Neel Kashkari Provides Update on the Implementation of the Troubled Asset Relief Program (TARP)

Following are remarks made by the U.S. Treasury's Interim Assistant Secretary Neel Kashkari at the Securities Industry and Financial Markets Association (SIFMA) Summit in New York City.

November 10, 2008

Good morning, and thank you for that kind welcome.

I am here today to provide a comprehensive update on the Treasury Department's progress in implementing the Troubled Asset Relief Program (TARP), which is a major component of the overall coordinated effort by the Federal Government to restore confidence in our financial system and ensure that credit continues to be available to consumers and businesses. In the past year, a number of complementary actions have been taken by the Administration, the Federal Reserve, and the financial regulatory agencies to maintain confidence in the viability and soundness of the U.S. financial sector.

This morning, I'd like to put a special emphasis on the Capital Purchase Program that Secretary Paulson announced 27 days ago on October 14. We at Treasury are in deep execution mode, launching and implementing a program that would typically take months or years to establish. Since the President signed the legislation creating the TARP, we have made tremendous progress on several fronts, but recognize that much more work remains to be done.

Today, I will brief you about five areas. First, I will discuss Treasury's progress implementing the Capital Purchase Program. Second, I will review some of the important developments in procuring essential services for the program. Third, I will describe how we have built up the leadership of the Office of Financial Stability and note a few of our recent critical additions to our team. Fourth, I will give you a detailed update on our important continuing work to meet the highest compliance requirements. And finally, I will briefly discuss our next steps.

However, before I start, I want to take a moment to discuss the actions we took today with American International Group (AIG) and how that relates to the TARP. The TARP's foremost purpose is to stabilize the financial system. We used TARP funds to purchase preferred stock in AIG, as part of a broader restructuring of their balance sheet, in coordination with the Federal Reserve. This action was necessary to maintain the stability of our financial system. In return, AIG must comply with stringent limitations on executive compensation for its top executives, golden parachutes, its bonus pool, corporate expenses, and lobbying. We recognize that the financial system remains fragile and we continue to stand ready to prevent systemic failures. We worked with the Congress to ensure the TARP included sufficient flexibility to do just this.

Implementation of the Capital Purchase Program

On Tuesday, October 14, Treasury announced a voluntary Capital Purchase Program (CPP), which we subsequently followed on October 20 with streamlined application guidelines. In developing this program, we worked closely with the four federal banking regulatory agencies with the following two policy objectives in mind. One, the CPP is intended to strengthen our financial system by increasing the capital base of a broad array of institutions. And two, the capital program aims to increase the flow of financing to businesses and consumers to support our economy.

Terms of the Capital Purchase Program

With these policy objectives in mind, let me describe the terms of the program. We designed the terms to be attractive to encourage broad participation, while also including important taxpayer protections.

Under the program, Treasury will purchase up to $250 billion of senior preferred shares on standardized terms, including a 5 percent dividend for five years, which then increases to 9 percent. The Capital Purchase Program is available to a broad array of financial institutions of all sizes- including qualifying U.S. controlled banks, savings associations, and certain bank and savings and loan holding companies.

We have allocated sufficient capital, $250 billion, so that all qualifying banks, potentially thousands, can participate. Therefore, it is important to note that Treasury will not implement this program on a first-come-first-served basis; there is enough capital allocated for all qualifying institutions.

The terms for this program are the same for all institutions that apply before the program deadline of November 14. 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 November 14 deadline will be extended for private banks so they have time to apply.

The minimum subscription amount available to a participating institution is 1 percent of risk-weighted assets. The maximum subscription amount in this program is the lesser of $25 billion or 3 percent of risk-weighted assets.

The funds we deploy in this program are an investment for taxpayers. The government will not only own shares which we expect to yield a reasonable return, but will also receive warrants for common shares in participating institutions. These warrants allow the taxpayer to benefit from any appreciation in the market value of the institution.

We have designed important features into the Capital Purchase Program to help ensure our policy objectives of strengthening the financial system and facilitating the availability of credit are met. First, we barred any increase in dividends for three years. Second, we restricted share repurchases. Increasing dividends or buying back shares would undermine our policy objective by taking capital out of the financial system. Some people have suggested that we should have barred dividends altogether. But this would have made private investments in our financial institutions less attractive. We want to encourage private capital to flow into the financial sector.

The program also has requirements to meet the guidelines set out by Congress in the law on executive compensation. Institutions that sell shares to the government under the program accept restrictions on executive compensation during the period that Treasury holds equity. Details of these executive compensation requirements are listed on the Treasury website.

Linkages to Increased Bank Lending

As Secretary Paulson explained, this program has the objectives of strengthening the financial system and increasing credit to our economy. A stronger capital base, especially for healthy banks, provides them with additional capacity to lend. They can provide loans to new or existing customers. Notably, healthy banks that take advantage of this program can now service clients that impaired banks, constrained by insufficient capital, cannot. We've already heard from regional banks who have applied to the program and plan to use the funds to take on new borrowers. To many banks, this is just common sense.

