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THE MAN IN THE MIDDLE OF THE TARP:
A DISCUSSION WITH TREASURY'S NEEL KASHKARI

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PARTICIPANTS:

Introduction and Moderator:

MARTIN NEIL BAILY

Senior Fellow, Economic Studies
The Brookings Institution

Featured Speaker:

NEEL KASHKARI
Assistant Secretary of the Treasury

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P R O C E E D I N G S

MR. BAILY: Good afternoon. I'm Martin Baily, and I would like to welcome everyone here to Brookings, and thank you for joining us.

This event today is part of our program of research at the Initiative on Business and Public Policy here at Brookings, which I direct. I'm very pleased to introduce the man who is quite literally in the middle of the effort to get America's financial markets back on track, Assistant Secretary of the Treasury, Neel Kashkari.

In October of last year, which to him and, indeed, to many of us may seem like a lifetime ago, Mr. Kashkari was asked to take the helm at the Office for Financial Stability, an office that was created to development, implement, and oversee all aspects of the $700 billion Troubled Asset Relief Program, or the TARP.

Since October, Treasury has established a number of programs under the TARP, including a significant capital purchase program for financial institutions, an order program, and a securitization program.

Mr. Kashkari joined the Treasury in July 2006, first, as a senior advisor to U.S. Treasury Secretary Henry Paulsen, and then, in

June 2008, he was confirmed as assistant secretary of the Treasury for International Economics and Development.

As the Wall Street Journal noted –- this was in a blog rather than in the paper –- he is the man with a $700 billion wallet. The move to overseeing the TARP essentially puts a new title on what Mr. Kashkari has been doing since he joined Treasury: examining the consequences of an economic housing fallout.

He recently submitted a report to Congress on progress on the rescue program, noting that it is "challenging at best, and it's difficult to track where individual dollars flow through an organization." He also asked for patience to all Treasury's capital injections to work their way through the financial system, and noted that with economic confidence low, the credit crisis is going to persist.

I know that there are many in this audience who are itching to ask questions, and there will, indeed, be an opportunity for Q and A after Neel talks.

Prior to joining the Treasury Department, Kashkari was a Vice President at Goldman, Sachs & Company. He came to Wall Street from an unconventional path. He was literally a rocket scientist helping to development technology for NASA.

And you probably thought that because you are speaking at Brookings, which is normally a sober institution, that this wouldn't come up, but I want to mention one fact about you. I understand you were featured in People magazine last month in an article entitled "Sexy A to Z."

(Laughter)

MR. BAILY: You were actually second on the list, so, you were B is for Bailout Guru, apparently. I'm sure you're tired of being ribbed about that, but I hadn't –- not being a regular reader of People, I hadn't seen that. So, if things do not work out in the financial sector, obviously, Hollywood is waiting for you to arrive.

Please join me in welcoming Assistant Neel Kashkari.

(Applause)

MR. KASHKARI: Good afternoon, and thank you, Martin, for that unique introduction.

(Laughter)

MR. KASHKARI: I would also like to thank the Brookings Institution for hosting us here today.

Today, I will provide a comprehensive update on the Treasury Department's progress in implementing the Troubled Asset

Relief Program, or TARP, and then spend some time taking your questions and having a discussion.

We are in a unprecedented period and market events are moving rapidly and unpredictably. We, at Treasury, have responded quickly to adapt to events on the ground. Throughout the crisis, we have always acted with the following three critical objectives in mind: One, to stabilize financial markets and reduce systemic risk. Two, to support the housing market by avoiding preventable foreclosures and supporting mortgage finance, and, three, to protect the taxpayers. The authorities and flexibility granted to us by Congress have been essential to developing programs necessary to meet those objectives.

Now, a program as large and complex as the TARP would normally take many months or even years to establish, but we did not have the luxury of first building the operation, then designing our programs, and then executing them. Given the severity of the financial crisis, we had to build the Office of Financial Stability, design our programs, and execute them all at the same time. We have made remarkable progress since the president signed the law only 97 days ago. Less than 100 days.

Today, I will brief you about five areas. First, I will give you an update on the execution of the programs Treasury has instituted under

the TARP. Second, I will review the progress we have made in building the Office of Financial Stability. Third, I will provide you an update on our efforts to meet the highest standards of compliance and oversight. Fourth, I will review the thorough reporting requirements we continue to meet. And, finally, I will update you on some of the measurements we look at to judge if our programs are having the desired effect.

