AN EXAMINATION OF THE EXTRAORDINARY EFFORTS BY THE FEDERAL RESERVE BANK TO PROVIDE LIQUIDITY IN THE CURRENT FINANCIAL CRISIS

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AN EXAMINATION OF THE EXTRAORDINARY EFFORTS BY THE FEDERAL RESERVE BANK TO PROVIDE LIQUIDITY IN THE CURRENT FINANCIAL CRISIS

Tuesday, February 10, 2009

U.S. HOUSE OF REPRESENTATIVES,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The committee met, pursuant to notice, at 1:01 p.m., in room 2128, Rayburn House Office Building, Hon. Barney Frank [chairman of the committee] presiding.

Members present: Representatives Frank, Kanjorski, Waters, Maloney, Watt, Sherman, Meeks, Moore of Kansas, Capuano, Hinojosa, Clay, Baca, Lynch, Miller of North Carolina, Scott, Green, Cleaver, Bean, Moore of Wisconsin, Hodes, Ellison, Wilson, Perlmutter, Donnelly, Foster, Carson, Speier, Minnick, Adler, Kilroy, Driehaus, Himes, Peters, Maffei; Bachus, Castle, Royce, Lucas, Paul, Manzullo, Jones, Biggert, Capito, Hensarling, Garrett, Barrett, Neugebauer, Price, McHenry, Marchant, McCotter, McCarthy of California, Posey, Jenkins, Lee, and Paulsen.

The CHAIRMAN. The hearing will come to order.

This is a very important hearing because it will begin the public discussion of the extraordinary powers granted to the Federal Reserve by a statute passed in the depths of the depression 60—77 years ago, which had not been used very much. As the Chairman of the Federal Reserve points out in his statement, it was not much used, and maybe not at all from the 1930's to recently. And I will tell you, I was surprised myself to learn about it, having been on this committee for some time, and having been chairman since January of 2007.

In September of 2008, what we were aware of is, first, under the Bear Stearns case, $29 billion seemed like a lot of money for the Federal Reserve to have at its disposal; those were the good old days. In September, the Chairman of the Federal Reserve, accompanied by the Secretary of the Treasury, Mr. Paulson, asked to meet with the congressional leadership, myself, the gentleman from Alabama, Mr. Bachus, and our Senate committee counterparts. And we were told that it was the intention of the Federal Reserve, with the full support of the Administration, to make $80 billion available for the insurance company AIG.

I remember at the time saying to the Chairman, "Do you have $80 billion?" And his answer was, "Well, we have $800 billion." And that is when many of us for the first time understood the full scope of this statute. I say that because there have been some questions raised about how did this happen and what has been the public discussion. People should understand that almost all of this money, I guess Bear Stearns began it, but almost all of this money that has been made available under this authority from the 1932 statute dates from late September to October. So much of the time, of course, is when we were out of session.

Now that we are back in session, it did seem to me, and I have talked to my colleagues on the Republican side, that it was important to begin a public discussion of this from several angles. First of all, there was a great deal of interest in how the Federal Reserve has used that authority, how much money has been deployed, what are the criteria, to what extent are taxpayers at of risk for losing money here. It is an ongoing effort.

I read just before coming here the Secretary of Treasury, the new Secretary of the Treasury's announcement of his plans to use the TARP funds. It is very clear that the Obama Administration, as did the Bush Administration, is using the money in the TARP program in conjunction with the lending authority of the Federal Reserve. That is, the TARP money is going further than it otherwise might because the Federal Reserve has its capacity to lend very much involved.

So we have the questions of how things have been deployed and what the plans are for the future. There are also some important questions involving the way in which we govern ourselves. The Chairman of the Federal Reserve, indeed, the Federal Reserve system, I believe was responding to very real needs in this society, and people need not agree with every specific decision that the Federal Reserve made, it seems to me, to appreciate the sense of very important public purpose that has motivated them. This has all been done in the interest of avoiding further damage to the economy and a credit collapse.

We are now still dealing with that crisis. And I am myself opposed to doing things that might hinder our ability to continue to cope. Going forward though, it does not seem to me healthy in our democracy for the amount of power that is lodged in the Federal Reserve with very few restrictions to continue. And I say that in no way meaning to criticize the Federal Reserve. Nobody currently in the Federal Reserve was there when they passed the 1932 statute. The responses of the Federal Reserve, I believe, have been motivated by a desire to stem further bumps in the economy. I think much of what they have done has been useful. I think the authority has been very responsibly wielded. And in the midst of crisis, we would not, I think, be wise to revise it.

But going forward, the allocation of responsibilities between Treasury and the Federal Reserve is a very important one. And the question of how, in a self-governing society, you allocate these responsibilities is important.

There are some who have said—including the Heritage Foundation—a while ago that they liked the fact that the Federal Reserve had this authority rather than the TARP, precisely because the Federal Reserve was so much more insulated from public opinion, and from electoral processes. I understand the desire that some have to diminish the electoral intervention, but ultimately in a democracy that is not, I think, an appropriate way to go. Certainly not with this degree of power.

So those are the questions we will be discussing not just today, but on into the future. The gentleman from Alabama.

Mr. BACHUS. Thank you, Mr. Chairman. And welcome, Chairman Bernanke.

When historians look back at the financial crisis and the ensuing economic evil of the last half of the first decade of the 21st Century, what will be the story line? I submit it will be that while the public was focused on the tax rebate program, then on the $700 billion TARP, and finally on the $100 trillion economic stimulus package, a much larger drama was unfolding below the surface. While the public was distracted and focused on these high-profile activities and events, other programs and activities, some 5 times larger than those debated and discussed in open forums, were being enacted by a select few unelected Federal regulators who were making commitments of trillions of dollars backed by taxpayer guarantees and loans. Perhaps much like the analogy of an iceberg, only the tip of which is visible, the public, and we as elected representatives, are left merely to speculate as to the exact nature and composition of these complex financial transactions, which have been made and entered into out of public view.

By using an obscure and seldom utilized provision of the Federal Reserve Act of 1913, the Federal Reserve, with Treasury's cooperation, has made unprecedented interventions into the financial markets. Not only has there been no disclosure or little oversight or accountability, there has actually been an active resistance on the part of these agencies to explain their actions or disclose the terms. At this time, because we know almost nothing about these transactions, we can only guess as to their ultimate success or failure.

In future years, I am sure those who write of these days will be intrigued and captivated by the question, how could such an unprecedented action have occurred without the consent of the government? In many of these transactions that have been undertaken so far, we have been told we could not be given the specifics or details or terms because it was proprietary information of the companies involved. We have been left to guess as to the terms, the conditions, the size in many cases, the results expected, the consequences, the criteria for eligibility, or even the identity of all the parties. What is unknown pales in comparison to what we know.

Perhaps of all the troubling aspects of these what I will call iceberg transactions, I am most troubled by what appears above the surface to be a total lack of guiding principles in entering these agreements and arrangements. This perception is only heightened by a series of ad hoc decisions and seeming policy reversals which gives an indication that there is, in fact, no detailed plan to navigate us through what we all agree are troubling times.

Let me close by suggesting a missing but essential guiding principle. I believe in a democracy it should be a requirement in any agreement or transaction involving the government. The principle is simple: In the event that our governing officials come to the conclusion that a commitment of public funds is necessary, if a commitment of taxpayer funds or guarantees cannot be disclosed because of the circumstances involved, it cannot and should not be made.

If a private party to a transaction not involving national security is unwilling to enter into an agreement open to public scrutiny and examination, the agreement should not be made. Thank you, Mr. Bernanke, and thank you, Mr. Chairman.

The CHAIRMAN. The gentleman from North Carolina is recognized for 3 minutes.

Mr. WATT. Thank you, Mr. Chairman. Using the authority of unusual and exigent circumstances under section 13(3) of the Federal Reserve Act, the Fed has set up emergency lending facilities to address severe market strains and commercial paper by activating a commercial paper funding facility to address severe strains related to money market funds by activating a money market liquidity facility and announced earlier today that it plans a substantial expansion of this term asset-backed security loan facility.

The use of each of these tools will, of course, expand the balance sheet of the Federal Reserve and subject the Fed to more attention, scrutiny, second guessing, and oversight, otherwise as the chairman has indicated we run the risk that the authority granted in the 1933 statute could be out of control or subject to abuse. The use of each of these tools also raises the question, what happens when the unusual and exigent circumstances are over? What is the exit strategy for winding down the various Fed lending programs when we return to normal economic times?

Today's review of the Fed's power under section 13(3) of the Federal Reserve Act is the first in a series of hearings and other actions that we must take to evaluate steps that certainly appear to be necessary to combat the current economic crisis that confronts us.

I trust that our evaluation will be transparent, open, and fair, and I certainly welcome Chairman Bernanke's testimony. I yield back.

The CHAIRMAN. The gentleman from Texas, Mr. Paul, for 3 minutes.

Dr. PAUL. Thank you, Mr. Chairman. I want to thank you for calling this hearing because the issue of transparency of the Federal Reserve System is something that is of crucial value to us. I rather enjoy the fact that the Federal Reserve has been in the limelight lately because that is the source of our problems, that is where the inflation comes from, and that is where the distortion comes from and that is where the malinvestment comes from, and it is a shame we do not know more about it. But I don't blame the Chairman of the Federal Reserve System for this, because it has already been quoted that 13(3) is in the law. So a lot of responsibility falls on us here in the Congress.

Also in Title 13, chapter 7 of subtitle 1, it says that the GAO has authority to audit the Federal Reserve Board, the Federal Reserve banks as well as the FDIC and the Comptroller of the Currency. It sounds good, except you go to the next paragraph and it says, except for you can't audit the Federal Reserve or any of these organizations for the things that matter, such as transactions with foreign banks, transactions with foreign governments, transactions with international banking organizations. We can't have real access to knowing what is happening at the discount window in detail as well as how reserves are used, as well as information in what really transpires at the FOMC.

The fact that we have information dribbling out to us, that is one thing, but for instance, in the last about 2 years, we have been denied the information that a lot of people consider rather important, and that is the total money supply. What is M3 doing? That for some of us, we think that is important. But it indicates that transparency is not always the goal.

The question we in the Congress have to ask is, why is it the Congress is so eager to give up their prerogatives and their responsibilities, whether it is foreign policy, or whether it is giving the Executive Branch the authority to go to war without the Congress saying much, or whether it is turning over the monetary system to somebody so they can operate essentially in secrecy and deal not with a few hundred billion dollars, like $800 billion, but tens of trillions of dollars when it adds up. And yet the Congress seems to do very little.

So if we are concerned about transparency, if we are concerned about what is happening with monetary policy, believe me, the code has to be changed. But I am delighted that the chairman of the Banking Committee is interested in this at least to put some pressure and we do get bits and pieces and dribbles of information. But as to why we turned over this tremendous power to actually run the economy, central economic planning through the manipulation of prices, the whole problem we are facing today is that the Treasury and the Congress and the Federal Reserve are trying to price things they are incapable of pricing. That is the toxic assets. The illiquid assets. So if we only allow the market to operate, we might clean up the mess we have brought upon ourselves.

Mr. KANJORSKI. [presiding] Thank you very much. Now, Chairman Bernanke, if you will be kind enough to give your presentation to the committee.

STATEMENT OF THE HONORABLE BEN BERNANKE, CHAIRMAN, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Mr. BERNANKE. Thank you. Chairman Frank, Ranking Member Bachus, and other members of the committee, I appreciate this opportunity to provide a brief review of the Federal Reserve's various credit programs, including those relying on our emergency authorities under 13(3) of the Federal Reserve Act. I will also discuss the Federal Reserve's ongoing efforts to inform the Congress and the public about these activities.

As you know, the past 18 months or so have been extraordinarily challenging for policymakers around the globe, not least for central banks. The Federal Reserve has responded forcefully to the financial and economic crisis since its emergence in the summer of 2007. Monetary policy has been especially proactive. The Federal Open Market Committee began to ease monetary policy in September 2007 and continues to ease in response to a weakening economic outlook.

In December 2008, the committee set a range of zero to 25 basis points for the target Federal funds rate. Although the target for the

Federal Reserve rate is at its effective floor, the Federal Reserve has employed at least three types of additional tools to improve the functioning of credit markets, ease financial conditions, and support economic activity. The first set of tools is closely tied to the central bank's traditional role of providing short-term liquidity to sound financial institutions.

Over the course of the crisis, the Fed has taken a number of extraordinary actions, including the creation of a number of new facilities for auctioning short-term credit to ensure that financial institutions have adequate access to liquidity.

In fulfilling its traditional lending function the Federal Reserve enhances the stability of our financial system, increases the willingness of financial institutions to extend credit, and helps to ease conditions in interbank lending markets, reducing the overall cost of capital to banks.

In addition, some interest rates, including the rates on some adjustable rate mortgages, are tied contractually to key interbank rates, such as the London Interbank Offered Rate or LIBOR.

To the extent that the provision of ample liquidity to banks reduces LIBOR, other borrowers will also see their payments decline. Because interbank markets are global in scope, the Federal Reserve has approved bilateral currency liquidity agreements with 14 foreign central banks. These so-called swap facilities have allowed these central banks to acquire dollars from the Federal Reserve that the foreign central banks may lend to financial institutions in their jurisdictions. The purpose of those liquidity swaps is to ease conditions in dollar funding markets globally. Improvements in global interbank markets in turn create greater stability in other markets at home and abroad such as money markets and foreign exchange markets.

The provision of short-term credit to financial institutions exposes the Federal Reserve to minimal credit risk, as the loans we make to financial institutions are generally short-term, overcollateralized, and made with recourse to the borrowing firm. In the case of the currency swaps, the foreign central banks are responsible for repaying the Federal Reserve, not the financial institutions that ultimately receive the fund. And the Fed receives an equivalent amount of foreign currency in exchange for the dollars that it provides to the foreign central banks.

Although the provision of ample liquidity by the central bank to financial institutions is a time-tested approach to reducing financial strains, it is no panacea. Today, concerns about capital, asset quality, and credit risk continue to limit the willingness of many intermediaries to extend credit, notwithstanding the access of these firms of central bank liquidity.

Moreover, providing liquidity to financial institutions does not directly address instability or declining credit availability in critical non-bank markets such as the commercial paper market or the market for asset-backed securities. To address these issues, the Federal Reserve has developed a second set of policy tools which involve the provision of liquidity directly to borrowers and investors in key credit markets. For example, we have introduced facilities to purchase highly-rated commercial paper at a term of 3 months and to provide backup liquidity for money market mutual funds.