In addition, the financial incentives to make new loans are both strong and clear. A bank's return on capital will decrease if it simply hoards the additional equity. Its shareholders will demand that the bank put the capital to the best use possible or watch their returns suffer.

Application Process

Let me now outline the application process for the Capital Purchase Program.

On Monday, October 20, Treasury announced a streamlined, systematic process for all publicly owned banks wishing to access this program. We worked with the four banking regulatory agencies to finalize the application process.

There is a common application form that all qualified and interested financial institutions use to submit to their primary regulator – the Federal Reserve, the FDIC, the OCC or the OTS. This common application form is available on the websites of all the regulatory agencies.

As a first step to applying for the program, banks should review the information on the Treasury website and consult with their primary federal regulator. They can go to the regional office of their primary regulator anywhere in the country, be it California, Kansas or Texas. After this consultation process, the institution should submit an application to that same regulator.

Evaluation Process

Treasury worked closely with the banking regulators to establish a standardized evaluation process; this means that all regulators will use the same standards to review all applications to ensure consistency.

Once a regulator has reviewed an application, it will take one of the following three actions:

1. For applications it does not recommend, it may encourage the institution to withdraw the application.

2. For applications it strongly believes should be included in the program, it directly sends the application and its recommendation to the TARP Investment Committee at the Treasury Department.

3. For cases that are less clear, the regulator will forward the application to a Regulatory Council, made up of senior representatives of the four banking regulators for a joint review and recommendation. Treasury is an observer on the Council. The Regulatory Council will make a joint recommendation of either withdrawal or approval.

The Treasury TARP Investment Committee reviews all recommendations from the regulators. This committee includes our top officials on financial markets, economic policy, financial institutions, and financial stability, as well as the Chief Investment Officer for the TARP, who chairs the Committee.

This is a Treasury program and Treasury makes the final decision on any investments. However, the Investment Committee gives considerable weight to the recommendations of the banking regulators. The Investment Committee is an advisory committee which makes recommendations to the Assistant Secretary for Financial Stability who makes the final decision on preliminary approval. In some cases, the Committee will send the application back to the primary regulator for additional information, or even remand it to the Regulatory Council for further review. At the end of the evaluation process, Treasury notifies all approved institutions.

Institutions then have 30 days to complete the required documents before we fund the transaction. All completed transactions will be publicly announced within two business days of execution, as required by the law. We will not, however, announce any applications that are withdrawn or denied.

We recognize that, in some cases, participating banks will need shareholder approval before completing the preferred stock investment. Moreover, the operational and processing complexity of executing hundreds or even thousands of these transactions is extraordinary. As such, we have brought-in the requisite expertise and are setting up a formal transaction processing model to ensure high quality and rapid execution. We have asked our master custodian, the Bank of New York Mellon, to handle much of the document management. In addition, we have engaged two outside law firms to help manage and close individual transactions. Senior Treasury staff oversee all aspects of the program. Any questions about the application process should be directed to the regulators.

Capital Deployed

While Treasury kicked off the program by signing final agreements with nine large financial institutions, we are now working diligently with the federal banking agencies to process applications from hundreds of other institutions. We have granted preliminary approval to a number of them.

Each transaction includes execution of at least three documents: a stock purchase agreement; a certificate of designation; and a warrant purchase agreement.

People often ask when we will see banks making new loans. First, we must we must recognize that less than half the money is out the door. Given the complexity of executing these numerous transactions, it will take a few months to complete all of these investments. Second, although progress has been made in the last month, our capital markets remain fragile and confidence is still shaky. As confidence returns to our institutions and our markets, we believe banks will put this capital to use by extending loans to creditworthy businesses and consumers. The last thing we want, however, is to encourage banks to resume the poor lending practices that are the cause of the current economic problems.

Procurement

Now, let me turn to the procurement of services to support the TARP.

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, we believe, to the extent possible, everyone should have a right to compete for these contracts, especially small businesses, veteran-owned businesses, and minority and women-owned businesses. Third, we are taking appropriate steps to mitigate potential conflicts of interest.

Since our last detailed update, we have hired several firms to assist execution of the programs:

- **Accounting Services**: We solicited six firms off GSA Federal Supply Schedule and awarded a contract to Ernst & Young.

- **Accounting Internal Controls Support**: We again solicited six firms off GSA Federal Supply Schedule and awarded a contract to PricewaterhouseCoopers.

- **Legal Services for review of documents under the CPP**: We solicited five firms off GSA Federal Supply Schedule and awarded Blanket Purchase Agreements to: Hughes, Hubbard & Reed and Sanders & Dempsey.

