remains a significant source of systemic risk.

We believe that the SEC should strengthen the regulatory framework around MMFs in order to reduce the credit and liquidity risk profile of individual MMFs and to make the MMF industry as a whole is less susceptible to runs.

Resolution Authority

As I discussed on Tuesday, we must create a resolution regime that provides authority to avoid the disorderly liquidation of any nonbank financial firm whose disorderly liquidation would have serious adverse effects on the financial system or the U.S. economy.

Please note that the draft resolution legislation we have submitted is a first step intended to address a significant void in today's regulatory structure. This mechanism is intended to be a permanent authority and therefore, will also be a critical element of Treasury's broader regulatory reform proposals. As we move forward on those proposals, we will need to align the draft legislation with the broader regulatory reform effort as it develops. At this point, however, I will focus on how the authority and mechanism would work within our current regulatory framework.

We must cover financial institutions that have the potential to pose systemic risks to our economy but that are not currently subject to the resolution authority of the FDIC. This would include bank and thrift holding companies and holding companies that control broker-dealers, insurance companies, and futures commission merchants, or any other financial firm posing substantial risk to our economy.

Before any of the emergency measures specified could be taken, the Secretary of the Treasury, upon the positive recommendations of both the Federal Reserve Board and the FDIC and in consultation with the President, would have to make a triggering determination that (1) the financial institution in question is in danger of becoming insolvent; (2) its insolvency would have serious adverse effects on economic conditions or financial stability in the United States; and (3) taking emergency action as provided for in the law would avoid or mitigate those adverse effects.

The Treasury and the FDIC would decide whether to provide financial assistance to the institution or to put it into conservatorship/receivership. This decision will be informed by the recommendations of the Federal Reserve Board and the appropriate federal regulatory agency (if different from the FDIC). The U.S. government would be permitted to utilize a number of different forms of financial assistance in order to stabilize the institution in question. These include making loans to the financial institution in question, purchasing its obligations or assets, assuming or guaranteeing its liabilities, and purchasing an equity interest in the institution.

This authority is modeled on the resolution authority that the FDIC has under current law with respect to banks and that the Federal Housing Finance Agency has with regard to the GSEs. Here, conservatorships or receiverships aim to minimize the impact of the potential failure of the financial institution on the financial system and consumers as a whole, rather than simply addressing the rights of the institution's creditors as in bankruptcy.

Depending on the circumstances, the FDIC and the Treasury would place the firm into conservatorship with the aim of returning it to private hands or a receivership that would manage the process of winding down the firm. The trustee of the conservatorship or receivership would have broad powers, including to sell or transfer the assets or liabilities of the institution in question, to renegotiate or repudiate the institution's contracts (including with its employees), and to deal with a derivatives book. A conservator would also have the power to fundamentally restructure the institution by, for example, replacing its board of directors and its senior officers. None of these actions would be subject to the approval of the institution's creditors or other stakeholders.

The proposed legislation would create an appropriate mechanism to fund the appropriately limited exercise of the resolution authorities it confers. This could take the form of a mandatory appropriation to the FDIC out of the general fund of the Treasury (subject to all the restrictions on the use of appropriated funds, including apportionments under the Anti-Deficiency Act), and/or through a scheme of assessments, ex ante or ex post, on the financial institutions covered by the legislation. The government would also receive repayment from the redemption of any loans made to the financial institution in question, and from the ultimate sale of any equity interest taken by the government in the institution. The Deposit Insurance Fund will not be used to fund such assistance.

Conclusion

The President has made clear that we will do what is necessary to stabilize the financial system and restore the conditions for economic growth. Working closely with the Congress, we have moved quickly and with forceful action to help get people back to work and the economy growing again. With your help we are also moving to repair the financial system so that it works for, rather than against, recovery.

Comprehensive regulatory reform is critical to these efforts. In the coming days and weeks, we will continue to lay out the steps we must take to protect against systemic risk. We will also lay out a detailed framework for stronger rules to protect consumers and investors against fraud and abuse.

Next week I will join President Obama in London for the G-20 leaders meeting to build support - with the help of other interested nations and strengthened international bodies - for higher global standards for financial regulation.

We are a strong and resilient country. We came into the current crisis without the authority and tools we needed to contain the damage to the economy from the financial crisis. We are moving to ensure that we are equipped with both in the future, and in the process, that we modernize our 20th century regulatory system meet 21st century financial challenges.

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