In addition, the Federal Reserve and the Treasury have jointly announced a facility expected to be operational shortly that will lend against AAA rated asset-backed securities, collateralized by recently originated student loans, auto loans, credit card loans, and loans guaranteed by the Small Business Association. Unlike our other lending facilities, this one combines Federal Reserve liquidity with capital provided by the Treasury. If the programs works as planned, it should help to restart activity in these key securitization markets and lead to lower borrowing rates and improved access in the markets for consumer and small business credit.

This basic framework could also expand to accommodate higher volumes as well as additional classes of securities as circumstances warrant, and Secretary Geithner alluded to that possibility this morning.

These special lending programs have been set up to minimize credit risk to the Federal Reserve. The largest program, the commercial paper funding facility, accepts only the highest rated paper. It also charges borrowers a premium which is set aside against possible losses. As just noted, the facility that will lend against securities backed by consumer and small business loans is a joint Federal Reserve Treasury program. Capital provided by the Treasury from the Troubled Asset Relief Program will help insulate the Federal Reserve from credit losses and the Treasury will receive most of the upside from these loans.

The Federal Reserve's third set of policy tools for supporting the functioning of credit markets involves the purchase of a longer term securities for the Fed's portfolio. For example, we have recently announced plans to purchase up to $100 billion of the debt of the Government-Sponsored Enterprises, which include Fannie Mae, Freddie Mac, and the Federal Home Loan Banks, and $500 billion in agency-guaranteed mortgage-backed securities by mid-year. The objective of these purchases is to lower mortgage rates, thereby supporting housing activity in the broader economy.

The Federal Reserve is engaged in an ongoing assessment of the effectiveness of its credit. Measuring the impact of our programs is complicated by the fact that multiple factors affect market conditions. Nevertheless, we have been encouraged by the response to these programs, including the reports and evaluations offered by market participants and analysts. Notably, our lending to financial institutions, together with actions taken by other agencies, has helped to relax the severe liquidity strains experienced by many firms and has been associated with considerable improvements in interbank lending markets.

For example, we believe that the aggressive liquidity provision by the Fed and other central banks has contributed to the recent declines in LIBOR and is a principal reason that liquidity pressures around the end of the year, often a period of heightened liquidity strains, were relatively modest.

There is widespread agreement that our commercial paper funding facility has helped to stabilize the commercial paper market, lowering rates significantly and allowing firms access to financing at terms longer than a few days. Together with other government programs, our actions to stabilize the money market mutual fund industry have shown some measure of success, as the sharp withdrawals from funds seen in September have given way to modest inflows.

Our purchases of agency debt at MBS seem to have had a significant effect on conforming mortgage rates, with rates of 30-year fixed rate mortgages falling close to a percentage point since the announcement of our program.

All of these improvements have occurred over a period in which the economic news has generally been worse than expected and conditions in many financial markets, including the equity markets, have worsened.

We evaluate existing and perspective programs based on the answers to three questions: First has normal functioning in the credit markets been severely disrupted by the crisis? Second, does the Federal Reserve have tools that are likely to lead to a significant improvement in function and credit availability in that market? And are the Federal Reserve tools the most effective methods either alone or in combination with other agencies to address the disruption? And third, do improved conditions in the particular market have the potential to make a significant difference for the overall economy?

To illustrate, our purchases of agency debt and MBS meet all three criteria. The mortgage market is significantly impaired, the Fed's authority to purchase agency securities gives us the straightforward tool to try to reduce the extent of that impairment. And the health of the housing market bears directly and importantly on the performance of the broader economy.

Section 13(3) of the Federal Reserve Act authorized the Federal Reserve Board to make secured loans to individuals, partnerships or corporations, "in unusual and exigent circumstances," and when the borrower is, "unable to secure adequate credit accommodations from other banking institutions." This authority added to the Federal Reserve Act of 1932 was intended to give the Federal Reserve the flexibility to respond to emergency conditions. Prior to 2008, credit had not been extended under this authority since the 1930's. However responding to the extraordinary stressed conditions in financial markets the Board has used this authority on a number of occasions over the past year.

Following the Bear Stearns episode in March 2008, the Federal Reserve Board invoked section 13(3) to make primary securities dealers, as well as banks, eligible to borrow on a short-term basis from the Fed. This decision was taken in support of financial stability during a period in which the investment banks and other dealers faced intense liquidity pressures.

The Fed has also made use of the section 13(3) authority in its programs to support the functioning of key credit markets, including the commercial paper market and the market for asset-backed securities. In my view, the use of section 13(3) in these contexts is well-justified in light of the breakdowns of these critical markets and the serious implications of those breakdowns for the health of the broader economy.

As financial conditions improve, and circumstances are no longer unusual and exigent, the programs authorized under section 13(3) will be wound down as required by law. Other components of the

Federal Reserve's credit programs, including our lending to depository institutions, liquidity swaps with other central banks, and purchases of agencies and securities make no use of the powers conferred by section 13(3).

In a distinct set of activities, the Federal Reserve has also used the 13(3) authority to support government efforts to stabilize systemically critical financial institutions. The Federal Reserve collaborated with the Treasury to facilitate the acquisition of Bear Stearns by JPMorgan Chase & Company, and to prevent a failure of the American International Group or AIG. And we worked closely with the Treasury and the Federal Deposit Insurance Corporation to help stabilize Citigroup and Bank of America. In the cases of Bear Stearns and AIG, as part of a strategy to avoid impending defaults by the companies, the Federal Reserve made loans against polls of collateral.

Activities to stabilize systemically important institutions seem to me to be quite different in character from the use of section 13(3) authority to support the repair of credit markets. The actions that the Federal Reserve and the Treasury have taken to stabilize systemically critical firms were essential to protect the financial system as a whole. And in particular the financial risks inherent in the credit extended by the Federal Reserve were, in my view, greatly outweighed by the risk that would have been faced by the financial system and the economy had we not stepped in.

However, many of these actions might not have been necessary in the first place had there been in place a comprehensive resolution regime aimed at avoiding disorderly failure of systemically critical financial institutions. The Federal Reserve believes that the development of a robust resolution regime should be a top legislative priority. If specification of this regime were to include clear expectations of the Federal Reserve's role in stabilizing or resolving systemically important firms, a step we very much support, then the contingencies in which the Fed might need to invoke emergency authorities could be tightly circumscribed.

I would like to conclude by discussing the Federal Reserve's ongoing efforts to inform the Congress and the public about its various lending programs.

I firmly believe that central banks should be as transparent as possible, both for reasons of democratic accountability and because many of our policies are likely to be more effective if they are well understood by the markets and the public. During my time at the Federal Reserve, the FOMC has taken important steps to increase the transparency of monetary policy, such as moving up the publication of the minutes of policy meetings, and adopting the practice of providing longer-term projections of the evolution of the economy on a quarterly basis.

Likewise, the Federal Reserve is committed to keeping the Congress and the public informed about its lending programs and its balance sheet. For example, we continue to add to the information shown in the Fed's H.4.1 release, which provides weekly detail on the balance sheet and the amounts outstanding for each of the Federal Reserve's lending facilities. Extensive additional information about each of the Federal Reserve's lending programs is available online, as shown in the appendix to this testimony.

Pursuant to a requirement included in the Emergency Economic Stabilization Act passed in October, the Fed also provides monthly reports to the Congress on each of its programs that rely on the section 13(3) authorities.

Generally the Fed's disclosure policies are consistent with the current best practices of major central banks around the world. With that said, recent developments have understandably led to a substantial increase in the public's interest in the Fed's balance sheet and programs. For this reason we at the Fed have begun a thorough review of our disclosure policies and the effectiveness of our communication.

Today I would like to mention two initiatives. First, to improve public access to information concerning Fed policies and programs, Federal Reserve staff are developing a new Web site that will bring together in a systematic and comprehensive way the full range of information that the Federal Reserve already makes available, supplemented by new explanations, discussions and analyses. Our goal is to have this Web site operational within a few weeks.

Second, at my request, Board Vice Chairman Donald Kohn has agreed to lead a committee that will review our current publications and disclosure policies relating to the Fed's balance sheet and lending policies. The presumption of the committee will be that the public has a right to know, and that the nondisclosure of information must be affirmatively justified by clearly articulated criteria for confidentiality based on factors such as reasonable claims to privacy, the confidentiality of supervisory information, and the effectiveness of policy.

Thank you. I will be pleased to respond to your questions.

[The prepared statement of Chairman Bernanke can be found on page 67 of the appendix.]

The CHAIRMAN. Thank you, Mr. Chairman. I apologize, but there were multiple things going on, so I had to leave.

The first point I want to make—and I appreciate your talking about openness—is that one of the things that we do too little of, I believe, in our politics, in our government, is when people predict disaster, we don't go back and see whether or not the disaster occurred. And sometimes that can be helpful.

When Henry Gonzalez was the chairman of this committee, Mr. Greenspan was the head of the Federal Reserve, probably even before. I think he may have taken over when Mr. Volcker was Chairman. He pushed hard for more openness. Back then, in the 1980's, the results of the Federal Open Market Committee (FOMC) weren't published, I believe, until the next Open Market Committee. People had to guess how the Committee voted. The question of the minutes came up. The first response, sadly, of the Federal Reserve Chairman was to deny that there were minutes, then later they were found in a drawer and made public.

There were serious arguments made that the kind of openness that Henry Gonzalez was pushing for would undermine the conduct of monetary policy. Despite that, he was able to persuade the Fed to make these changes, probably out of fear that if they didn't do that, there would have been legislation which would have been, from their standpoint, a hardship, and zero negatives have resulted. In fact, I think you are better off today. I don't know what you think, but if we were still in a period where the FOMC voted, and people didn't know how they voted, the uncertainty and the ability that you have to influence the markets would have been greatly attenuated.

We had a previous hearing at which one of our colleagues, the gentleman from Florida, Mr. Grayson, asked Mr. Kohn, who I thought was an excellent witness, forthcoming, thoughtful—I congratulate Mr. Kohn on his performance as a witness in being constructive. But he said that he couldn't give information about who the recipients were. I hope in this study of openness that it will be completed quickly and that you will put a very severe test against these claims. Historic experience is that there was a tendency to claim damage when there isn't any.

Next, you know, we are in a very difficult political situation. We have this problem. We will talk about it again tomorrow. It is essential that we reinvigorate the credit system. We do not have the option of creating a whole new credit system. That means we have to work with the existing one. The problem is that there are a lot of people who are very angry at the people who are running the credit system, and we will have to do things that look like they are helping them or may be helping them, because there is no way to reinvigorate the system without that. But that creates a political climate where we have to be very, very careful.

Let me ask one of the important questions you touch on here, and that is the fear that you are insufficiently collateralized. The fear ranges from some people who believe that, given the deterioration of assets, with the best will in the world, it would be hard for you to be assured of that. There are others who think less highly of you than I do, who believe that this is some plot to enrich some bad people, but you are deliberately taking less collateral than you should. There are a whole range of opinions in between.

Please elaborate. You talk about this. We have had some experience with Bear Stearns, and the AIG experience does not appear to be as hopeful as some have thought, but what has been the experience to date with the collateral, and how much assurance can you give the American public that however much the money is, whatever the total is, you will be asked about that, how much of it is at risk, what loss can we reasonably expect to suffer?

Mr. BERNANKE. I thank you, Mr. Chairman.

I would like to maintain throughout this hearing a very clear distinction between the 95 percent of our balance sheet which is devoted to regular lending programs, such as lending to sound financial institutions or supporting the credit commercial paper facility, versus the other 5 percent of our balance sheet which has been involved in—

The CHAIRMAN. Fair point, but quantify those. How much does the 5 percent amount to?

Mr. BERNANKE. I will. The 5 percent, about $100 billion, is commitments that have been undertaken in government efforts to prevent the failure of major financial institutions. I want to make that distinction. The 95 percent, the bulk of our lending, those programs are extremely safe. They are overcollateralized. I could go through each one, I did in my remarks, and explain why each one is safe, mostly very short term, and very constructive.

The CHAIRMAN. And that would be about $1.9 trillion?

Mr. BERNANKE. That would be at $1.9 trillion, yes. That is correct. The other $100 billion, which is related to Bear Stearns and AIG operations, is a bit less secure, although our anticipation is that we will not lose money on those extensions.

The CHAIRMAN. my time has expired. Let me just say that I think that is an important point, and I know you will be asked to get back to us.

What you are saying is that people who extrapolate from the Bear Stearns and AIG experience to the rest of your holdings; that is too pessimistic. I think that is a very important point that you will have to establish to people. The most public ones are Bear Stearns and AIG, and I think that is part of it, that people do not see those as safe. And then you are going to have to make clear that distinction you just made.

Mr. BERNANKE. Thank you.

If I may, just very briefly, we engaged in those AIG and Bear Stearns transactions with great reluctance, because there is no existing structure to resolve systemically critical nonbanking institutions. If Congress would provide such a structure, the Federal Reserve would be more than delighted to step aside from such operations.

The CHAIRMAN. That is a very important point.

The gentleman from Alabama.

Mr. BACHUS. Mr. Chairman, in my opening statement I said that we should not enter into arrangements with financial institutions if the terms and conditions of those agreements cannot be fully disclosed. Would you like to react to that?

Mr. BERNANKE. Yes, sir. The terms and conditions, to my knowledge—and if you have any exceptions, I would be glad to get information to you—but the terms and conditions of all our agreements, to my knowledge, are fully disclosed. There are two types. There are the lending programs, such as the discount window and commercial paper facility. Those are all public information and all on the Web site. The testimony has a list of 5 pages of Web sites where information can be obtained. That information is fully disclosed. The one-off deals associated with AIG and Bear Stearns likewise, to my knowledge, they are fully disclosed in terms of—

Mr. BACHUS. Are the assets and the prices paid, the valuations, are those disclosed?

Mr. BERNANKE. The categories of securities and loans are disclosed and the valuation.

Mr. BACHUS. By categories—

Mr. BERNANKE. Well, one agency MBS is very much like another agency MBS, sir. The only distinct assets in the Bear Stearns portfolio which are not securities are individual loans to companies and so on, and those companies didn't ask to be in this portfolio, so we don't want to cast aspersions on them because they happen to be captured in that operation. But if your staff would like more detailed information, we can arrange to have that information provided. We provide quarterly information, we require monthly information on the evolution of the portfolio and of the arrangements, and we provide quarterly fair value accounting the same way banks have to do about the valuations of the portfolios.