I will begin with the Capital Purchase Program, or CPP. On October 14, Secretary Paulson announced that we would allocate $250 billion of the Financial Rescue Package for a voluntary Capital Purchase Program for healthy, viable banks of all sizes. The CPP was designed to first stabilize the financial system, and then, by increasing capital in our banks, restore confidence so credit could flow to our consumers and our businesses.

People often ask –- this is the most common question I get -- why are you investing in healthy banks? Shouldn't the TARP be used for failing banks? Healthy banks are in the best position to support their communities by extending credit. A dollar invested in a healthy bank is far more likely to be used to promote lending to credit-worthy borrowers than that same dollar given to a failing bank, who would more likely use it just to stay afloat.

It has been 86 days since Secretary Paulson announced the Capital Purchase Program. We started from scratch, recruited, and built a world-class team, designed the program details, hired necessary outside vendors, and implemented a complex, but efficient processing model. In that time, we have invested $178 billion in 214 institutions in 41 states across the country and Puerto Rico.

There is a huge demand for the program. The number of applications under review at the regulators is in the thousands, representing every state in the country, and hundreds more have already been pre-approved by Treasury.

We are very pleased with the large number of banks that have applied. The regulators are working diligently to get through their review and then forward recommended applications to us as quickly as they can. We expect their reviews to continue for several months. We continue to process applications quickly, but carefully, to ensure that our program guidelines and goals are met. Our investment committee meets virtually every day to review applications as soon as they are sent to us by the regulators, and we close transactions often within days of approval. In fact, we find that institutions need more time to complete their legal requirements than Treasury needs to execute the investments. Our work will not let up until the last application has been reviewed and processed.

Completing investments in more than 200 institutions across the nation in less than 90 days is a feat I believe is unmatched in the public or the private sectors. This progress is remarkable, not only for its speed and quality, but also for its scope. We have reviewed applications from every state in the country and touched almost every major banking market with applications from small and large banks alike, including community development financial institutions. The largest investment under this program has been $25 billion, and the smallest investment, less than $2 million, with applications for upcoming investments of a few hundred thousand dollars.

Now, let me shift gears. I will discuss Treasury's actions under the TARP to support the auto sector.

While the TARP was designed first and foremost to stabilize the financial sector, the legislation provided broad authority to act to stabilize the domestic auto industry. Absent Congressional action, no other authority existed in the federal government to stave off a disorderly bankruptcy of one or more auto companies. Treasury was forced to act to prevent a significant disruption of the auto industry that would pose a systemic risk to financial markets and negatively affect our economy.

Last week, Treasury began funding transactions under this program. We funded our full commitment of a $4 billion loan to Chrysler,

and we funded the first $4 billion of a $13.4 billion commitment to General Motors. The last $4 billion of which is depending on future congressional action.

The terms of these loans require the companies to move quickly to develop plans demonstrating long-term viability, and they also include significant taxpayer protection provisions.

Now, because the finance companies serve as the lifeblood of the automakers, we knew that our program would need to address the short-term needs of the auto finance companies, as well.

Last week, we funded a $5 billion investment in GMAC, and we also committed to an additional $1 billion loan to General Motors to be used to participate in a rights offering at GMAC as part of its recapitalization in becoming a bank holding company.

These financings were designed to use our limited remaining resources to address the participating companies' short-term needs, while providing them enough time to begin the hard work necessary with all stakeholders to achieve long-term viability.

Now, shifting to consumer finance, support of the consumer finance sector is a high priority for Treasury because of its fundamental role in fueling economic growth. Like other forms of credit, affordable

consumer credit depends on ready access to a liquid and affordable secondary market. In this case, the asset-backed credit markets.

The Federal Reserve is setting up a $200 billion program to support the consumer finance securitization markets. Specifically, credit cards, auto loans, student loans, and small business loans. Under the TARP, Treasury will provide $20 billion in this facility, which will enable a broad range of institutions to step up their lending and enable borrowers to get access to low-cost consumer finance and small business loans.

The facility might be expanded over time and eligible asset classes may be expanded to include, among others, commercial mortgage-backed securities, non-agency, residential, mortgage-backed securities, or other asset classes. Treasury and the Federal Reserve continue to make progress in establishing this facility, which we expect to become operational in February.

We also established an asset guarantee program under Section 102 of the law. This program provides guarantees for assets held by systemically significant financial institutions that face a risk of losing market confidence due in large part to a portfolio of distressed or liquid assets.