- **Human Resources Support**: We solicited four firms off GSA Federal Supply Schedule and awarded a contract to Lindholm & Associates.

On Friday, November 7 we published a new notice for financial agents to serve as asset managers for the equity, warrants and senior debt issued to the Treasury by financial institutions participating in the CPP. This solicitation is open to all entities that meet minimum qualifications and responses are due within six days on Thursday, November 13 at 5pm. We set the minimum requirement at $100 million in assets under management to ensure that all qualifying small, veteran, minority and women owned businesses may respond. Finally, all of our completed contracts and financial agency agreements are available on the Treasury website.

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. While the permanent team is being identified for tomorrow, we are tapping the very best, seasoned, financial veterans to help launch the program today and provide stability during the transition. We have been successful in recruiting outstanding interim leaders for key positions in the Office of Financial Stability. In each case, the interim official is charged with: One, setting up the office; two, hiring permanent staff; three, operationalizing our programs; and, four, identifying their permanent successor.

The team is growing daily and the team members are too numerous to name individually. However, I want to highlight a few of our key interim leaders we have added in the last few weeks:

- **James Lambright**, Chairman and President of the Export-Import Bank, has joined as our interim Chief Investment Officer. At Ex-Im since 2001, Jim brings both public and private sector experience underwriting and executing multi-billion dollar deals, including invaluable expertise in real estate banking at Credit Suisse.

- **Don McLellan** is serving as our Capital Purchase Program Manager. He previously worked at Motorola, where he served as the Senior Vice President for M&A and strategy. A transactional attorney by training, Don has 18 years of experience managing large, complex corporate transactions, including mergers and acquisitions, private equity investments, financings, corporate restructurings and IPOs.

- **Howard Schweitzer** is serving as interim Chief Operating Officer. He brings in-depth knowledge of government operations and financial transactions to the TARP team. Since 2005, Howard has been senior vice president, general counsel and a member of the senior management committee of the Export-Import Bank.

These leaders round out what I call our “Joint Chiefs” – which include previously announced management personnel. These leaders are actively building out their operations and contributing to all phases of the TARP. The Office of Financial Stability now has about forty dedicated personnel and will need to expand further to ensure high quality execution.

Compliance

Let me now turn to compliance. We are committed to transparency and oversight in all aspects of the program and continue to take strong action to make sure we comply with the letter and the spirit of the requirements established by the Congress. We want to inform the public as much as possible about our operations, so we have posted an abundance of information on the Treasury website to allow everyone to have insight into our actions.

First, we moved quickly to establish the Financial Stability Oversight Board. The law required the first board meeting to take place within fourteen days and then meet monthly thereafter. Again, we moved rapidly and the new Oversight Board met within four days and has met four times in the five weeks since the President signed the law, including just yesterday to discuss the AIG investment.

Second, Treasury staff continues to meet regularly with both the Government Accountability Office, who has an on-site presence at Treasury, as well as Treasury's Inspector General. A search is underway to identify a permanent Special Inspector General for this program.

Third, on October 29, we released transaction reports for the first nine investment commitments we made under the Capital Purchase Program. The law requires such disclosure within two business days of entering into such a commitment. Last week, on November 4, we submitted the first Tranche Report to Congress, which is required by law within seven days of committing each $50 billion. The report we submitted covered the first $125 billion that we committed under the CPP. We will issue additional reports when further commitments are made and thresholds are crossed.

As you can see, Treasury is committed to an open and transparent program with appropriate oversight. We look forward to continuing to brief the Oversight Board, the Inspector General, the Comptroller General, and the Congress as we set up and execute this program. Transparency will not only give the American people comfort in our execution, it will give the markets confidence in what form our action will take.

Next steps

Since the announcement of our Capital Purchase Program, and the coordinated actions with the Federal Reserve and FDIC, we have seen numerous signs of improvement in our markets and in the confidence in our financial institutions. For example, the average credit default swap spread for the eight largest U.S. banks has declined almost 245 basis points since before Congress passed the law. One month LIBOR has declined 243 basis points and three month LIBOR has dropped 192 basis points.

Nonetheless, while there have been recent positive developments, our markets remain fragile.

We have accomplished a great deal in a short period of time. But our work is only beginning. As I previously described, the operational scale and complexity to execute hundreds or even thousands of investments in banks across the country is extraordinary. It will take months to fully execute and fund all of these transactions. We are working around the clock to make it happen quickly while ensuring high quality execution. We intend to keep the incoming Administration fully apprised of our initiatives so that there is smooth transition as the leadership of the Treasury changes hands.

Our goal is to use the TARP to attack the root cause of the financial market turmoil, so American families and businesses can get the credit they need. This is Secretary Paulson's highest priority.

We will continue to provide you with regular updates on our progress. Thank you.

# # #