Mr. BACHUS. You have talked about stabilized, systemically critical institutions. What is the criteria between an institution that is systemically critical and one that is not? I mean, what I have said, you know, you have too big to fail, which implies too small to save. To me that doesn't seem to be a fair criteria.

Mr. BERNANKE. Well, Congressman, you have two different questions there. The first is what are the criteria for systemically critical. And in each of the cases we have confronted, we have looked very carefully not only at the size and complexity of the firm in question, but also at the types of markets, counterparties and other transactions it was involved in, and tried to extrapolate if this firm failed, if it defaulted in the morning, how big would the implications be for the entire financial system and for the economy. And those cases where the risks for the broad system are just too great to take, we have to take whatever measures possible to try to prevent the failure.

Your second point that it is not fair, I agree 100 percent. If I was a small banker, I would be very upset. Small bankers don't have this protection. The "too big to fail" problem is a serious, serious problem, and it should be a top priority to greatly reduce this problem as we go forward with restructuring the financial system.

Mr. BACHUS. And one way to do that would be simply not to permit a corporation of that size; is that right?

Mr. BERNANKE. That would be one strategy, but other strategies include tougher regulation and supervision, or, as I have mentioned before, having a tough resolution regime like the prompt corrective action regime already in place for banks that would allow the government to come in at a stage before a default and resolve the company in a safe and sound manner.

Mr. BACHUS. Let me ask you this: There have been numerous reports recently that you have hired Wall Street firms to help you value and price assets. So in many cases those are the same firms that have relationships and business associations, as well as personal relationships, with the very firms that they are negotiating with.

Do you disclose the identities of, say, the negotiating teams? How do you deal with conflicts of interest? And how much disclosure is there?

Mr. BERNANKE. Well, except for the Bear Stearns case where we had only a few hours to operate, we have done, generally speaking, an RFP-type process where we accept bids and try to make sure that the usual firewalls are in place.

It is probably impossible to completely separate these firms from the other organizations in some sense, but these firms are specialists, and they provide services in evaluating those difficult-to-value assets. And there are a number of them that we have relied on at different times to help us provide expertise that we don't have inhouse.

Mr. BACHUS. Do you disclose the existence of actually who is on each transaction, who these consultants were?

Mr. BERNANKE. Who was involved? Well, typically it would be— for example, in the case of New York Fed, it would have been the president of the New York Fed and the chief counsel, the chief legal counsel.

Mr. BACHUS. No, I am talking about the private parties that they get to help them evaluate the deals.

Mr. BERNANKE. Yes. Well, certainly everyone knows who the principals and the leading players are in those firms. We can certainly ask if more information is needed. But these companies, of course, have to establish credibly that they do have separations between their different activities, otherwise nobody would use them because of concerns about conflict of interest.

Mr. BACHUS. Thank you.

The CHAIRMAN. The gentleman from Pennsylvania.

Mr. KANJORSKI. Thank you, Mr. Chairman.

Mr. Chairman, thank you for coming up here. I think already, while listening to your opening remarks and some of the questions proposed by the Members thus far, it becomes very clear that we don't all have a very clear understanding of what has been carried out over the last several months. I am going to put it in perspective of myself.

I became acutely involved in this situation as of about September 15th, as you may know, and we have been working on various pieces of legislation, obtaining various information. Under the prior Administration, I thought that both the Secretary of the Treasury and the President, quite frankly, were less than able to really spell out what some of the problems were, and I recognize that as shortcomings of the Administration. But since that time, the new Administration has taken office, and the other night at dinner, I listened intently to the President describe what his actions would be and what he wanted to do. And then I realized why so many of my constituents and so much of the news media, regardless whether it is specialized in financial affairs or the general news media, seems to be talking about questions that are not sufficiently clear as to what the problem is. And I realized last night when we were briefed by Treasury as to what the Secretary of the Treasury's statements would be today that it was represented by one of the staffers who sat in the back of the room after the briefing was concluded and it was open for question and answers, and his question was a very pertinent one: What is the plan, and what is the problem?

I think he succinctly put it, and maybe I would like to reiterate what he said. I think all of you, you, sir, from the Federal Reserve, to the Secretary of the Treasury past, to the present Secretary of the Treasury, to our two Presidents, the present President and the past President, have failed for all of us, particularly the general public, to enunciate what the problem is. And it is very clear when we listen to the debates of the various parties and the interest groups that they are talking past each other, not to the problem.

What I am really raising, the question is what can we do, what can you do, what can the key players do to take the time to define, in as simple terms as possible, what is the problem, what are the potential end results of the problem if not handled in a correct way or are incapable of being handled, and where our glide path is going?

I am really so sick and tired of listening to you and others saying, well, when we evolved this solution 4 weeks ago, the economy has materially changed since then, and that is no longer operative.

That is of little consequence or value to me as a policymaker or as a legislator to know that all the work we put in for the last 4 weeks is useless because the circumstances changed.

Surely in describing the problem, I think the President described it pretty simply the other night; he said we are in an accelerating whirlpool. That makes sense to me. I understand what that means. Why can we not simply say what that means if you take today's circumstances and you extrapolate 4 weeks from now or 8 weeks from now?

But more than that, you know, there was a question last night at the President's news conference. One of the reporters asked, are there going to be requirements for additional funds? I was a little disappointed in our President, because I think he is a straight, up-front guy, but he sidestepped the question.

And the reality, unless I am terribly mistaken—and maybe I want to pose that question for you to answer—I see no question that more funds will be necessary on the side of stabilizing the financial institutions of this country. The $700 billion or the $350 billion we are working on right now is not going to be sufficient enough to resolve this problem. And there is an attempt, as I sense it, of Treasury and the Federal Reserve to find other conduits for funds to be used or guarantees to be put in place that really do represent commitments in funds of the United States, but do not have to be passed by Congress or openly declared. As a result, every time that is heard, I think we lose the support of the American people in understanding how serious this problem is and what the end result could be if we don't get precipitous action, either today on the recovery bill in the Senate or in our next bailout bills, TARP 2, or what you may call it, or going down the road as to what may happen. What can we do to facilitate identifying and describing the problem?

The CHAIRMAN. The gentleman's time has expired. The response will have to come in writing.

The gentleman from Texas, Dr. Paul.

Dr. PAUL. Thank you, Mr. Chairman.

In my opening remarks, I mentioned that Title 31 gives the GAO authority to audit the Fed, except in the final conclusion they exempt the Federal Reserve and the FDIC and the Comptroller of the Currency, so there is no authority.

If Congress ever wants to know what is going on, we have to change the U.S. Code. For instance, right now I think it would be important for us to know what our monetary authorities are thinking about and talking about and planning internationally, because this system isn't working, and the new system is going to be devised, and I am sure it has been discussed.

I would like it know if there are plans for another pseudo-Bretton Woods agreement. It is very, very important to us. It is important to our sovereignty and important to our wellbeing, but we don't even have the right to know that as Members of Congress.

In section 13(3), it gives you the authority, and you cite the authority, to make loans and bail out individuals, partnerships, and corporations. And it hasn't been used much, but it is there, and that is congressional responsibility.

But, you know, transparency is one thing, and I want that because it would expose the system as to how it operates, but there is more to it than that. To me, it is the power, it is the power and the authority that gravitates to the hands of a small group of people who can create money out of thin air. This is an ominous power. It is the most powerful tool for central economic planning around, and that really has to be the issue as much as transparency. Once you have this power to control money and credit and centrally plan, you can distort contracts. So we are talking about distorting contracts, rewriting contracts when we get involved in these bailouts like we have been.

But you know, Chairman Bernanke, you have written a lot about the Depression, and, of course, there was a famous quote that you made once to Milton Friedman about apologizing about the Federal Reserve bringing on and creating and prolonging the Depression, but you assured him it wouldn't happen again. The free-market people agree with you entirely; the Federal Reserve is responsible. But the irony of all of this, and the key to this discussion has to be, was it too much credit in the 1920's that created the conditions that demanded a recession, Depression, or was it lack of credit in the Depression that caused the prolongation? And that is the debate. Obviously, the free-market people say the Fed brought it on by too much credit in the beginning.

But the question I have is the adjustment of real value of assets. The Federal Reserve brings on these crises by interfering with the cost of money and through interest rates and the supply of money, but here we are working frantically to keep prices up. Housing prices have to be up; we have to stimulate housing.

To me, from a free-market perspective, we are doing exactly the opposite of what we should do. The prices of houses should drop. We have 19 million unoccupied houses. Now, why should we in Congress stimulate housing? What is so terribly wrong with the market dictating this? We are frantic today. We are offering a new $1.5 billion program to buy up toxic assets, and that is propping up prices. That is illiquid, they are worthless; let us get rid of them and get it over with, get the pain and suffering behind us. How long are we going to be locked into this idea that we have to be involved in this price fixing? What is wrong with allowing the market to allow these prices to adjust and go down quickly so we can all go back to work again?

Mr. BERNANKE. Congressman, that was very interesting. Could I respond to a couple of points you made?

First of all, in the Great Depression, Milton Friedman's view was that the cause was the failure of the Federal Reserve to avoid excessively tight monetary policy in the early 1930's. That was Friedman and Schwartz's famous book. And with that lesson in mind, the Federal Reserve has reacted very aggressively to cut interest rates in this current crisis. And moreover, we have also tried to avoid the collapse of the banking system, which was another reason for the Depression in the 1930's.

On the prices of housing and the like, we are not trying to prop up the price of housing. What we are trying to do is get the credit markets working again so that the free market can begin to function in a normal way instead of a seized-up way in which it is currently acting.

And finally, on price fixing of so-called toxic or legacy assets, the plan that Secretary Geithner described this morning would have as an important component private asset managers making purchases based on their own profit-maximizing analysis. So that would be true market prices that would free up what is now a frozen market to get transactions flowing again and should restore real price discovery to those markets.

Dr. PAUL. But so far, every one of these suggestions over the past year was more money, more credit, more government involvement. Nothing seems to be working. Even today, the markets weren't very happy with these announcements. I think the market is still pretty powerful.

The CHAIRMAN. The gentlewoman from California, Ms. Waters.

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

I thank you, Mr. Bernanke, for being here today. And I suppose I am in awe of the kind of power and flexibility that I have learned that you have, particularly in the execution of section 13(3).

Let me just ask, because I don't really know how these discussions are made, I don't understand how they are made. You participated using your section 13(3) authority with Treasury, as you indicated, for the acquisition of Bear Stearns by JPMorgan Chase & Company to prevent the failure of American International Group, AIG, and to stabilize Citigroup and Bank of America.

Now, I suppose when you all get together, you all have a way by which you decide which of these institutions are systematically or systemically critical financial institutions. In doing that, you make a determination about whether or not, for example, Bank of America needs to be stabilized, and whether or not their attempt to purchase Merrill Lynch is in keeping with being stabilized, and your support of all of that.

What do you determine about Bank of America, and what are you concerned about in terms of using your resources to stabilize them? Is the purchase of Merrill Lynch consistent with your wanting to stabilize Bank of America?

Mr. BERNANKE. The Bank of America's purchase of Merrill Lynch was consummated or was initiated back in September and approved by its shareholders in the beginning of December. So that was a done deal as far as we were concerned. Our question was when Merrill Lynch revealed these very large losses, that we saw a risk that the combined company, Bank of America plus Merrill Lynch, would come under severe pressure in the market, and in some scenarios might fail or default. This is one of the largest financial institutions in the world. It has enormous numbers of counterparties and participates in many, many critical markets, and I don't think many people seriously would dispute the view that the failure of that company would have had enormously bad consequence not just for Wall Street, but Main Street as well.

Ms. WATERS. As you provide these resources under your tremendous authority, are you concerned at all about AIG and some of the reported ways that they spend money or have spent money? Does that concern you at all?

Mr. BERNANKE. Of course. It is critically important that taxpayer money be used well and there not be waste or abuse or fraud in those companies. But if you want me to take the time where I can do it in writing, we have extensive controls, we have people on the ground in the company, we attend all the board meetings, we have a whole set of policies, we put in our own CEO. So we have quite a few checks and balances to make sure that the expenses that are incurred at AIG are legitimate business expenses that advance the interest of the company. After all, if we are going to get paid back as taxpayers, we don't want the company to fail.

Ms. WATERS. Didn't AIG continue to have expenditures that the average person would consider unacceptable after your support and participation with saving them?

Mr. BERNANKE. There may have been a few occasions, but our overall view and our overall policy is that they have committed to making only expenditures which have a strong business rationale.

Ms. WATERS. Given that it appears that the policy is that these institutions are so important that, no matter what, you have to save them, because in the description of this kind of policy, it is just too detrimental to the overall economic system to allow them to fail, what do you think is your responsibility to the smaller institutions, the regional banks and others, who have been begging for support and assistance forever?

Mr. BERNANKE. Well, of course, all banks were eligible, for example, for the Capital Purchase Program.

Ms. WATERS. Yes, but they must be—again, as you have described, they must be stable institutions where you are not taking any risk. But the game changes if you are too big to fail. How can we correct that?

Mr. BERNANKE. Two comments. The first is when we get involved in a "too big to fail" situation, usually the terms are much more onerous and difficult. For example, with AIG we imposed much tougher conditions than we would on an average bank taking capital from the TARP.

The second comment repeats what I said earlier: Too big to fail is an enormous problem. We are very unhappy with this problem, and it should be a top priority to fix it as we go forward so the situation doesn't arise again.

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

Mr. NEUGEBAUER. Thank you, Mr. Chairman.

Chairman Bernanke, I have a couple of questions. I think the first question is an overall concern that I have. When you look at the meltdown in the economy, it is just not a domestic issue, it is a global issue, and we are seeing major contractions in the Chinese economy, the Japanese economy, and the European economy.

Many of these countries were countries that we enjoyed them being able to buy our debt because we had a credit deficit or surplus with them. Now, with their economies shrinking and our need to borrow more and more money, some of the countries that were selling us oil at $150 a barrel, those prices have gone down. So a couple of things. One is, what happens when we get to the point where there aren't any buyers for Treasuries out there and we continue to move down the road of throwing trillions and trillions of dollars at this problem and trying to borrow that?

Now, one of the things, when you look at the overall bailout of the markets, some people are quoting $7- to $8 trillion that is committed to this. You have expended your bank at a pretty rapid rate. With the balance sheet, you are now about $2 trillion with a $42 billion, I guess, net worth.