Treasury is exploring use of this program to address the $5 billion guarantee provisions of our recent agreement with Citigroup. And, as part

of our recent $20 billion investment in Citigroup, Treasury also established the Targeted Investment Program, the objective of which is to foster financial market stability. In an environment of high volatility and severe financial market strain, the loss of confidence in a major finance institution could result in a significant market disruption and threaten the financial strength of similar institutions. This investment in Citigroup includes important restrictions on execution compensation, corporate expenses, as well as provisions to protect the taxpayers.

Now, let me turn to our work to establish the Office of Financial Stability. We've made a lot of progress here.

I mentioned earlier that a program as large and complex as the TARP would normally take months or years to establish. And, given the severity of the crisis, we had to build the office, design our programs, and execute them literally all at the same time.

Recruiting excellent people was the first and most important part of successfully establishing the office. We started by tapping the very best seasoned financial veterans from across the government and the private sector to help launch the program. We were successful in quickly recruiting outstanding interim leaders for key positions in the office. In each case, the interim official was charged with, one, setting up the office, two, hiring permanent staff, three, operationalizing our programs, and,

four, identifying their permanent successor. That process has worked extremely well.

Today, we have almost 90 dedicated TARP staff, including full-time employees we have hired since the law was signed and experienced detailees we have recruited from across the government. In many cases, those detailees are choosing to become permanent members of the TARP team. And this does not include the numerous main Treasury employees who are spending most of their time working on the TARP. We also have a robust pipeline of outstanding new people joining the team each week, literally every day.

We have worked very hard to ensure the transition to the next administration is smooth. The only political position within the TARP is the assistant secretary position, my position. Almost all of the remaining positions are being filled by people who are planning to remain with the program after the transition. The next administration will inherit an Office of Financial Stability that is fully staffed and executing extremely well. We have worked very hard to make sure there would be continuity so that the program does not slow down.

As I previously mentioned, we have many applications to process for the Capital Purchase Program over the next several months. We have made sure the team is in place to see that work through. We

also have worked closely with GSA to acquire dedicate space for the entire team. We moved in this past Monday, and we expect the special inspector general to move to the same space in the next few weeks.

For a sense of the execution challenges this team has already successfully faced, consider that last week alone, our team closed $48 billion of transactions. We signed and funded over $15 billion in the Capital Purchase Program through multiple investments, we signed and funded a $20 billion investment in Citigroup, and a total of $13 billion to GMAC, GM, and Chrysler all in one week.

Now, let me turn to oversight and compliance.

Congressional committees of jurisdiction are the traditional bodies of oversight, and Treasury has participated in five congressional hearings on the TARP since the law was signed. You may have seen some of my hearings.

In addition, the Congress established four additional avenues of oversight. One, the Financial Stability Oversight Board, two, the special inspector general, three, the Government Accountability Office, and, four, the Congressional Oversight Panel.

I will briefly review Treasury's interaction with each body.

First, just days after the law was signed, we moved immediately to establish the Financial Stability Oversight Board, which

Chairman Bernanke from the Federal Reserve chairs. The law requires the board to meet once a month, but it has already met numerous times since the law was signed, with numerous staff calls between meetings, and we have posted the bylaws and minutes from the board meetings on Treasury's Web site.

Second, the law requires the appointment of a Senate-confirmed special inspector general to oversee the program. We welcomed the Senate's confirmation of Neil Barofsky as special inspector general. I meet weekly with Neil, the inspector general, and our staffs also meet regularly.

Third, the law calls for the GAO to establish a physical presence at Treasury to monitor the program.

Treasury provided workspace for our auditors within days of the president signing the law. I have participated in numerous briefings with the GAO, and our respective staffs meet almost daily to for program updates and to review contracts.

And, finally, the law called for the establishment of the Congressional Oversight Panel to review the TARP.

That oversight panel was recently formed. We had our first meeting on Friday, November 21, and our second meeting on Thursday, December 18. The Congressional Oversight Panel posed a number of

questions to Treasury, and we provided a detailed response, which we published on our Web site on December 31.

Now, shifting again, I will discuss reporting requirements in transparency.

Reporting results to the Congress and to the American people is a critical responsibility of the TARP. People need to see what we are doing, understand why we are doing it, and know the effects of our actions. The law defined numerous reporting requirements for the TARP, which I will briefly review here.

Treasury has met every single one of our reporting requirements on time, and we will continue to do so. All of our reports are posted on the Treasury's web site.

First, the law requires Treasury to publish a transaction report within two business days of closing every transaction. We have published 11 transaction reports so far.

Second, the law requires Treasury to publish a (inaudible 18:58) report to Congress within 7 days of each $50 billion commitment that is made. To date, Treasury has published 4 (inaudible) reports, including one this week.

