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**Interim Assistant Secretary for Financial Stability Neel Kashkari
Testimony before the Senate Committee
on Banking, Housing and Urban Affairs**

Washington - Chairman Dodd, Senator Shelby, members of the committee, good morning and thank you for the opportunity to appear before you today. I would like to provide an update on the Treasury Department's progress implementing our authorities under the Emergency Economic Stabilization Act of 2008.

Every American depends on the flow of money through our financial system. They depend on it for car loans, home loans, student loans and household needs. Employers rely on credit to pay their employees. In recent months, our credit markets froze up and lending became extremely impaired.

The President asked Congress to move rapidly last month to grant the Treasury Department extraordinary authority to address this unprecedented situation. Congress, led by this Committee and others, recognized the threat frozen credit markets posed to Americans and to our economy as a whole.

The Treasury has moved quickly since enactment of the bill to implement programs that will provide stability to the markets and help enable our financial institutions to support consumers and businesses across the country. We are focused on applying the authorities you provided in ways that are highly effective and protect the taxpayer to the maximum extent possible.

Secretary Paulson is implementing the Department's new authorities with one simple goal - to restore capital flows to the consumers and businesses that form the core of our economy. To achieve this goal, Treasury is pursuing steps that are intended to help financial institutions remove illiquid assets from their balance sheets and to attract both private and public capital. Our programs are being designed to help financial institutions of all sizes so they can grow stronger and provide crucial funding to our economy.

Since the announcement of our capital purchase program, we have seen numerous signs of improvement in our markets and in the confidence in our financial institutions. While there have been recent positive developments, the markets remain fragile.

Implementation

I'd like to spend a few minutes outlining the steps we have taken to implement the EESA. In the three weeks since Congress passed the new law, we have accomplished a great deal on many fronts. We are

moving quickly - but methodically - and I am confident we are building the foundation for a strong, decisive and effective program.

As I have previously described, we have seven policy teams driving forward. They are making rapid progress:

1) Mortgage-backed securities purchase program: This team has made tremendous progress. We have announced that the Bank of New York-Mellon has been selected to serve as our master custodian. A Treasury team has been working with the Bank of New York to design the auction, identify which mortgage-backed securities to purchase and determine how best to reach thousands of potential bidders, quickly and effectively. This team is completing its review of more than 100 securities asset manager solicitations and expects to hire asset managers in the coming days.

2) Whole loan purchase program: This team is working with bank regulators to identify which types of loans to purchase first, how to value them, and which purchase mechanism will best meet our policy objectives. They also have made tremendous progress in reviewing over 100 whole loan asset manager proposals and expect to hire asset managers very soon.

3) Insurance program: We are establishing a program to insure troubled assets. On Friday, October 10 we submitted a request for comment to the Federal Register seeking the best ideas on structuring options for the insurance program. That request posted on Thursday, October 16 and responses are due by Tuesday, October 28. We already have received responses and expect to receive many more before the comment period closes. We will begin designing and establishing the program immediately.

4) Equity purchase program: On Tuesday, October 14, Treasury announced a voluntary Capital Purchase Program to encourage U.S. financial institutions to build capital to increase the flow of financing to U.S. businesses and consumers and to support the U.S. economy. Throughout the process of developing this comprehensive and effective program, we worked very closely with the four banking regulatory agencies.

Under the program, Treasury will purchase up to \$250 billion of senior preferred shares on standardized terms. The program is available to qualifying U.S. controlled banks, savings associations, and certain bank and savings and loan holding companies engaged solely or predominantly in financial activities permitted under the relevant law.

The minimum subscription amount available to a participating institution is 1 percent of risk-weighted assets. The maximum subscription amount is the lesser of \$25 billion or 3 percent of risk-weighted assets. Treasury intends to fund the senior preferred shares purchased under the program by the end of this year.

As Secretary Paulson noted on Monday, this is an investment. The government will not only own shares that we expect will result in a reasonable return, but also will receive warrants for common shares in participating institutions. And we expect all participating banks to continue to strengthen their efforts to help struggling homeowners avoid preventable foreclosures.