The question that I have is, what happens when we can't issue debt and there is more pressure then on the Fed to intervene in these? And when I look at your balance sheet, I see the monies that you have actually advanced, but I know, for example, you are on the hook for $37 billion if Bank of America has some additional losses; and with Citi, I believe it is $308 billion. I think with Fannie and Freddie, it is half-a-trillion dollars or maybe more we have committed to backstop them. I don't see those numbers on your balance sheet. So when I look at your balance sheet, you have a 2 percent net worth; you have these contingent liabilities out there. You would be on a watch list if you weren't the Federal Reserve.

So I guess the question is, what happens if we get to that point, and what is the real number that the Fed is in this game?

Mr. BERNANKE. So, first of all, a couple of points. One is that even though foreign investments in U.S. securities have gone down, the investments have gone down on the private sector side, and investments in Treasuries have gone up because Treasuries are very safe, so there is still plenty of funding for Treasuries.

But I think it is very important that, even as we run a large deficit this year and next year, and the President has said the same, that we work very hard to make sure that we restore a fiscal balance as soon as possible. So I think that is very important, and if we do that, that will make it possible for us to finance our way through this emergency.

On the Federal Reserve's balance sheet of $2 trillion, as you point out, there is no government debt involved there. There is no borrowing that is not Treasury. And also we have nothing to do with the GSEs. We are not lending anything to the GSEs.

You are correct in pointing out that we have a fourth loss position for both Citi and Bank of America which under extraordinarily severe, unprecedented conditions could cause us to lose some money. But, right now, I feel very comfortable that we are not on the watch list, that we have plenty of capital, that our likely losses are quite small. In fact, while I haven't put together numbers, I would guess that the profits we make on our lending programs would be a very substantial offset to any losses that we might make.

Mr. NEUGEBAUER. What would you say is growing the Fed too much? Would you be comfortable growing the Fed to $5 trillion or $10 trillion?

Mr. BERNANKE. The critical issue, sir, is that while the interest rate is at zero, there is no real bound, because with the interest rate at zero, we can essentially borrow at zero or close to zero in order to finance these funding programs. But, in practice, we have to worry about the fact that, at some point, and I hope it is sooner rather than later, the economy will begin to recover, and it will be necessary then for the Federal Reserve to begin to raise interest rates. In order to raise interest rates, we have to, among other things, there are various things we can do, but among other things, we will have to bring the balance sheet down to a more normal size. So all our expansion taking place at this point has to be very carefully planned to make sure we can unwind it and bring the balance sheet down in time to raise interest rates in order to prevent any insurgence or incipient surge in inflation.

Mr. NEUGEBAUER. So a $5- or $10 trillion Fed is not necessarily out of the question?

Mr. BERNANKE. It would depend on the maturity of the loans. Longer-term loans, borrowing, some other mechanism for sterilizing the effects on the money supply, we couldn't go anywhere like that. But for overnight loans, we can go pretty high.

The CHAIRMAN. The gentlewoman from New York, but first, I recognize the gentleman from Pennsylvania for a unanimous consent request.

Mr. KANJORSKI. Thank you, Mr. Chairman.

I ask unanimous consent that the following statements be made part of the record: a statement from the National Association of Realtors; and a joint statement from the Commercial Mortgage Securities Association and 19 other entities.

The CHAIRMAN. Is there any objection?

There being no objection, they will be made a part of the record.

The gentlewoman from New York is recognized for 5 minutes.

Mrs. MALONEY. Thank you.

Welcome, Chairman Bernanke.

Over the past 6 months, the Fed has been tremendously proactive in its efforts to preserve liquidity and help our economy to recover. By some reports, when you add in the stimulus and other activities, our government has spent or guaranteed over $7 trillion. The question I am hearing from my constituents is not so much transparency going forward, but backwards. They would like to know how that money was spent and who were the counterparties and what were the guarantees.

I have been told there have been individual suits and suits by news agencies that have sued the Fed in a Freedom of Information Act request for disclosure of borrow banks and their collateral and that, to date, none of this information has been released. And I am not going forward on transparency. Everyone is talking about transparency, but what I keep hearing from my constituents, they want to know what happened to these guarantees. They want to know not just that it went to AIG, but then what did AIG do with it and tracking that.

Is that information available? Can you make that information available?

Mr. BERNANKE. Congresswoman, I think these numbers that get thrown around like $7 trillion and $9 trillion and $12 trillion, I think they are adding apples, oranges, bananas, and grapefruit all together. They are adding all kinds of incommensurate quantities into one big number.

Mrs. MALONEY. Well, they were adding the stimulus plan, the TARP plan, and the Fed window. But let's not use numbers. Let's say the Fed spending. The Fed spending, what happened to it? Is that available now? I have been told there have been suits and it is not available to the public.

Mr. BERNANKE. First of all, I want to insist that the Fed does not spend. We lend.

Mrs. MALONEY. Lend. Lend and guarantee.

Mr. BERNANKE. We are repaid. We are repaid, without exception. We are going to provide as much information as we can. But there is a good reason. The one, in particular, you mentioned is, why don't we reveal the overnight short-term loans we make to banks? In the recent period, almost every big bank and many of the medium and small banks in the country have borrowed from us for short periods, and we could give that list, I suppose. The risk we have is that during periods where fewer banks borrow, being put on that list is some sort of saying to the market, I had to go to the Fed, maybe there is something wrong with me, and that causes trouble for the bank.

So if we have to give that information, and we will if Congress insists, but if we have to give that information, it will destroy that program and have a significant adverse effect on the liquidity provision and the stability of the financial system. So that is one case where I think that there is nothing devious going on.

Mrs. MALONEY. Well, that is one case. But in the guarantees, sort of the bulk guarantees, certainly to know the counterparties and the guarantees there should be made available.

Mr. BERNANKE. Which one are you referring to, ma'am?

Mrs. MALONEY. I would say the ones to the major banks, to AIG, those.

Mr. BERNANKE. The information about AIG and Bear Stearns and Bank of America and Citi is a monthly report which is given to Congress. It provides all the information, and we are happy to try to make sure that all that information is available to the Congress.

Mrs. MALONEY. And that includes the counterparties and the guarantees and that information?

Mr. BERNANKE. To whom we make the loans? Yes, of course.

Mrs. MALONEY. What gets me is we keep trying so many things, and what I am hearing from the public and what I hear from my colleagues in Congress is that the loans are not getting out to the public. Now, banks say that they are increasing their loans, but there is some type of disconnect. Maybe they are long-term loans that were made a long time ago. New credit is not getting out into the markets.

We just came back from a retreat of the Democrats, and my colleagues were telling me across the country, in every State, they feel that their constituents are telling them they can't get access to credit. Very reasonable, respected businesses are having their long-term credit cut, and there is no credit for commercial loans. There seems to be a huge problem there, and I would like to hear your ideas.

Obviously, the bank system is the wheel that has to get our economy going, yet we hear that part of the new program is there is going to be a business and consumer loan program coming from the Federal Reserve. Why is that coming from the Federal Reserve? Shouldn't that be coming from our financial institutions? Why can't we get them working properly? Is the problem the toxic assets? Do we need to get them off the books?

I don't think we should have to create a new lending system. Why can't we get the lending system that has served this country for decades working? Why is credit not getting out there to the public, and what can we do about it?

Mr. BERNANKE. Well, Congresswoman, one very important fact about the American financial system is that only about half of the loans in normal times come through banks. The other half go through other kinds of markets, like securitization markets. And all the programs I described today are about getting credit card lending, auto loans, student loans, commercial paper loans, mortgage loans, commercial mortgage-backed securities, all those things going again. That program will help get credit flowing outside the bank. So that is an important part because that is about half of our credit system.

Then the other part of the program that Secretary Geithner talked about this morning is about recapitalizing, taking away the bad assets and getting the banks working again. So it is really two parts, and I think you have to address both parts or else you will not give people the access to the credit that they need in order to carry on their lives and their businesses.

The CHAIRMAN. The gentlewoman from Illinois.

Mrs. BIGGERT. Thank you, Mr. Chairman.

Mr. Chairman, my constituents have the same problem and are questioning, when are we going to return to normalcy so consumers and small businesses and everybody would be able to get loans?

But can you describe in more detail why banks are parking their excess reserves at the Fed instead of using those excess reserves to facilitate interbank lending as well as private and consumer and small business lending?

Mr. BERNANKE. Well, in many cases, they don't have—so the reserves at the Fed are very, very safe and have a very low weight against capital. In many cases, they either don't have enough capital, or they are simply worried about the creditworthiness of the borrowers or the demand for lending. That inhibits their willingness to take those reserves and lend them out.

If they were to lend them out and the money supply began to grow, I am sure Congressman Paul would be very concerned about that, then the Fed would pull back and let them take the lead. But for the moment, their capital, their worries about creditworthiness, and their lack of loan demand and uncertainty about the economy is causing them to be very reticent.

Mrs. BIGGERT. Isn't this a vicious circle then? Because if we can't restore confidence of the banks, if we can't restore confidence of the consumer or anybody, it is just going to keep revolving around that without having the ability to make the loans that are necessary?

Mr. BERNANKE. Well, I think at this point the reason the banks and the credit markets are frozen is no longer the legacy subprime mortgages and those things. It is more concern about where the economy is going. So I think we need strong action to stabilize the economy and the financial system. If we can do that, we will get a virtuous circle rather than a vicious circle that will get the economy back to a more normal state.

But I have to say that this has been an extraordinary episode. This is the most severe financial crisis since the 1930's, and in all honesty, I have to tell you, we can't expect immediate results. We have to be patient and keep working with it.

Mrs. BIGGERT. Well, then I would love to know what specific measures could Congress take to further stabilize both the short and long term of our financial system. But, at the same time, in your January 13th speech at the London School of Economics, you talked about a continuing barrier to private investment and financial institutions is the troubled hard-to-value assets that remain on the balance sheets of these institutions and that these assets significantly increase uncertainty about the underlying value.

Have you looked at the proposal that AON submitted to the Treasury? And how do you or how will you value these mortgage-backed securities and the toxic assets? And will legislation be necessary, further legislation? It seems like we had that legislation a long time in the TARP.

Mr. BERNANKE. Well, there are many important legislative steps to take, including the resolution regime I mentioned and regulatory reform at a minimum. I am not familiar with the proposal you mentioned.

The plan that Secretary Geithner described this morning would work to take assets off of the banks' balance sheets at market-determined prices, and the way we would have market-determined prices would be by using the private sector and the skill and interest and self-interest of those private sector participants in purchasing the assets from the banks, and that would reduce that source of uncertainty that is now plaguing bank balance sheets.

Mrs. BIGGERT. Just for your information, the AON plan was really taking what we had originally proposed as the insurance in the TARP proposal, and that was just to codify that how that would actually work. So it has been enacted, but it has never been used. I would hope you would take a look at it.

Mr. BERNANKE. Thank you.

Mrs. BIGGERT. Thank you.

I yield back.

The CHAIRMAN. In defense of the Chairman, I would note that the TARP is under the jurisdiction of the Secretary of the Treasury, so that is why that would be his. I would also note that one of the points that the Chairman has mentioned, the question of power to resolve institutions that are in trouble, which Mr. Paulson had also talked about, will be on our agenda when we get to the whole systemic risk issue.

The chairman of the subcommittee, the gentleman from North Carolina, Mr. Watt.

Mr. WATT. Thank you, Mr. Chairman.

Chairman Bernanke, you indicate on page 7 of your testimony that many of the section 13(3) steps that you have taken could have been avoided or might have been avoided or not necessary had there been in place what you call a "comprehensive resolution regime aimed at avoiding the disorderly failure of systemically critical financial institutions." That is a mouthful, but I think I understand.

Now, some of these systemically critical financial institutions have a comprehensive resolution regime in place already, do they not?

Mr. BERNANKE. The banks do, yes.

Mr. WATT. The banks. So the ones that you are aimed—and with reference to those banks, whatever regulatory reform might include enhancing those steps. But outside the banks are other entities that do not have regulators that are systemically critical or too big to fail. Is that right?

Mr. BERNANKE. Yes, sir. Examples would be the insurance industry, the AIG example, or investment banks like Bear Stearns or Lehman Brothers. Primary dealers would be examples.

Mr. WATT. And as we approach the new discussions that we are having about a systemic regulator, I assume the thinking then would be to try to put some regulatory framework, or at least when those entities posed systemic risk to the broader system, a triggering mechanism in place that would avoid things getting worse and worse and worse. That is what you are saying?

Mr. BERNANKE. Yes, sir. In the case of FDICIA, there is a systemic risk exception which requires majorities of the Federal Reserve Board, the FDIC and the Treasury Secretary in consultation with the President. So it is a very high bar. But if the systemic risk section is approved, that means the FDIC could take actions to resolve a bank, for example, that would be, not under normal circumstances, would be extraordinary actions—

Mr. WATT. It would be in place for an AIG or an insurance company?

Mr. BERNANKE. That is what I am thinking of, yes, sir.

Mr. WATT. Now, it is the Fed that stepped in under 13(3) to exercise the authority to keep systemic risk from materializing even and getting worse. Would it be appropriate to think of the Fed as a potential repository of the authority as the systemic risk regulator, or is that something that is really different in your mind from what the Fed's real purpose for existence is or has been at least historically?

Mr. BERNANKE. I think there are two separate questions. One has to do with the resolution of large firms. I would think there the natural place for the authority would be in the Treasury, because fiscal funds might be used in consultation with the Federal Reserve and other agencies.

The other question you are asking me is about a regulator that looks at the broader system and looks at how firms and markets interact and doesn't just focus on each individual institution, the way our system works now. I think that is an important idea. I think we need to work towards having more systemic oversight. I think the Federal Reserve would have a role to play in that, because we have a long-standing commitment to financial stability. We have very broadbased expertise. We have the lending authority under the discount window. But that being said, I think there are many ways that you could structure that that would be satisfactory and would be effective.

Mr. WATT. And can you just identify some of the other players that would have a dog in that fight? The Fed, obviously?

Mr. BERNANKE. Some of the other players would be the Treasury, the SEC, the FDIC, the OCC, a number of different agencies that have broad interests in the CFTC, have interests in various aspects of the markets, could work together in some way to look for risks that are emerging.

Mr. WATT. But if you diffuse this too much, I mean, nobody has control of it.

Mr. BERNANKE. Yes, sir. I think you would have to think hard about what the right governance is, and I think that is a very big question.

Mr. WATT. Thank you, Mr. Chairman.

I yield back.

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

Mr. HENSARLING. Chairman Bernanke, allow me to somewhat follow up on my colleague's line of questioning since there is some serious discussion within congressional circles of adding additional responsibilities to the Fed, that being systemic regulator.