Finally, the law requires Treasury to provide a detailed report on the overall program within 60 days of enactment and monthly

thereafter. We have published two reports so far, the most recent also this week.

Now, finally, the fourth topic I will address, the important issue of measuring results of our programs. People often ask: How do you know the programs are working? The most important evidence we have that our strategy is working is that we've stemmed a series of financial institution failures. The financial system is fundamentally more stable than it was when Congress passed the legislation, and while it is difficult to isolate one program's effects, given policymakers numerous actions, one indicator that points to reduced risk of default among financial institutions is the average credit default swap spread for the eight largest U.S. banks, which has declined by about 275 basis points since before Congress passed the law.

Another key indicator of perceived risk is the spread between LIBOR and OIS. The one month and three-month LIBOR-OIS spreads have declined about 202 and 147 basis points respectively since the law was signed, and by about 312 and 242 basis points respectively from their peak levels just before the Capital Purchase Program was announced.

People also ask: When will we see banks making new loans? Now, it is important to note that roughly $75 billion of the $250

billion Capital Purchase Program has yet to be received by the banks. Treasury is executing at rapid pace, as I indicated, but it will take some time to review and fund all of the remaining applications. The capital clearly needs to get into the system before it can have the desired effect.

In addition, we are still at a point of relative low confidence, both due to the financial crisis and due to the economic downturn. As confidence remains low, banks will remain cautious about extending credit and consumers and businesses will remain cautious about taking on new loans. As confidence returns, Treasury expects to see more credit extended.

People have then asked: How will you track lending activity? Treasury has been working with the bank and regulators to design a program to measure the lending activities of banks that have received TARP capital. We plan to use quarterly call report data to study changes in the balance sheets and intermediation activities of institutions we have invested in and compare their activities to a comparable set of institutions that have not received TARP capital investments.

Now, because call report data is fairly infrequent, we also plan to augment that analysis with a selection of data we plan to collect monthly from the largest banks we've invested in for a more frequent snapshot.

The increased lending that is vital to our economy will not materialize as fast as any of us would like, but it will happen much faster as a result of having used resources from the TARP to stabilize the system and increase the capital in our banks.

Now, while we have made significant progress, we recognize challenges lie ahead. As Secretary Paulson has said, there is no single action the Federal Government can take to end the financial market turmoil or the economic downturn, but the authorities Congress provided last fall dramatically expanded the tools available to address the needs of our system.

We are confident we are pursuing the right strategy to stabilize the financial system and support the flow of credit to our economy. We have worked around the clock to build the Office of Financial Stability, design our programs, and execute them, and we will hand the next administration a program that is staffed and fully operational.

Thank you very much, and I'd be happy to take your questions.

(Applause)

MR. BAILY: I know there are lots of questions, and I'm going to abuse my position by asking you one, and let me frame it the right way.

I know from bitter experience that explaining complicated economic issues is a real hard challenge. And David Ricardo explained the benefits of trade a long time ago, and, still, I think most Americans probably don't really understand well the issues.

But one of the challenges you faced and Secretary Paulson's faced has really been explaining what you're going to do, how it's going to help, how to measure its outcome, and you touched on that a fair amount in what you said, although, you also talked a lot about the process and hiring and good people and all that kind of thing.

Could you sort of address that challenge a little bit? Do you think that's a problem? Do you think it's just intrinsic to the situation or are there things that you would suggest maybe to President-Elect Obama or to Tim Geitner or Larry Summers that you've learned about how you can communicate to people the response to a situation like you're in now?

MR. KASHKARI: It's a huge challenge, there's no question. We began contingency planning, recognizing that there may come a time when the private markets would not be willing to provide the necessary capital to the financial system. And that contingency planning probably started a year ago around this time. And one of the key challenges was, once we would come up with a plan, how do you go to the American

people and to the Congress and ask for authority to intervene before a crisis has happened?

It's a communication challenge. A lot of people jump and point to the RTC and they say well, the RTC is the model. The RTC is nothing like this. The RTC was an institution set up after 1,000 institutions have failed to dispose of assets. It was not an intervention before a collapse. And, so, that was part of the challenge that we faced, is how can you go early?

Ultimately, in September, conditions got so bad, the crisis was right before us, Secretary Paulson and Chairman Bernanke went to the Congress. Nonetheless, so, even though the crisis was right before us, getting that passed was not trivial. We all know the House voted no the first time. And, even since then, some of the most basic messages that we've been trying to get out there, such as the Capital Purchase Program is for healthy banks, it's still hard to get that message out there, and, so, I don't have a good solution.