On Monday, October 20, Treasury announced a streamlined, systematic process for all banks wishing to access this program. We worked with the four banking regulatory agencies to finalize the application process. Qualified and interested publicly-held financial institutions will use a single application form to submit to their primary regulator – the Federal Reserve, the FDIC, the OCC or the OTS. These regulators have posted this common application form on their websites. We are working hard to finalize and publish the required legal documents so private banks can participate as well on the same economic terms as public banks.

The terms for this program are the same for all institutions that apply before the capital purchase program deadline of November 14, 2008. We have allocated sufficient capital, \$250 billion, so that all qualifying banks can participate. Therefore, it is important to note that Treasury will not implement this program on a first-come-first-served basis.

I would like to walk you through the application process, which we made very simple so that all banks can apply. To apply for the capital program, banks should review the program information on the Treasury website and consult with their primary federal regulator. They can go to the regional office of their primary federal regulator anywhere in the country, be it California, Kansas or Texas. After this consultation, the institution should submit an application to that same regulator. Treasury worked with the regulators to establish an evaluation process; this means that all regulators will use a standardized process to review all applications to ensure consistency.

Once a regulator has reviewed an application, it will send the application and its recommendation to the Office of Financial Stability at the Treasury Department. Treasury will give considerable weight to the regulators' recommendations and decide whether or not to make the capital purchase. All completed transactions will be publicly announced within 48 hours of execution, as per the requirements of the law. We will not, however, announce any applications that are withdrawn or denied.

5) Homeownership preservation: We have begun working with the Department of Housing and Urban Development and HOPE NOW to maximize the opportunities to help as many homeowners as possible, while also protecting taxpayers. We have hired Donna Gambrell, Director of the Community Development Financial Institutions Fund and former Deputy Director of Consumer Protection and Community Affairs of the FDIC, to oversee this effort and to serve as interim Chief of Homeownership Preservation. When we purchase mortgages and mortgage-backed securities, we will look for every opportunity possible to help homeowners.

6) Executive compensation: Companies participating in Treasury's programs must adopt the Treasury Department's standards for executive compensation and corporate governance, for the period during which we hold equity issued under this program. These standards generally apply to the chief executive officer, chief financial officer, plus the next three most highly compensated executive officers. We do not believe senior officers should be rewarded for failure. Treasury issued executive compensation guidelines on Tuesday, October 14, for three TARP programs:

A. Troubled Asset Auction Program- As prescribed by the Act, any financial institution that sells more than \$300 million of troubled assets to the Treasury via an auction would be prohibited

from entering into new executive employment contracts that include golden parachutes for the term of the program. Treasury released Treasury Notice 2008-TAAP regarding this restriction. Furthermore, under the Act, (1) the financial institution may not deduct for tax purposes executive compensation in excess of \$500,000 for each senior executive, (2) the financial institution may not deduct certain golden parachute payments to its senior executives and (3) a 20-percent excise tax will be imposed on the senior executive for these golden parachute payments. Treasury released I.R.S. Notice 2008-94 regarding these new tax rules.

B. Capital Purchase Program- Any financial institution participating in the Capital Purchase Program will be subject to more stringent executive compensation rules for the period during which Treasury holds equity issued under this program. The financial institution must meet certain standards, including: (1) ensuring that incentive compensation for senior executives does not encourage unnecessary and excessive risks that threaten the value of the financial institution; (2) required clawback of any bonus or incentive compensation paid to a senior executive based on statements of earnings, gains, or other criteria that are later proven to be materially inaccurate; (3) prohibition on the financial institution from making any golden parachute payment to a senior executive based on the Internal Revenue Code provision; and (4) agreement not to deduct for tax purposes executive compensation in excess of \$500,000 for each senior executive.