Clearly you now have the responsibility of monetary policy. You could have the responsibility of becoming systemic regulator. You have the responsibility in many cases of being bank regulator. You have consumer credit responsibilities, and somewhere along there, I think, is taxpayer protection as well.

Do you believe that the Federal Reserve is poised to handle what many view as competing interests or goals? Do you believe that this can compromise your ability to manage monetary policy?

Mr. BERNANKE. Congressman, I think the overload issue is a real issue. I take it very seriously. Whoever manages the Federal Reserve would have to worry about allocating resources and so on. As I was saying to Congressman Watt, there are probably a number of different ways to organize in this, and the Fed might be the principal regulator or it might be coordinated with others. It would depend on what is Congress' view as the most effective mechanism.

But I do think the Fed already has substantial systemic responsibilities that have gone back to the founding of the Federal Reserve. The Fed was founded principally not to manage prices or output but to manage financial crisis. That is why the Federal Reserve was created, and it has a long tradition of being involved in those issues.

So I think that you would probably not have an effective system without the Fed's involvement. But, again, I am very open as to exactly how the governance of that would work and how resources would be allocated and so on.

Mr. HENSARLING. There has been some discussion as well within congressional circles of exploring specific inflation targets for the Fed. I am curious about your opinion of explicit inflation targets.

Mr. BERNANKE. Well, as you know, Congressman, I have long had the view that I think that would be a constructive step. We have gone slowly in that direction, and to some extent, we would be interested in Congress' views.

Mr. HENSARLING. Not by way of criticism, but by way of observation, many economists believe that but for the actions of the Federal Reserve earlier in this decade fueling the then existing housing bubble, that we would not have the economic turmoil we have today. Again, nothing is quite as clear to us as 20–20 hindsight.

But do you have an opinion on, if we had had explicit inflation targets earlier in the decade, whether or not we might have avoided the present economic turmoil?

Mr. BERNANKE. Congressman, I have a very open mind about this, and I think it is very important to understand what went wrong, and there are probably many elements that contributed to the crisis.

I do not think the evidence supports the view that Federal Reserve monetary policy in the early part of this decade was the principal source of the crisis. I think the principal source of the crisis had to do with the huge capital inflows coming from our trade deficit which overwhelmed our system and made risk management inadequate.

That being said, I think we need to review monetary policy and make sure in particular that we don't err in terms of leaving policy too easy too long. Now, whether inflation targets would have helped, I am not sure. One of the key proponents of this view that the Federal Reserve kept rates too low explains the worldwide nature of this crisis by saying all the other central banks did the same thing, and most of them had inflation targets.

Mr. HENSARLING. Let me change the line of questioning. In exploring your powers under 13(3) as I have studied this and asked experts, and certainly your opinion is a relevant one, what is it that Treasury can do under TARP that the Fed cannot do under 13(3)?

Mr. BERNANKE. Well, critically, and this is why the former Secretary and I came to Congress to ask for the TARP, is that the Treasury can inject capital. The Federal Reserve can only make loans, and those loans must be secured to the satisfaction of the Reserve Bank that makes the loan.

Mr. HENSARLING. That is to your satisfaction.

Mr. BERNANKE. Yes, but we have legal counsel and other documentation, which means it is not a trivial requirement.

Mr. HENSARLING. My time is about to run out, but in your testimony on page 6, you say that at some point 13(3) will be "wound down as required by law."

As I read the law, I don't see what requires you to necessarily wind it down. Can you cite me the provision?

Mr. BERNANKE. Yes, sir. The law requires that we find that conditions be unusual and exigent. So when financial markets begin to look more normal, we would no longer have the authority.

Mr. HENSARLING. But it is your determination?

Mr. BERNANKE. That is correct.

The CHAIRMAN. The gentleman from California.

Mr. SHERMAN. Thank you, Mr. Chairman.

We ask the country to strive toward the best possible policy options, not just to joyfully embrace anything on the theory that it is better than inaction. This especially applies to dealing with collateral benefit for the malefactors of risk on Wall Street. We need to work to eliminate the subsidies to Wall Street firms and to close the giant loopholes in executive compensation limits.

Transparency is good, but insufficient. We see clearly, transparently, that the Federal Government was screwed out of $78 billion. We see billions of dollars in bonuses. And Wall Street firms are going to keep the $78 billion; the executives are going to keep the bonuses. Sunlight may be a disinfectant, but it does not kill all pathogens.

Chairman Bernanke, your statement was good, but it did not contain a single dollar figure. I hope you would provide for the record in a simple dollar amount the total risk taken by the Fed so far. By that I mean, assume that every security that you own or have a lien against is worthless except for those backed by the full faith and credit of the United States; what is the total amount that taxpayers would have lost by actions taken so far by the Fed?

Now, I know that you have told us you believe you are fully secured, but Wall Street gave AAA to Alt-A. The Secretary of the Treasury overpaid by $78 billion, and he says he was trying to pay par. He was just off by 31 percent. So you can imagine there is some distrust in the country as to what "fully secured" means or whether Wall Street and the financial establishment is correctly valuing assets and risk.

Section 13(3) is an enormous grant of power. I know you have told us that you can only make loans if you are secured to your satisfaction, but as Mr. Hensarling pointed out, in the hands of another Chairman of the Board, that could be no limit at all. And under desperate circumstances, even you might say, well, I am satisfied with bad security; otherwise, the entire country is going to collapse, and so I am satisfied to be able to do something.

I cannot think of the words that will really limit you in terms of the quality of the loans you make. It is up to you what is good security, what is bad security and what is in the national interest. So if we are going to limit your power at all, we can do so in terms of quantity.

Mr. Chairman, would you actively oppose legislation that limited the total risks that you can take to $12 trillion, to say that all of the risks you take, other than the purchase of securities backed by the full faith and credit of the United States, cannot exceed $12 trillion? And if that is a bad dollar amount, what else do you suggest, or is it necessary for the quantity of your power to be utterly unlimited?

Mr. BERNANKE. Well, our balance sheet is currently $2 trillion, of which 95 percent I would say is gold-plated secure and the rest is largely secure. So $12 trillion sounds very comfortable to me. I don't think that would be a problem.

But, quite frankly, seriously, we take very seriously our obligation to make sure that our loans are well-secured, and I think that a loan to a strong financial institution overnight with collateral, given that we have never lost a penny in such a loan, is not adequately considered as being a highly risky loan.

Mr. SHERMAN. I don't consider it highly risky, but I think there should be limits on the low risk that you take.

Moving on to my next question, the oversight board on TARP has documented that the taxpayer got screwed by $78 billion by certain institutions who received cash and gave us securities worth far less than the cash they received. I believe that the taxpayer should be "unscrewed." That is to say that these institutions should provide additional securities to Treasury to fully compensate us for the cash we have given them.

Those firms that refuse to unscrew us, those firms that say, thanks for giving us $10 billion for $7.5 billion in securities and we are keeping the difference, can they do business with the Fed as if they were snow-white virgins; that they are eligible to participate along with everyone else? Or will you join in this effort to say that that $78 billion shortfall should be made whole, and that aside from purchase of U.S. securities, you will not provide bailouts to the malefactors that have underpaid us by $78 billion?

Mr. BERNANKE. I think that $78 billion number has been misinterpreted. In the newspapers, it sounds like that is money that has been actually lost from the principal, which is not the case.

Mr. SHERMAN. No, no, no. I think, Mr. Chairman, I do understand the report.

The CHAIRMAN. The gentleman's time has expired.

The gentleman from South Carolina.

Mr. BARRETT. Mr. Chairman, it is good to see you.

We sent an e-mail out yesterday, Mr. Chairman, to folks in South Carolina, and these are just a sample of the questions that I had for you to be asked today, because people are concerned about what is going on.

I am concerned. I am concerned about what happened with the Treasury and the implementation of the TARP, oversight, transparency.

In the same breath, I am concerned about the Fed, too. You guys have spent hundreds of millions of dollars with a lot less oversight. So if you can, Mr. Chairman, let me just ask you a couple of simple questions, and I want you to explain these to these folks right here in terms that they can understand.

Number one, after all the stuff that you have done, after all the stuff the Treasury has done, why haven't the credit markets come back?

Mr. BERNANKE. A two-part answer. First of all, the financial crisis has been extraordinarily severe, and those financial effects are incredibly powerful. And the intensification of the financial crisis in September knocked the global economy for a loop, which it is now just beginning to get its feet. So I think that the actions that were taken prevented a much worse situation, a meltdown that would have led to a catastrophic and long-term low level of activity. So the fact that we haven't gotten back to normal is just consistent with the experience that financial crises are very, very serious matters.

The second answer I would make, though, and I would just like to emphasize that all these programs I talked about, the program for consumer and small business lending, the mortgage-backed security program, the interbank lending program that affects LIBOR, all these things have already shown up as improvements in those credit markets which directly affect people in South Carolina. They are not banks and investment banks.

The 30-year mortgage rate affects your constituents. The commercial paper rate affects the company they work for. The rate on auto loans, on student loans, on credit card loans, all those rates will be affected by the programs we are undertaking. We are doing this, not because we have some nefarious scheme; we are trying to help the American economy recover, and we are using whatever methods we have to overcome what has been an enormous blow from this financial crisis.

Mr. BARRETT. And I hear you, Mr. Chairman.

A second question: Do you have, the Federal Reserve, do you have an overall arching goal that underpins the decisions of when and how you intervene into the market, that is what they want to know; and number two, when do you stop? When do you draw a line? When do you say, okay, no more?

And I guess that is part of the third question, how much more is it going to take?

Mr. BERNANKE. So, as I have tried to emphasize throughout the hearing, there are two types of intervention. There are the interventions that have involved trying to stabilize systemically critical firms whose failure would create substantial problems for the financial system and the economy. As I have indicated, I am very unhappy about having to be involved in those things, and the sooner I can shed that responsibility, the happier I will be.

On the other side, the other type of activities has to do with our expansion, trying to create and stimulate credit markets where credit markets have broken down. And there, we want to keep looking for situations where we believe we have tools that can get the markets working again; that will create lower rates or better credit availability; and will stimulate the economy.

I think those things are in the interests of the people and that it can be explained to them that it is in their interests. I don't know how much more, but I think, given the severity of the situation, that we do expect to expand somewhat more to address the severe dislocations we are seeing in a number of key credit markets, including consumer credit markets

Mr. BARRETT. When you are talking about expanding more, can you be a little more specific?

Mr. BERNANKE. For example, the so-called TALF, the assets-backed securities program, was slated for $200 billion to support new lending in credit cards, student loans, auto loans and small business lending. As part of the plan announced this morning by Secretary Geithner, the Treasury and the Federal Reserve would collaborate to bring that amount up to $1 trillion, which would be another $800 billion of credit made available to broad categories of consumers and businesses.

Mr. BARRETT. Last question. Yes or no, was the first $350 billion of the TARP spent well?

Mr. BERNANKE. It was critical to stop the meltdown that would have occurred otherwise.

Mr. BARRETT. Was it spent like it was sold to the United States Congress? Yes or no?

Mr. BERNANKE. There was a confusion in the sense that there was an honest representation of the goals of the program to focus on taking assets off of balance sheets, which I believe was an appropriate objective and we are now returning to it. But shortly after the bill was passed, the global financial crisis erupted. The purchase of assets was not fast enough to address it, and so capital infusion was the only method that would save the situation.

Mr. BARRETT. I will take that as a no.

Thank you, Mr. Chairman.

The CHAIRMAN. The gentleman from New York.

Mr. MEEKS. Thank you, Mr. Chairman.

Mr. Chairman, I have really two separate questions that I want to ask. The first goes toward local municipalities. I actually had a big question with my comptroller in the City of New York, and we started talking about munibonds that the City of New York tries to, has to sell. It is important for them to sell the variable rate debt.

One of the things that they had indicated to me that was tremendously important was that, under the numerous programs that were designed for banks and security firms to use as commercial paper to credit cardholders, that they can continue to get access to credit. But the one group of borrowers that I am told left out of all this help is State and local governments. I am told the conditions in the municipal bond market are better than they were 2 months ago but by no means back to normal, and many State and local governments want to borrow to finance new construction projects. We have a lot of new construction projects but cannot access the capital market at reasonable terms.

So the question is, do you think to help these local governments and municipalities, would you support initiatives designed to make financing more readily available to States and localities, such as providing standby liquidity facilities for variable rate municipal bonds?

Mr. BERNANKE. Sir, I think that is something that the Congress ought to consider if the Congress has close relationships to the State and local municipalities, and certainly that would be something that could easily be done by the Congress.

It is actually more difficult for the Federal Reserve for a number of reasons, technical and otherwise. But one I would point out is that the 13(3) authority, as broad as it is, excludes loans to municipalities, so we could not do that, at least not directly.

But I do think that addressing the credit issues of State and local governments might be one way to help them, even though, as you point out, the municipal credit markets have improved somewhat.

Mr. MEEKS. Well, what about if—for the new liquidity being provided through some kind of receipt of TARP assistance, for example to carry a requirement that some of the new credit capacity be directed strictly to municipal issuers?

Mr. BERNANKE. Well, I would ask you to direct that to Secretary Geithner. It would really be his call.

Mr. MEEKS. Let me then move to another area that I think is of critical importance as we move forward. I have also been looking at a number of individuals who talk about the lack of availability of warehouse lending credit facilities. We had a hearing back, I guess it was a couple of weeks ago, and we heard testimony that 85 to 90 percent of the warehouse lending capacity is gone from the market, and some of the remaining warehouse providers may not stay in business. I know that lowering the overall rate is one thing. But if there is no money available by the warehouse lenders, then there is nothing to do at closing, and so people will not be able to take advantage. You know, we want to get folks to refinance or to be able to mitigate the mortgage they are in, but there needs to be some additional money therein.

So, first, I want to make sure you are aware of this problem, and, second, what impact will it have in the marketplace if we stimulate demand for mortgages without ensuring adequate funding capacity at closing tables across the country for the warehouse credit facilities?

Mr. BERNANKE. Well, I need to look into that to give you a better answer. But, as I indicated, as Secretary Geithner indicated, the TALF program will be looking at other mortgage-backed securities, including both residential and commercial. It is possible that might be included in that category, but I don't know.

Mr. MEEKS. So it is possible, but you don't know.

Mr. BERNANKE. No, sir, I don't.