We want to stay on the message and keep repeating the message, work with the regulators, work with leadership in both Houses of Congress to try to get the message out there, but it's not easy, and these are very subtle, complex, economic ideas. And I think the American people did a great job embracing free trade by and large, embracing

letting the markets work. Now we're dealing with very subtle, complex, financial and economic issues. Communication, I think, is our biggest challenge.

Yes?

MR. BAILY: Could you wait for the mike and just identify yourself?

MR. CHASIN: Thank you very much, Mr. Kashkari. David Chasin, OMB Watch.

I've got a question I don't know that you've addressed yet.

You know that call reports on a broad range of banking institutions that have received TARP funds describe, as you say, viable banks of all kinds and national and local, but viability is a reasonably broad standard, and, so, some of these recipient institutions are weaker than others, and the difference, the disparity among them can be considerable, so, I would be interested in hearing from you your perspective on strategy.

And I'm not exactly using that term in the way that the Congressional Oversight Panel did when it, I think, asked in its first question: What is your strategy? Not looking at macroeconomic strategy, not even really looking at stability, but looking, strictly speaking, at the banking sector and the thoughts, the sectoral considerations that go into

determinations of which banking institutions should receive funds, with a view, I guess, toward what you regard, you and your colleagues regard, as the optimal outcome regarding the structure of the banking sector at the end of the day?

Thanks.

MR. KASHKARI: Okay. There's a lot there. Let me start by talking about viability and how we make the selection of whom to invest in in the Capital Purchase Program.

We worked very closely with the regulators in designing the program. Let me just take a second and explain how the process works. You may know this, but for everybody in the audience.

Banks that are interested in applying to the program submit an application for their primary regulator. OCC, OTS, FDIC, or Federal Reserve. They review the application and they review the reams of data they have on that institution and then submit a recommendation, they submit recommended applications to Treasury. We review the packet and make the ultimate determination. And banks that are close calls will go to a council of the four banking agencies for a peer review. They'll review the applications and then submit a combined proposal to Treasury.

Now, we said this is a healthy bank program. We want healthy banks across the country to apply to the program. And, as you said, there are different degrees of how healthy banks are.

We set the floor at viability. Banks must be deemed viable without government assistance to be eligible for the program. There's no one metric I can point to and say this is what viability means. Ultimately, it's the judgment of the regulators and Treasury who is viable and who isn't. And we think that the process has worked quite well.

Again, all four banking regulators collaborated with us in developing that standard, and they're all applying it quite uniformly across the four agencies. But viability, again, is a complex measurement, and we look at a lot of things from capital levels to their loan portfolios to regional concentrations to the management teams, et cetera.

All of that because the regulators in most cases have been regulating these institutions for years and they know these institutions much better than Treasury does, so, they're relying on all of their experience with that institution in coming up with their own recommendation of viability.

Now, in terms of long-term structure of the banking sector, we are not making these investments with some view of what the banking sector should look like in the future. This program is about putting more

capital into the banking sector for financial stability to increase confidence in the banking sector and ultimately to get credit flowing again to our communities across the country.

I think longer-term, structural questions around the banking sector need to be asked; longer-term, regulatory structural questions need to be asked and need to be debated.

Treasury has published, a year ago almost, a blueprint for modernizing the regulatory system a long-term vision of what the regulatory structure should look like. We're not trying to address those in the immediate using the TARP. The TARP is about stabilizing the financial system today so that we get through this period and then can much more -- at a much more measured pace ask the kinds of questions that you're asking and have a thoughtful debate.

MR. BAILY: To follow-up on that, can you say a little bit more about viability, what you mean? There may be a number of institutions that if you mark all their assets to market might look insolvent. Would you say that would mean they would be not viable or is viability something different than solvency at current prices?

MR. KASHKARI: Yes, we're not asking the regulators to go change their accounting treatments and apply the most extreme conditions against the balance sheets. We're asking them to look at and

we look at a whole range of metrics of the institutions, the history that the regulator has had with the institutions, their experience with the management team, CAMELS ratings, capital levels, everything that the regulator looks at to put together a package that ultimately is a judgment of what viability is.

And I'll tell you, cases that are on the margin, we are not shy about sending it back to the four regulators for the peer review, to the council. So, a lot of times regulators will send us an application directly saying we think this is clearly viable. We'll look at it and we'll say we're not so sure.

I've said this before; we don't want to invest in banks ultimately that are going to fail. That's not a good use of taxpayer resources. And, so, we're not shy about going back to the four regulators and saying listen, ask each other tough questions. Drill in. If you need to get more data, go get more data before coming to us with a joint recommendation.