C. Programs for Systemically Significant Failing Institutions- The Treasury Department may have to provide direct assistance to certain failing firms on terms negotiated on a case-by-case basis. Treasury issued guidance for the executive compensation standards that will apply to the firms participating in such programs and their senior executives (Treasury Notice 2008-PSSFI). These standards are similar in all respects to the Capital Purchase Programs executive compensation standards described above, with one significant difference. In situations where Treasury provides assistance under the systemically significant failing institutions programs, golden parachutes will be defined more strictly to prohibit any payments at all to departing senior executives.

7) **Compliance**: Treasury is committed to transparency and oversight in all aspects of the program and has taken several important steps to meet the letter and spirit of our important compliance requirements.

A. Government Accountability Office: We have been meeting regularly with the Government Accountability Office to monitor the program. In addition, GAO is establishing an office at Treasury.

B. Financial Stability Oversight Board: The Financial Stability Oversight Board was established and the group selected the Chairman of the Federal Reserve Board to chair the group. While the law requires the Oversight Board to meet once a month, the Board had its second board meeting only six days later, on Monday, October 13 to review the Capital Purchase Program. The Board met again on Wednesday, October 22 to review progress of the TARP work-streams, as well as

to appoint staff to the Board, including William Treacy as Executive Director, Kieran J. Fallon as General Counsel, and Jason A. Gonzalez as Secretary.

C.Special Inspector General: The Administration is working to identify and interview potential candidates to serve as Special Inspector General for potential nomination and confirmation in November. In the interim, Treasury's Inspector General has been monitoring our progress.

Recruitment

Recruiting the right people is essential to the success of this program and we continue to move quickly. It will obviously take time to bring on board permanent members of the team that will manage this program over the long term and provide stability during the transition. While the permanent team is being identified for tomorrow, we are tapping the very best, seasoned, financial veterans from across the government to help launch the program today. We have been successful in recruiting outstanding interim leaders for key positions in the Office of Financial Stability and the team continues to grow daily.

Procurement

Now, let me turn to procurement.

Our approach to procurement is based on the following strategy. First, in order to protect the taxpayers, we will seek the very best in private sector expertise to help execute this program. Second, to the extent possible, opportunities to compete for contracts and provide services should be available to small businesses, veteran-owned businesses, and minority and women-owned businesses. Third, we are taking appropriate steps to mitigate and manage conflicts of interest.

We have established formal procurement processes, to ensure that selections are fair and in the best interest of the taxpayers. In many cases, we have established expert review panels, comprised of Treasury employees, employees of other federal agencies and expert consultants who review submissions and make recommendations regarding the quality of the proposals. The review committees make recommendations for a final decision to a senior career officer in the Treasury.

As announced, Treasury has retained: The Bank of New York Mellon as our lead custodian; EnnisKnupp as our investment adviser; Simpson, Thacher and Bartlett as our legal adviser for the equity program; Pricewaterhouse Coopers and Ernst & Young for internal control and accounting services. In the coming weeks we expect to issue additional procurement requests.

Taking aggressive steps to manage conflicts of interest is essential because firms with the relevant financial expertise may also hold assets that become eligible for sale into the TARP or represent other clients who hold troubled assets. Firms competing to provide services must disclose their potential conflicts of interest and recommend specific steps to manage those conflicts. Treasury's review team evaluates firms' conflicts and their plans and ability to impose procedures to manage them. Treasury will only hire firms when we are confident in our and their ability to successfully mitigate any conflicts. Furthermore, the Office of Financial Stability has a Chief Compliance Officer who will be responsible for making certain that firms comply with agreed upon mitigation procedures.

Secretary Paulson and I believe that it is essential that the TARP be structured in a manner that encourages participation of small businesses, veteran-owned businesses, and minority and women-owned businesses. We asked vendors to demonstrate their ability and commitment to working with small, veteran, minority and women-owned businesses as sub-contractors. And we are evaluating their submissions in part on their capability to do this. In addition, we announced on Friday, October 17 subsequent guidelines for solicitations with specific opportunities for these businesses.

As you can see, we have accomplished a great deal in a short time. But our work is only beginning. A program as large and complex as this would normally take months - or even years - to establish. We don't have months or years. Hence, we are moving to implement the TARP as quickly as possible while working to ensure high quality execution.