Mr. MEEKS. Could you get back to me or get back to the office, because that becomes tremendously important. I know Secretary Geithner is coming up next week, was talking about the second portion, at least with the TARP money; how are we going to take care of those home mitigations. So it is important to me I think that it is clear whether or not there is going to be that additional money for the warehouse facilities. Is there a way that you can—

Mr. BERNANKE. Well, there may be—we need to understand exactly how the market works and what technical issues would be involved in doing it. So I just don't have the information to answer you. But it is certainly something we will put on our list and look at and see if it is, you know, something that will work. For example, if it isn't securitized through an asset-backed securities-type mechanism, it wouldn't fit with our structure. But we will certainly look at it.

The CHAIRMAN. The gentleman from North Carolina.

Mr. HENRY. Thank you, Mr. Chairman.

And thank you, Chairman Bernanke, again, for testifying. This is very helpful and constructive, not just for us on the committee, but for the American people, to know the actions you are taking, and we appreciate it.

Secretary Geithner's proposal this morning or outline or vague outline or bullet points, whatever he offered, it mentions the extension of the term asset-backed securities lending facility to other types of assets. One area in particular that some of us have concerns about are commercial-backed mortgage securities. That market has dried up in assets. There was $270 billion lent in 2007; $12 billion in 2008; and a number of loans are coming due in 2009. And so we have seen a vague reference to this. If, in fact, the lending will be extended or the TALF program will include CMBS, when do you see that being up and running and functional?

Mr. BERNANKE. Well, as you know, the initial program is not yet quite running. It is still going to be a couple of weeks before it is operating, and we are probably going to learn a bit about how it works and what other technical issues might arise. So I would be a little bit hesitant to give you a very precise number. But what I can say is that there is a lot of agreement that the CMBS problem is quite serious and that it would be a very strong candidate for being included at the nearest possible date in the TALF program.

Mr. HENRY. Okay. There is mention that it would only incorporate the newer, recently originated CMBS. Is that in fact the case, or is this going to be extended to a larger array of CMBS?

Mr. BERNANKE. It doesn't necessarily mean that it deals only with new buildings. If there is a refinance which is then resecuritized and therefore it is resecuritized and then re-rated, then that would will be eligible for our program. So a refinance would be, if newly securitized, would be eligible.

Mr. HENRY. Certainly.

There is a challenge the Fed has of managing inflation. Congressman Hensarling had a question about inflation targets. I kind of want to go to the next step here.

A number of concerns that I and my colleagues have are about the long-term economic growth. We saw with the stimulus package that the CBO says in the end, this, quote-unquote, stimulus spending bill will crowd out capital and in the outyears have a negative economic impact. Likewise, some of the actions that the Fed is taking as well as the TARP program in TARP 2 is this mass infusion of money into our economy, and I believe that this will cause inflationary pressures on a mass scale.

Now, I am certainly not a Ph.D. and not as learned as you, but I would like to have your input on how we avoid rampant inflation like we have seen before in this country?

Mr. BERNANKE. That is a very good question and one we take very, very seriously. In the near term, inflation looks to be very low. In fact, we are seeing disinflation, so we don't see inflation as anything like a near-term risk. However, it is certainly the case that when the economy turns around, which it will, and begins to grow again, that in order to avoid inflation, the Fed will need to undo its balance sheet expansion, need to bring down these programs, or use other methods to sterilize the effects of our programs on the money supply.

We understand that. We will look at it very carefully. That is one of the chief things we look at at our FMOC meetings. We want to be sure that whatever actions we take, which under the current circumstances will not be inflationary given how slack the economy is and how commodity prices have come down and so on, we want to be sure that when the time comes, we will be able to tighten appropriately to make sure that inflation does not in fact become a problem.

I am entirely persuaded that stable prices are critical for long-term economic health, and we at the Federal Reserve are absolutely committed to assuring that.

Mr. HENRY. So you don't have a fear of 1970's-style stagflation?

Mr. BERNANKE. Well, I think the main risk for stagflation would be if we don't fix the banking system. We saw in Japan, for example, or in the 1930's in the United States, that if the financial system is badly damaged and left to wither, that it is very difficult for entrepreneurs to get credit, for firms to invest, and that has a very negative effect on growth. So I think that it is absolutely essential that however difficult it may be, that we get the financial system running again. That will allow the economy to return to a more normal growth path.

Mr. HENRY. In closing, why do you believe the credit markets haven't normalized?

Mr. BERNANKE. They haven't normalized, first, because they were traumatized by the huge losses and the failures and all the factors that have created much risk aversion and caused people to pull back from markets. But now, going forward, the main concern of many bankers and others is the uncertainty about where the economy is going. If the economy is weakening, that means that credit quality is going to deteriorate, and that makes it harder to make loans and makes you more worried about your capital.

So we need both to stabilize the economy and to stabilize the financial system. You have to have both in order to get a return to growth.

The CHAIRMAN. The gentleman from Kansas.

Mr. MOORE. Chairman Bernanke, I think a lot of the people in our country and I are very concerned about the huge bonuses handed out by Wall Street last year; according to the New York State Comptroller, $18.4 billion. This is happening at a time of national emergency where the Federal Government is providing billions of dollars of taxpayer funds to stabilize the financial sector.

Last week, I filed a bill, H.R. 857, the Limit Executive Compensation Abuse Act, which would limit the annual executive compensation, including salary, bonuses, and stock options to the same compensation paid to the President of the United States, $400,000, and a couple of days after I filed that, President Obama announced new requirements on TARP limiting future recipients an executive compensation cap of $500,000.

I understand the Fed's TALF program utilizes $20 billion of TARP funds and perhaps even more after Secretary Geithner's announcement today. For firms that receive any of these TARP funds, via TALF or other Federal programs, will the Fed or the Treasury be responsible for enforcing the new executive compensation requirements?

Mr. BERNANKE. Absolutely.

Mr. MOORE. That will happen. You will personally assure that is done?

Mr. BERNANKE. We have systems in place that will require them to attest that they need it. That will be audited, and we will confer with the Treasury and IG to make sure those things are followed through.

Mr. MOORE. Thank you, sir.

The CHAIRMAN. The gentleman from New York.

Mr. LEE. Thank you, Mr. Chairman.

I appreciate the opportunity to voice the concerns of many of the constituents in my district. The Fed's balance sheet, I believe, today sits at over $2 trillion. We have authorized over $700 billion in TARP 1 and TARP 2. Today, Secretary Geithner's new proposal could put several hundred billion dollars into play in some form of a TARP 3. On top of that, we are sitting at record national deficits, and the budget deficit, I believe, this year will be over $1.2 trillion.

I was an economics major way back when at the University of Rochester, and it is hard for me to see this when I look at what impact this will have on crowding out investment, the potential impact on the staggering amount of borrowing we are going to have to do and what impact that will have on interest rates.

I am curious, in your view, how are we going to go out and borrow unprecedented trillions of dollars into the market and what impact that may have?

Mr. BERNANKE. Thank you.

First, I would like to make the point that the $2 trillion Fed balance sheet is not government debt. In fact, the $2 trillion Fed balance sheet is a source of income for the government because we lend at higher interest rates than we pay, and that difference, so-called seigniorage, is paid in the tens of billions of dollars to the Federal budget every year. So that is a profit center, not a loss center.

With respect to the other issues, though, in terms of the deficits, you are absolutely right that the deficits planned for this year and next year are extraordinarily large. They reflect the severity of the overall economic situation. Partly they are caused by the recession itself, which is hitting tax revenues and so on. And as the President and others have emphasized, it is very important that discipline be regained as soon as possible consistent with getting this economy going again and getting the financial system going again. Because if we leave the system in kind of a stagflation kind of situation, without growth, then the debt will be that much harder to service in the long term.

But your point is absolutely right, that the deficits are an issue and a concern. It will raise the debt to GDP ratio of the United States probably by about 15 percent points. That is tolerable for a growing economy, but we do need to make sure, first, that we are growing and, secondly, that we have mechanisms to unwind these fiscal expenditures and loans as the economy improves.

Mr. LEE. Just one last question as a follow-up. Do you have any concerns about the balance sheet of any of that debt not being paid back? You mentioned that right now it is a source of income. Are there any risks associated with that?

Mr. BERNANKE. So, as I said, the risks are somewhat greater in that 5 percent of the balance sheet where we have been involved in financial rescues. And specifically, in the Bear Stearns portfolio, on a mark-to-market basis, we are now in the red on that portfolio. I would defend still the decision, because I think the costs of letting Bear Stearns fail would have been many, many times greater than whatever costs we may or may not yet experience, because that is a mark-to-market, we are not selling. But as I was trying to indicate before, the great majority of the portfolio, 95 to 98 percent, is extremely low risk and is very comfortably considered a source of income for the government.

Mr. LEE. Thank you.

The CHAIRMAN. The gentleman from Massachusetts.

Mr. CAPUANO. Thank you, Mr. Chairman.

Thank you, Mr. Chairman, for being here again. I want to go back for a minute when Mr. Meeks—

The CHAIRMAN. If the gentleman would yield, if the Speaker doesn't stop expanding this committee, next year you will be testifying in the round.

Mr. CAPUANO. I thought he already was.

Mr. Meeks has suggested some assistance for cities and towns, and I think, a year ago, most people would have thought that the Fed wouldn't be involved with loaning billions of dollars to unregulated investment banks, mutual funds, or getting into credit card debt, auto debt, student debt. I don't think anybody would have really thought you would be doing that now.

You found a way to do that. Find a way to help the cities and towns and the States, maybe through insuring their bonds, if you can't actually take the bonds. I understand what the law says, but I also have absolute and total faith in your ability to go around any law that is clear and unequivocal.

Mr. BERNANKE. I appreciate your confidence.

Mr. CAPUANO. It is only for the good things.

Mr. Chairman, I want to talk a little bit about the thing that was announced today. I know that in some ways my questions should be addressed to Secretary Geithner. But as I read it today, you have chosen to now get married, and once you are married, you do have to answer for your spouse, as I do, as my wife does. When I write a bad check, she has to explain it.

The Treasury, and, again, I understand this, with the new Administration and new Treasurer, there are some things that have to begin anew, and that is one of the reasons I voted for the second \$350 billion; not voted for it, but I understood where it had to go and understand that.

At the same time, there are some people in the same places. Mr. Kashkari is still there. To my knowledge, he still believes that individual institutions shouldn't report anything. It still questions me as to who? Is it going to be you, or is it going to be the Secretary of the Treasury who values these bad assets when we go out and buy them, because we all know that is the real underlying problem we have with the whole issue, is valuing these things. Is it going to be you, or is it going to be somebody else?

Mr. BERNANKE. We are not married. We are just good friends. The Treasury, of course, is responsible for the execution of this program. Under the plan which Secretary Geithner expressed today, the valuation of the assets would be at least substantially done by private parties who are experts in this area and who are acting in their own interests. He will be discussing that I am sure in great detail with the Congress.

Mr. CAPUANO. Well, I would much prefer you do, and the reason is, obviously, I believe all you have said thus far. I have read all of the documents. I believe that the decisions you have made are relatively safe. I feel confident where we are.

We all know that the Treasury, again, not this Treasurer or the past Treasury, didn't do such a good job valuing assets. And I have a really hard time trusting the private market, who actually valued, I assume it is not new people who came in in the last 5 months, it is going to be the exact same people who got us into the mess in the first place valuing these assets. So their professionalism I think is subject to question based on the current economic crisis we have. They created the economic crisis, number one.

Number two is their motivation. Your motivation is to save this economy, because that is your job. That is who pays you. Their motivation is make money. God bless them, it is the American way. It is not a problem.

But I am not interested in private investors making money on the backs of taxpayers. I would rather have you do it. You have the motivation I trust. You have the professionalism I trust. You have the professionalism that, up until this point, has proven more accurate than those, and I would strongly suggest it is your money they are going to use. Don't write those checks unless you are comfortable with those values, because otherwise, I don't mean to be disrespectful, but you will be back on the hot seat along with them.

Mr. BERNANKE. Sir, I just want to be clear on the joint effort on the TALF, the asset-backed securities program, the Federal Reserve will certainly take full responsibility for valuations.

Mr. CAPUANO. That is exactly what I wanted to hear. Because I guess the other question I want to follow up on, in this provision, when you had some concerns, some general concerns that we can't make private entities do anything they don't want to do, report anything they don't want to report, because then they wouldn't take the money or something like that, and yet I am reading this release today, and it says that "all recipients of capital investments in the new initiatives announced today will be required to commit to participate in mortgage foreclosure mitigation programs."

I happen to think that is a good thing. But if they can be required to do that, why can they not be or why should they not be required to do things like tell us what they have done with the billions and billions of dollars that we have given them? If we can do this, why can't we or why shouldn't we do that?

Mr. BERNANKE. As I understand it, sir, the program will require them to report on a monthly basis on their loans and other activities.

Mr. CAPUANO. What about the past money?

The CHAIRMAN. Will the gentleman yield?

Mr. CAPUANO. I certainly will.

The CHAIRMAN. The Special Inspector General is in the process of imposing that requirement on recipients in the past. He ran into some problems with OMB, who declared the Paperwork Reduction Act interfered with that. We had some conversations about that, and that has been cleared up. So Mr. Barofsky's demand that all the current recipients comply with that is in the process of being sent out.

Mr. CAPUANO. I am a happy, happy guy. Thank you, Mr. Chairman.

Thank you, Mr. Chairman.

The CHAIRMAN. Would the recorder please take note that today was a day on which Mr. Capuano was happy. We don't always have those.

Mr. CAPUANO. Don't get used to it.

The CHAIRMAN. The gentleman from Florida.

Mr. POSEY. Thank you very much, Mr. Chairman.

This is fairly elementary. But when we were on a gold standard, it was pretty easy to tell where we stood. Would you agree with that?

Mr. BERNANKE. It was a simpler system, yes.

Mr. POSEY. And off the gold standard now, how would you best summarize what substantiates the value of our money, in the shortest possible explanation?

Mr. BERNANKE. It is the central bank which establishes the money supply which in turn affects the rate of inflation. So it is the integrity and professionalism of the central banks and their mandates that has succeeded in keeping inflation quite low in the world for the last 20 years or so.

Mr. POSEY. But we don't have access to their balance sheets, do we?

Mr. BERNANKE. We have done a review of the balance sheet disclosures and so on of the major central banks around the world, and the Fed is as good as any. But they do provide general information about balance sheets, yes.

Mr. POSEY. But we don't have—like the Fed's, we have never seen the Fed's balance sheet either, have we?

Mr. BERNANKE. Yes, sir. Every week in the H41 there is a breakdown of our lending programs and details on the maturities of the different loans, and we are looking to add more information.