MR. BAILY: Yes?

MR. SMITH: Bruce Smith, retired Brookings, now at George Mason University. I have two questions for you, sir.

One was I was rather struck by your initial conception of the troubled assets in the name of the program, and I'm not claiming I

understood it fully, but it seemed to offer the promise of establishing a price of starting the process of getting rid of these troubled assets, getting private investment in, and getting this off the books.

My first question is: Are we ever going to get back to that? And, if so, how and when?

Second question is it -– here, I may be on shaky ground, but I'm informed by some colleagues that an equity investment would have been better than preferred shares because a preferred share is something like a debenture in functional terms, and if it were an equity investment in a bank, this would help get the money out the door, and having to repay it and so on means that this contributes to banks sitting on those assets.

So, I wondered if you might be able to address those two questions.

MR. KASHKARI: Sure. So, to the first question about buying troubled assets versus injecting equity, let me talk about our decision-making process around that.

We had to converge on an asset purchase program sometime in the spring as our contingency planning continued, and as we went up to the Congress, we sized -– it was ultimately the judgment of Secretary Paulson and Chairman Bernanke that the $700 billion was their

judgment, the right size to go for in terms of being able to buy these assets relative to the sizes of their markets.

Now, I don't have the data with me, but, for example, if you looked at some of the metrics that I talked about, the liable OIS spread, and watched what happened over the course of September, just in the two weeks between when we went to Congress, they executed in rapid speed, passing the law in two weeks. Just in those two weeks, conditions deteriorated very quickly, much more quickly than we had anticipated, and in the two weeks following when the law was signed, conditions deteriorated even faster, they accelerated.

So, the judgment was made that we had to move to stabilize the system as fast as possible with as much dynamite as possible all at once, and, so, leading with a large Capital Purchase Program, obviously, as you know, a dollar of capital goes further than a dollar of asset purchases, given leverage balance sheets, and, so, leading with capital meant that we could take bolder action to stabilize the system, given the deteriorating market conditions.

So, that's why we ended up having to go and lead with capital.

Now, another key for an asset purchase program to be effective, it must be done in a very large scale. Once we concluded that

we need to allocate $250 billion of the 700 for capital and we had other programs that we saw were necessary in the very near future, the available resources for an asset purchase program became much smaller. Doing an asset purchase program in small scale isn't going to be a very good use of resources, so, I can't comment on if the next administration may want to go ahead with an asset purchase program. I would just recommend to them if they choose to do that, I can see the merits of it. It should also be done in a very, very large scale, number one.

Remind me of your second question.

MR. SMITH: Equity rather than preferred shares.

MR. KASHKARI: Sure. First of all, we worked very hard with the regulators to ensure that the preferred shares we were buying would qualify as Tier One capital. So, they are Tier One capital. That was key, to make sure that they would really be counted as equity first.

Second, we have a view –- we have a reluctance for the government to own interest in private enterprises across the country, and, so, owning a bunch of common stock is different than owning a bunch of preferred shares. We designed our program so that we don't have voting rights, and to the extent that we ever do get voting rights for various conversions, we would not exercise those voting rights. And, so, not only does buying preferred provide more protection for the taxpayers; it also

keeps the government one step further away from having its fingers in thousands of banks across the country, which we don't think is a good idea. And we also designed the preferred shares to be very attractive in terms of 5 percent dividend rate to encourage financial institutions, healthy banks from across the country to find the terms attractive and want to apply for the program.

MR. BAILY: Let me take some out of the back there.

Charlie? Can you use the mike?

MR. SCHULTZE: Sorry. Charlie Schultze, Brookings.

I want to get back to Martin's first question, which is kind of explaining what you're trying to do. I think TARP's been given a raw deal by people who say they really haven't got a flow of new capital or new lending going and the banks aren't lending this money. You explain that in terms of the fact your first job is to get financial stability, and I think there's some very good evidence that that was a good choice, a necessary choice.

In early October, the IMF reported that the potential losses just from mortgages alone in the global banking system, U.S. mortgages, was something in the order of $700 billion. With $700 billion lost out of the capital base because of these losses, the IMF said in the years from –- I may not get all the numbers right, but 2008 to 2013, there would be about

$10 trillion worth of deleveraging necessary of sale of assets -– this is around the globe –- sale of assets and/or just running off loans and not renewing them, which is a tremendous negative burden to be faced, and what, in fact, TARP presumably is doing is taking care of that first problem of making sure that not only did banks not make loans, that the necessity of getting their capital up or their assets down is going to mean a really big further hit on the economy in terms of credit tightening. And I would think that, while I don't quarrel with what you said, that there's a lot of evidence out there that would make a very good case for what you've done and that the problem still remains substantial and $250 billion isn't the end of the story at all.

MR. BAILY: So, you haven't been touting your own trumpet enough. Do you want to respond to that or?

MR. KASHKARI: Well, I agree with you.

(Laughter)

MR. BAILY: Maybe it should be more effectively that you need to do it, yes.

MR. KASHKARI: I mean, clearly, we didn't think that the Capital Purchase Program by itself was the whole answer. That's why we have other tools, not to mention one of the programs I mentioned, the asset-backed securitization facility, in addition to the deleveraging that you

talked about in the banking sector, the non-banking sector plays a vital role in our economy, as well. And with securitization frozen right now, it's putting even more pressure on the banking sector. So, we need to get the securitization markets working again and make sure our banks are in the position to not retrench and to continue lending.

So, I agree with you completely. I think that's why the next administration will find it important to use the full resources of the TARP, not just the first 350, and I think it's also important that the programs be designed to the extent that they can to encourage private capital to come in so it's not just the government and the taxpayers providing the necessary capital. We need all of the capital to come in to try to get through this. So, I couldn't agree more.

MR. BAILY: Doug?

MR. ELLIOTT: Thank you. It's Doug Elliott from Brookings.

There are now more demands on TARP and the other federal programs you've named, plus a number of potential programs that have been proposed. There are more demands on them than there are likely to be federal resources employed. So, choices are going to have to be made.

Do you have any advice about how to make those allocation decisions? In particular, the private sector, faced with investment

decisions such as that, looks at return on capital. Is there any kind of analog that would look at the public good compared to the risk being taken?

MR. KASHKARI: Sure. We think about that a lot. I mean, over the course of the past three months or so, my phone has rung off the hook from people around the country, businesses, community leaders, governors saying we have an institution or a community that needs help, and if we took the $700 billion and went out to the endpoints of everybody who needed help, it certainly wouldn't go far enough. And, so, our focus has been on the system as a whole, how do we stabilize the system to get credit flowing, and then once credit will flow, it will then flow out to everybody who needs it.

An analogy that somebody gave to me was think about a tree. You've got a tree trunk, you've got branches, you've got leaves. Stabilize the tree trunk to get credit flowing out to all of the branches as opposed to going out to each of the branches and leaves individually. That's a visual characterization. It's hard to quantify that, but that's, I think, how we think about it, and that's how I'd recommend to continue thinking about it. Think about dollar for dollar which part of the financial system will provide maximum benefit to the economy as a whole.

So, the banking sector, I've seen different measurements,

provides something like 60 percent of the credit in our economy, the non-banking, something like 40 percent. Different measurements are different. If you think about the asset-backed securitization facility, we focused on consumer to start in part because those are of a sufficient scale where we can really have an impact. We want to get the program up and running with these relatively smaller markets, show that the program works, and then, over time, potentially expand it to, for example, commercial mortgage-backed.

So, it's a triangulation of what can we solve, where can we make a real difference given the size of the market, how much of the economy is going to be benefited if we can get that piece of the market going? It's not an exact science, but I agree with the spirit of your question.

MR. BAILY: Okay, now, let's take at the back there. Peyton?

MR. YOUNG: Peyton Young, Brookings.

You've been very eloquent in saying how quickly and efficiently you move the funds to the institutions. How are you going to get them back? It would be very helpful to sort of understand if Treasury has in mind certain benchmarks of progress, benchmarks which would tell you okay, now it's time to cash out.

Can you say something about that?

MR. KASHKARI: Sure. It's something we've thought about clearly. It's not been our first priority because we don't think we're anywhere close to being ready to start monetizing or liquidating these investments.

I'll say one thing just to start. When we were negotiating the legislation, we were hesitant to set up a new government agency or a new bureau. We wanted this to be contained within Treasury because we thought that gave us the best chance that it would become a temporary program.

If you think about Fannie Mae, I like to point out that Fannie Mae was created -- one of four banking agencies in the Great Depression, Fannie Mae, FHA, Federal Home Loan Banks, and the Homeowner's Loan Corporation. Three of those four are still with us today, and serving an important role today, no question. We didn't want the TARP to become a new agency that would last for 100 years and then find a reason to keep buying new investments and keep the investments around.

So, first, that's how we structured the program, with an eye towards keeping it temporary.

We are in the process of reviewing and selecting equity asset managers to help us monitor our investments, help us make sure

that the banks are complying with their requirements under the contracts. At some point, they're also going to help us with the disposition strategy.