Mr. POSEY. So why would they be exempt from audit then?

Mr. BERNANKE. They are not exempt from auditing. We have an outside auditor that does annual accounting. We have an Inspector General. And we have internal mechanisms, internal divisions, that look at the practices and management.

Mr. POSEY. What practices were in the statutes that I saw that were exempt from audit so they could not be audited?

Mr. BERNANKE. Congressman Paul, and frankly, this was news to me, says that certain international types of transactions are not subject to the review of GAO. If that is the case, again, as I said, I wasn't aware of it, but certainly they would be subject to the review of the external auditors and our internal audit teams in the IG.

Mr. POSEY. There are three paragraphs, for your information, of exemptions. It is not just one international audit. We sat here and we heard from Mr. Markopolis who told us about the Ponzi scheme that he exposed at the SEC 10 years before Madoff basically turned himself in, and with all due respect, one can't help but be captivated by the possibility we are running the biggest Ponzi scheme in the world right now.

We are not really trading anything. We are running up values. We are borrowing from Peter to pay Paul. But there is nothing added to the bottom line. It is just hard to explain or it is hard for me to conceive that we are headed in the right direction like that.

Mr. BERNANKE. Well, speaking for the Federal Reserve, we have a very clear knowledge of our liabilities and assets, and they are well matched. We don't have any kind of Ponzi scheme or other such thing going on.

Mr. POSEY. Thank you, Mr. Chairman.

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

Mr. HINOJOSA. Thank you, Mr. Chairman.

Chairman Bernanke, I have a great deal of interest in the federally guaranteed student loan programs, so for my 5 minutes I will focus on that area.

The not-for-profit secondary markets for student loans have been decimated by the failure of the auction rates securities market. These lenders have played a key role in the federally guaranteed student loan program as well as have been providers of low-cost, consumer-friendly, non-Federal loans to fill the gaps between the cost of attendance and what is available through Federal financial aid.

I received the announcement today that the Federal Reserve Board is prepared to increase the size of the term asset-backed securities loan facilities, better known as TALF, and could broaden the eligible collateral to encompass commercial mortgage-backed securities as well as private-label residential mortgage-backed securities and other asset-backed securities.

Mr. Chairman, I was going to ask for unanimous consent to enter a document into the record of today's hearing. When he returns, maybe he will give—

Mr. WATT. [presiding] Can you identify what the document is and—

Mr. HINOJOSA. I wanted to ask for the remarks by Treasury Secretary Timothy Geithner, introducing the Financial Stability Plan, dated Tuesday, February 10th.

Mr. WATT. Without objection, it is so ordered.

Mr. HINOJOSA. Thank you.

Chairman Bernanke, at the last hearing at which you testified before us, I asked why the term "asset-backed securities loan facility" will help these lenders return to making the purchasing student loans and was told that you were seeking stakeholder input.

What more can you tell me about all of this?

Mr. BERNANKE. There are several fronts on which the student loan issue is being addressed. To begin with, those auction rate securities markets have largely dried up. Like many other types of securitization markets, they involve short-term financing of long-term assets, and that has not proved to be stable in the current environment, which is one reason why our liquidity provision has been supportive.

But three things: First, the Federal Reserve, as you point out, has included government-guaranteed student loans in our asset-backed securities facility and, you know, we stand ready to do that.

Second, using, I believe, the Kennedy-Masterson law, if I recall the title, the Department of Education has set up a backstop facility to purchase student loans, including legacy loans or combination loans, and they are working with that.

And then third, though, I would just comment that one of the problems with the student loan market has been the misalignment of commercial paper rates and LIBOR rates, which has made it unprofitable for banks, given the formulas in the student loan law, to issue new loans. So Congress has a role here as well.

I strongly recommend that you take a look again at the compensation formula. If you want private-sector lending involved in the student loan market, you need to address the problem that, under current rules, the student loan lenders would be looking at a negative rate of return, and that has to do with the way that their formula is structured, for what they earn on their loans. So Congress could do a lot to help that situation.

Mr. HINOJOSA. With what we are investing in the financial sector, and with the fact that approximately 97 percent of the federally guaranteed loans are guaranteed by the Federal Government, it seems to me that this is probably the lowest-risk loans that they could possibly make. That they want to have a bigger spread, I don't believe that is fair to the families who are trying to get their students to be able to go to college and afford them.

Let me ask a second question: What plans do you have to ensure that the State and not-for-profit lenders are able to continue fulfilling their mission?

Mr. BERNANKE. Sir, I was asked to look at that by a previous speaker, but as I mentioned, there are limitations on our authorities to lend to governments; and it seems, given the longstanding relationship between the Federal Government and the State and local governments through block grants and so on, that a natural approach would be for the Congress to authorize backup facilities or some other support for credit extension to nonprofits and municipalities.

Mr. HINOJOSA. Thank you.

Going to my last question, the troubled asset loan facility program aims to create availability for credit cards, auto loans, student loans—

Mr. WATT. Unfortunately—

Mr. HINOJOSA. I yield back, Mr. Chairman.

Mr. WATT. —the gentleman's time has expired.

Let me announce that the Chairman has to leave at 4:00, so if we keep going fairly quickly, I think we will be able to get to virtually everybody. So we will try to keep on a tight string.

Mr. Price from Georgia.

Mr. PRICE. Thank you, Mr. Chairman.

I appreciate your coming again and being with us. You have described your role in the current challenges in many ways. I think I wrote these down correctly. One of them was to stabilize systemically critical firms and that you felt that the sooner you could leave that role, the better. Is that accurate?

Mr. BERNANKE. Yes, sir.

Mr. PRICE. And is that opinion shared—that desire to leave that role, do you know if that is shared by the current Administration, the Secretary of the Treasury?

Mr. BERNANKE. I think it is. We have discussed this in the past, and I believe he has spoken about this in public as well.

Mr. PRICE. And when is it that we will know that you believe it is time to leave that role? Will you announce it?

Mr. BERNANKE. No. It will be time when there is in place an appropriate legislative framework that allows for a more systematic, prompt, corrective, action-type approach that will outline exactly how the government wants these firms resolved.

Mr. PRICE. So regulatory reform will—

Mr. BERNANKE. Regulatory reform is what we are waiting for.

Mr. PRICE. Another item that you said was one of your roles in these challenges was to stimulate credit markets where they have broken down. Other than the interest rate decrease, which is as low as it can go now, and the injecting of capital, what else can be done there?

Mr. BERNANKE. Sir, as I have indicated, people sometimes argue that once interest rates get to zero that the central bank can't do anything else. Well, we have found some other ways to try to ease financial conditions, and I have talked about three general areas: One is lending to banks, financial institutions, increase their liquidity; the second is to buy securities, including mortgage-backed securities, which lowers mortgage rates and strengthens that market; and then the third is to use various tools to try to address specific credit markets like the commercial paper market and the asset-backed securities market.

I think we are going to have to explore what the alternatives are and see which markets could use assistance and whether we have tools available between us, the Treasury, and other agencies to address those problems, so I really can't tell you now. But our most immediate plans, as discussed this morning, would be to expand the TALF to include other types of asset-backed securities like commercial, mortgage-backed securities.

Mr. PRICE. In response to a couple of questions as to why credit markets aren't working now, you have said, I think on two separate occasions today, that initially institutions pull back because of the degree of the calamity, and secondly, that currently the uncertainty in the economy precludes them from moving forward with providing credit.

My sense is—do you have any sense about the role that the Federal Government has to play in that uncertainty?

Mr. BERNANKE. Well, certainly, if policy can be laid out in a comprehensive and predictable way, that is going to make it easier for firms to understand their environment to make good decisions. Again, the effort of the Treasury Department has been to try to lay out major elements of a comprehensive plan.

Mr. PRICE. What about private capital? If I have private capital, and I am sitting on the sidelines right now, agreeing with you that there is a huge amount of uncertainty and therefore I ought not invest, for if I invest, I don't know whether my investment is going to be diluted or whether the Federal Government is going to come in and bail out my competition, isn't that a degree of uncertainty that we ought to address?

Mr. BERNANKE. That is an element of uncertainty. But also things like the amount of assets on the balance sheet which are very hard to value is a very important source of uncertainty.

So I agree, you want to have comprehensive, predictable policies, and you also want to address the underlying problem, which is the losses and the bad assets.

Mr. PRICE. But from a private capital standpoint, is there any incentive right now for private capital to get back in?

Mr. BERNANKE. There are some cases, but very few.

Mr. PRICE. If we agree that markets ought to be allowed to work, wouldn't it behoove us to put in place a system or to concentrate on a solution that allows or incentivizes that private capital to get back in?

Mr. BERNANKE. Absolutely. That should be a top priority.

Mr. PRICE. And as a top priority, if that private capital is sitting on the sidelines because of governmental intervention, isn't it appropriate that we wind down the governmental intervention as rapidly as possible?

Mr. BERNANKE. As soon as possible. But I would not want to say that the government intervention is the primary source of uncertainty.

Mr. PRICE. I didn't—

Mr. BERNANKE. The primary source of uncertainty has been credit losses in the economy.

Mr. PRICE. In closing, in the few seconds I have left, you mentioned that the debt-to-GDP ratio has increased about 15 percentage points and that is, "tolerable in a growing economy."

In a contracting economy, what level of ratio is tolerable?

Mr. BERNANKE. In a contracting economy, all else equal, the debt-to-GDP ratio will just keep rising. The economy won't keep up with it.

Mr. PRICE. Is that where we are?

Mr. WATT. The gentleman's time has expired.

Mr. BERNANKE. We are looking for long-term growth.

Mr. WATT. The gentleman from St. Louis.

Mr. CLAY. Thank you so much, Mr. Chairman.

And welcome back to the committee, Chairman Bernanke.

I, like most Americans, have serious concerns about the economy and the remedies that are used to address the problems. Americans are concerned that TARP provided money to financial institutions to provide liquidity for lending, and after investing hundreds of billions of taxpayer dollars, we are still seeing a lack of liquidity.

Many smaller banks declared they needed no bailout as they had good paper, yet many of them received tens of millions of dollars, some in excess of $100 million, all unsolicited.

I won't name all of the concerns, but I find some of the distributions of funds questionable at best.

Mr. Bernanke, did you or are you aware of former Secretary Paulson's forcing some banks to take TARP money?

Mr. BERNANKE. Well, there was some implicit pressure put on the very largest banks, whose stability is viewed critical to the economy, but I am not aware of any medium or small banks that were forced in any way to take TARP money, no.

Mr. CLAY. And I guess it was either your opinion or Secretary Paulson's opinion that the larger banks needed to take the money?

Mr. BERNANKE. I think that has been borne out. I think that has clearly been the case that many of the largest banks were the ones that have had the worst hits to capital and the biggest losses.

Mr. CLAY. And they still have not freed-up credit?

Mr. BERNANKE. Everything is relative, sir.

I mean, the first thing to do was to prevent collapse and meltdown, and that is something—people don't realize how close we came to that. It was a very, very serious risk.

We have also mitigated to some extent the contraction, the deleveraging of credit. And I think the credit—the capital which has already been deployed will be constructive and useful in the next stage, proposed this morning by Secretary Geithner. In particular, he is proposing to have that first round of capital convertible into common equity at the—if the bank and the supervisor decide it is appropriate, which may provide additional strength for the banks.

Mr. CLAY. Help me with the process here.

Under Secretary Geithner's plan, we will have private investors and money handlers separating good assets from bad assets. Will the assets be purchased by the taxpayers?

Mr. BERNANKE. There will be—I need to leave the details to Secretary Geithner, but I think the general idea is that the private sector and the public sector would share both in the cost and in the return. Therefore, the private sector would have money on the line, they would have skin in the game, and they would have a strong incentive to make good decisions and make good prices.

Mr. CLAY. So does that say we will put money up front to purchase bad assets?

Mr. BERNANKE. No. I think the idea is that there will be a sharing, that there will be a combination of public and private money and private purchases. But that is—again, the Secretary is going to want to work out details with the Congress. I am not trying to front-run him here.

Mr. CLAY. I see. Thank you for that.

And, Mr. Chairman, what is your opinion of the handling of the first $350 billion of the TARP? In hindsight, what changes would you have made in the distribution of the money, and what are your recommendations for going forward with the second half of the money?

Mr. BERNANKE. Well, I think the capital that was distributed was very important, as I said. I said I think it avoided a global meltdown and has benefits that will show up and be important in the second stage.

I think the biggest mistake was that communication and explanation was not adequate, and we should have done a better job of explaining to the Congress and to the people exactly what we were trying to accomplish—and this point was made earlier—and how it would be facilitated through the TARP.

Mr. CLAY. Thank you for your responses.

I yield back. Thank you.

Mr. WATT. The gentleman from New Jersey.

Mr. GARRETT. I thank the chairman. Before I begin, let me go to the opening comment by the chairman about the need for and—the greater transparency by your department and the efforts that you made in that regard.

As other people have said, we received a number of questions from our constituents, and I just remind you, though, that when we get those questions, we forward them on to you. And in the case—of course, we did that last year after Bear Stearns; I think it was around in April, and it took us around 2 months in order to get a response. And we have since—we finally did get a response. It was December 4th of last year, after everything else has occurred; and we are now 2½ months just about down the road, and we are still waiting for a response.

These are questions not just coming from myself. These are questions coming from our constituents, the American public. So when we talk about the need for transparency, it is right there.

And if you could—I appreciate the fact that you are able to turn on a dime, if you will, when an emergency situation happens; and it is often on a Sunday afternoon or a Sunday evening that you are able to move like that, to not spend money but to lend money. And we would ask that you would be able to turn on a dime a little bit quicker to respond back to our constituents on these things.

Secondly, the chairman of the Capital Markets Committee, Mr. Kanjorski, said he hears from his constituents as to what the plan is. I think that question goes to the questions that we have heard from the gentleman from Georgia as to what the plan is.

As we sit here today—and I know the Treasury Secretary is over on the other side testifying—I think we are still—capital markets are still with that question mark out there, what's the plan? And the gentleman from Georgia raises the point very well, that assets will sit on the sidelines until they feel that—the old saying goes, "Don't just do something, stand there," might be more appropriate for a period of time so the markets could settle down.

Some of the questions we had is—going to the situation with AIG specifically, are you able to tell us who the specific counterparties are that specifically benefited from the infusion of cash into AIG?

And secondly, are you able to tell us, in light of the fact that the default credit swaps are basically moved off balance sheet at this time, and we were told that that was really where the systemic risk was and what made it so important, why are we so engaged and involved and why do we still have the problem with AIG?