When is the right time to dispose of them and in what manner?

I don't think we're anywhere close to that. I mean, I think we need to see true financial market stability, see a return to normalcy in the credit markets before one could begin thinking about that. So, I think we're quite a ways off, but it is in our minds, and we are putting in place the programs to get us there, but we're not there yet.

MR. BAILY: I want to ask you one quick question myself.

Under the rules, certain financial institutions basically banks can qualify for TARP funds and others can't. That's created an incentive for non-bank financial institutions to buy banks or affiliate with banks or turn themselves into banks, and that sometimes seems a little nutty.

Do you have any comment on that? Are you concerned about that incentive to -– it sort of jumbles up the financial system to have non-banks suddenly wanting to move just so they can get access to the money?

MR. KASHKARI: Yes. We certainly watched it very, very closely and carefully, and there's been a lot of noise about it. It actually happened, I think, in the end, less than I thought it would. Once it started

happening, we were a little bit nervous that there'd be a huge wave, and there really wasn't. They also had certain deadlines that they had to meet. The application period is now closed. So, I think it's less of an issue than it could have been.

Number two, we also wanted to make sure that nobody gamed the system, meaning buying a bank, getting the capital, then selling the bank. And, so, we put provisions in place that as long as we're an investor, they're going to maintain becoming a bank and being subject to federal bank supervision.

So, it's something we looked at. I'll tell you -- and government intervention was clearly not our first choice. Government intervention always has unintended consequences, and it creates unexpected incentives around the margins. So, I guess it's not surprising. I don't think it's as big a problem as we feared it could have been.

MR. BAILY: Okay. Yes?

MR. RAYPOWERS: Neil Raypowers –-

MR. BAILY: Could you get the mike?

MR. RAYPOWERS: Neil Raypowers, I'm unaffiliated.

Yesterday, Secretary Paulson's remarks addressed the future role of GSCs and specifically looked at credit risk, addressed credit

risk, and noted that effectively all of the three mortgage entities are currently explicitly guaranteed for all intents and purposes.

In your view, would you characterize the pricing, the risk pricing across all three programs as consistent, and do you believe that there should be a mechanism to adjust pricing to reflect changes in the levels of credit risk that prevail in the marketplace?

MR. KASHKARI: And, so, you're speaking of "the three" being Fannie, Freddie, and FHA? "The three?" You said "the three." Fannie, Freddie, and FHA?

MR. RAYPOWERS: Yes, Fannie, Freddie, and FHA.

MR. KASHKARI: I honestly don't know if the risk is being priced consistently across the three. We work closely with HUD, but I'm not close enough to FHA. I know in the past they have pushed hard for risk-based pricing to allow them the ability to adjust more granularly, and I don't think they have all of the tools, I don't believe they have all of the flexibility that they want.

So, honestly, I don't know the answer of whether or not the pricing is consistent across the three.

MR. RAYPOWERS: To the extent that pricing remains stable over the course of the crisis or it's not adjusted sharply, would you

agree that that effectively increases risk to government or increases the subsidy?

MR. KASHKARI: I guess it depends on what level it's set at. It could increase or it could be overpriced in times where the risk is lower. So, I just don't know.

MR. RAYPOWERS: Thank you.

MR. BAILY: Last question. Yes?

MR. BRUCE: Mr. Kashkari, Chris Bruce with BNA Bank.

I wondered if you could bring us up to date on Treasury efforts to spell out qualifications in the capital program for mutual firms, Subchapter S, and other corporate structures.

MR. KASHKARI: Absolutely. We have been doing a lot of work on this. I know it's been a point where people have been concerned. We have been doing a lot of work on this, and I'll share we have a term sheet that we're looking at working with the regulators on it to make sure that it actually works.

These are classes of banks, Subchapter S and mutuals, that are private institutions, but are not C corps, so, they don't qualify for the claim C corps term sheet that we've already put out there. These are complex structures where you can't just put in a new third party equity investor, so,

we've been working hard with lawyers, et cetera, to try to figure out a structure.

I think we're getting close, and we're working with the regulators to make sure that it both will meet the legal requirements of the type of institution, and also actually qualify as capital. It doesn't do them any good if doesn't qualify as capital. So, we're making progress on it. I don't have a date yet though.

MR. BAILY: Thank you very much.

MR. KASHKARI: Thank you.

MR. BAILY: We really appreciate Neel Kashkari coming and talking to us and making yourself available for questions. That was great. Terrific. Thank you. Thanks for coming.

(Applause)

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