Mr. BERNANKE. On the former, that is on the list of things we are reviewing to try to make sure that legal, privacy, and other concerns are manageable in the context that you are asking for.

On why we are involved in AIG, partly it is that we have in some sense reduced the risks associated with AIG by taking some of the critical counterparty risk off the balance sheet, as you point out. There still are important risks associated with the company that have not yet been eliminated by any means—

Mr. GARRETT. So these are other than the default credit swaps and the—

Mr. BERNANKE. —other than those.

But beyond that, obviously we want the company to pay us back. So we are watching it.

Mr. GARRETT. That can't be accomplished just by allowing the company to—

Mr. BERNANKE. Well, since we now have—since we are now the principal creditor and the principal shareholder, we certainly have some, I think, responsibility to make sure that the company is operating in ways that are consistent with the goal of paying the taxpayer or paying the Federal Reserve.

Mr. GARRETT. Well, do you have an obligation that the company is sustaining itself or will actually stay as a company or actually pay—itself, pay back the taxpayers, that that may be not in the current format?

Mr. BERNANKE. We are open to different approaches and we are in consultation with the management.

Our main—we have two objectives. The first is to make sure that the company doesn't fail and create systemic risk; and the second is to make sure that the U.S. Government is fully repaid for the loans and capital that were injected into the company.

Mr. GARRETT. All right.

Also a question of mine is what the Fed does and what the Treasury does. You had made reference here, and I know in the past as far as the plans to spend $100 billion for GSEs direct obligations, and up to $500 billion in GSEs mortgage-backed securities. And I understand what the goal is there, both that and also your efforts with regard to the asset-backed securities issues.

In light of all the authority and the money that we have appropriated through the TARP program for Treasury, can you explain to us why the Fed continues in this action and why both of these areas are not relegated to the Treasury to handle? Don't they have the authority and the money to do it?

Mr. BERNANKE. Yes, they do. I would add, though, that the Fed, in making those purchases, is not using any extraordinary authority by any means, not 13(3) or anything else. It is part of our usual open market operations to be able to transact an agency's securities, and we thought it would be constructive to add our purchasing power to this effort to try to bring down mortgage rates and try to strengthen the economy.

Mr. GARRETT. Well, you appreciate what Congress went through to come up with the $700 billion to authorize for the TARP program. You are talking about $600 billion, obviously without any discussion of Congress here.

So I understand you have the authority, but shouldn't it be that Congress has already given you direction in those areas to take that action?

Mr. WATT. The gentleman's time has expired.

Mr. BERNANKE. These are acquisitions of Fannie and Freddie securities, which is already basically in conservatorship under the authority of the U.S. Government. We are not making additional—taking additional risks, for example.

Mr. WATT. The gentleman's time has expired.

Mr. Lynch is recognized.

Mr. LYNCH. Thank you, Mr. Chairman.

Thank you, Mr. Chairman, for your willingness to come forward and help the committee with its work.

I understand it is widely known that you are an expert of some sort on the Depression, the Crash of 1929. Hopefully, your education in that area won't become too relevant. But I have to say that there is one response, I think, of Congress and of the capital markets back in 1929 that I think we have ignored thus far.

In looking at what happened in 1929 and the years following that, I was struck that it appears that Congress and Wall Street got together in one regard and said that in order to try to stabilize the markets and get them on firm footing, Wall Street agreed to transaction fees.

What they came up with was a formula which was rather modest in those days. I think the volume of trades on the major exchanges were around 5 million shares a day, at its maximum on a good day back in 1929; and they agreed that 1/300 of 1 percent of each share traded on the major exchanges would go into a fund. And essentially it started off funding the SEC and some other things that were, I think, very helpful in the regulatory framework around the markets at that time.

We have been giving out money left and right here, and there has been no similar effort to ask Wall Street, the people who—some of whom caused this major problem, the people who are certainly benefiting from the first phase of TARP, the second phase of TARP, a lot of the things that you have been doing.

And I don't discount that you have been on the mark a number of times in terms of the relief you have provided, but isn't there a place—this Congress is going to consider a regulatory reform regime in the coming months. Isn't there some place in all of this—rather than ask the American taxpayer to pick up every red cent for generations for all the mistakes that have been made here, isn't there a rightful place for transaction fees to say to Wall Street, "Look, this was part of the solution in 1929; this could be part of the solution now?"

There were only 5 million shares a day on the major exchanges back in 1929 on a good day. We haven't had a good day in a while; on a good day these days, you have 5 billion shares a day. So it could be a microscopic, a very small fee, that would at least tell the American people that, "Hey, for those of you that don't have money on Wall Street, you can rest assured that the people who are trading there, the people who are doing business on Wall Street are kicking in a little bit, finally."

Is there a role for transaction fees? Might we ask Wall Street to help out?

Mr. BERNANKE. I understand your concern. I have a couple of issues with the transaction fees. One is that the people who trade shares—the cost is actually passed on to the people who own the shares, which is people with 401(k)s, and half the public own shares.

Mr. LYNCH. I understand. But there are a lot of people in my district, probably 40 percent of them don't have any money at all, and—you talk about unfair—they are being asked to pay for this. And I think there is a way to structure these things that you make sure it comes out of the firms, as well as—opposed to just—and, you know, bond activity is not assessed at all; and we could look at that. They haven't been less than culpable in a lot of this crisis as well.

But I am sorry. I didn't mean to interrupt your response.

Mr. BERNANKE. I was just going to make the comment that some economists have suggested transaction fees as a way of reducing liquidity and speculation in stock markets. I would have to say at the moment that liquidity is very short and that we are not seeing much of a speculative bubble in shares.

I understand—I understand your general sentiment that trying to find ways to finance some of this cost in the longer term from the financial industry, for example, is worth looking at. But I don't think that is—that wouldn't be my first choice, and I am afraid in the very short run that it doesn't make much sense to put in capital and then take it right back out for financing.

But certainly as we go forward, as I said to a number of people, it is going to be very important to try to get back to fiscal sensibility and fiscal stability; and there are lots of ways to get there, and Congress should look at a broad range of options.

Mr. WATT. The gentleman's time has expired.

The gentleman from Michigan.

Mr. MCCOTTER. Thank you, Mr. Chairman.

People in my district woke up one day sometime late last year and found out that the world, as they knew it economically, was going to end because someone had done something wrong to seize up the credit markets. And since that time they have witnessed disorder in the sense of the government's response.

They have perceived this to be an unjust appropriation of their money, spent on the very people who caused the problem, and they see a long-term loss of economic freedom due to government intervention. And most importantly, they don't see much benefit to their daily lives from all the things that the government has done.

My concern in studying human nature is twofold: one, the concept of "too big to fail." When you tell people they are too big to fail, they will, because they know there is no responsibility to be incurred, no accountability if they do.

Where is the stigma for the people who failed and put us in this mess? Where are the measures taken to ensure that they pay a price for their problems that they have put onto us? I don't see any. I don't see any at this point.

And the second part of my question is kind of that these people thought they could go on forever doing what they were doing, that it would just keep going, that the dot-com bubble was replaced by a housing bubble, and it would never end. Now we are talking about creating a government bubble to fix the housing bubble, but they never thought they were wrong.

I asked you and Mr. Paulson once, "What happened?" The answer was, "Mistakes were made." Well, I understand human beings are fallible. But the problem is, if people think they are too big to fail or they are too important, the hubris that enters into the prognostications that they make and the actions that they take leads them to make very, very big mistakes.

So my question is this: If these people were wrong and we are suffering the consequences of their bad decisions; if people like Mr. Greenspan, who has admitted he was wrong, have caused us to suffer the consequences of his bad decisions; if—as you have written a book about the Great Depression—the people at the Federal Reserve were wrong and the people at the time had to live with their bad decisions, what in the odd chance happens if you are wrong? What is your worst-case scenario for the decisions and the actions that you have made and taken being incorrect, how will that affect the people who sent me here to work for them?

Mr. BERNANKE. Let me just start first by saying something about "too big to fail;" and I just want to reiterate this once again, that the "too big to fail" problem is an unacceptable problem. It needs to be addressed through tougher regulation, through resolution regimes, through other steps that will make fewer if—and ideally, no firm is too big to fail. That is critically important; I support that 100 percent.

In terms of my own decisionmaking, I am doing the best I can with limited information. This has been an extraordinary, unprecedented event. Many things have happened that we thought couldn't happen. It has been extraordinarily severe. We have not gotten a complete grip on this thing yet. It has been 18 months already.

I believe that the policies that the Federal Reserve is taking and the steps that the Treasury and others are proposing are the best methods for addressing these issues; and it is based on, not pure guesswork but on some knowledge of history and other countries' experience and so on.

But certainly it is possible that it won't be enough and that there will be further problems down the road. There is no way I can guarantee that, but certainly any policymaker, yourself included, has to make the best decision given the information and experience and knowledge that he or she has.

Mr. MCCOTTER. On that point, I appreciate that, but when you make a decision, you also have to look at the potential ramifications of what will happen if you are wrong. Given the unprecedented actions of the Fed and the unprecedented amounts that are being utilized, leaving aside the unprecedented amounts and actions that the Federal Government has taken to try to address this, you have to know what happens if you are wrong, before you can make a decision to proceed and do what you think is right.

So my question is, if you are wrong, what do you foresee as being the consequences?

Mr. BERNANKE. Well, some have raised the concern about inflation. If we don't get the balance sheet under control and the money supply under control in time, in an appropriate moment, we could risk having higher prices down the road. That is certainly a possibility. It is one that we are very aware of and doing our best to manage.

But, you know, nothing is certain. So that is one risk that I see.

The other risk I would point out would be just that the efforts that are being made, including our attempts to stabilize key credit markets, prove insufficient and the situation gets further—deteriorates further.

Those are the things I can foresee. There must be things I can't foresee, but by definition, I don't know what they are.

Mr. WATT. The gentleman's time has expired.

The gentleman from North Carolina.

Mr. MILLER. Thank you, Mr. Chairman.

There are two versions of what the problem with the banks is, mainly. One is a liquidity problem—and you have spoken about a liquidity problem several times in your testimony—that banks have hard-to-value assets for which there is no active market, and they have persnickety accounting rules.

The other is that there is an insolvency problem. The problem is that—the market is doing a pretty good job of valuing the assets. That is what markets do best; that is their core competency. The problem is, the assets aren't really worth very much and that the banks are really insolvent.

Without asking you which it is, which I think would take all of my 5 minutes, do you agree that there are huge policy implications that turns on whether we have, "principley"—that is "l-e"—a solvency problem or a liquidity problem, that what we do to address a solvency problem is not what we do to solve a liquidity problem?

Mr. BERNANKE. I would—I would make a choice there and say that while liquidity is very important, particularly for short-term stability, that what we have here is a question of uncertainty about solvency; people don't know if the banks are solvent or not because they can't really value the assets. And that is why I think that trying to take the assets off and value them at some—at some market clearing price is an important component of getting more clarity into the market and potentially attracting capital back in from the private sector.

Mr. MILLER. So you agree that if the result of an asset purchase program that established an active market and had realistic values might be that many banks would be revealed to be insolvent, that actually would be a healthy development because it would increase confidence in the financial system? It might attract private capital because they know that the banks—that the books were honest?

Mr. BERNANKE. An interesting historical example is the bank holiday of 1933, when Roosevelt shut down the banks for a week and said, "We are just going to check their books and open them up only when we think they are solvent." And a lot of the banks opened up pretty quick. So it is not really clear how much they really looked through the books, but when they opened them up again, people felt much more comfortable and more confident in the banks.

And part of the proposal that Secretary Geithner put out this morning is to have a supervisory review not only of the quality of assets, the reserving and the potential future losses, but also to ask a very important question: How well would the banks do in an even more severe scenario?

Mr. MILLER. A stress test?

Mr. BERNANKE. A stress test.

Are they able—do they have enough capital that, even putting aside whether they are solvent today, they could survive an even worse scenario and get enough confidence that they could survive that scenario. Putting enough capital in that they could survive that scenario should help to restore confidence that they are, in fact, solvent; and that would, in turn, attract private capital.

Mr. MILLER. Assuming there was confidence in the stress test itself.

Mr. BERNANKE. Correct.

Mr. MILLER. Mr. Chairman, we have heard some pretty dire estimates of how much banks' values are—assets are overvalued. Goldman Sachs economists, just in the past couple of weeks, have said that the total losses to American financial institutions is probably about $2.1 trillion, and about $1 trillion of that had been realized now, had been recognized on the books, and that meant there was another $1.1 trillion of losses yet to be realized.

Not surprisingly, Nouriel Roubini, "Dr. Doom," put the number higher; he said $3.6 trillion, and about half of that banks and brokerage houses and that the total capitalization of the American banking system is about $1.4 trillion which, he said, if his own numbers were right, meant the entire American banking system was insolvent.

The Federal Reserve is one of the principal safety and soundness regulators. You have responsibility for safety and soundness regulation for most of the Nation's banks one way or the other; and you have been taking hundreds of billions of dollars of assets, trillions of dollars of assets, as collateral for loans.

So I assume you have been giving some due diligence to what the value of assets are. You have paid some attention. Do you have a sense of whether American banks are overvaluing their assets and by about how much, if they are?

Mr. BERNANKE. Well, it is—how much are the banks overvalued?

Mr. MILLER. How much have they overvalued their assets?

Mr. BERNANKE. Well, let me give you a number from the IMF. They have raised their loss estimates—I will get this approximately right, and we will try to get you the exact numbers.

But they have raised their estimates for total losses to about $2.1 trillion, of which about half, I believe—and again, if I am mistaken, I will correct this—are in American institutions. I believe that they estimate that about half of that has been taken, leaving something like $500 billion or so more to take.

Banks, of course, earn income outside of their asset positions, which will offset part of that. So their estimates would put the system as losing money still—having losses still to come; but I don't think it would come very close at all to saying that the system was insolvent. So I think it is safe to say that there is very wide disagreement about exactly what the amount of losses are; it depends on your views.

Mr. WATT. The gentleman's time has expired.

The gentleman from Texas.

Mr. MARCHANT. Thank you, Mr. Chairman.

Mr. Chairman, in this announcement that was released today expanding the eligible collateral, do you feel like it also expands the definition of those people who are able to come to the Fed to post that collateral?

Mr. BERNANKE. Are you talking about the TALF program?

Mr. MARCHANT. Yes.

Mr. BERNANKE. Sir, the expansion of the assets that we take, it would still work the same way, which is that investors would purchase these assets from the issuers of the ABS, and then we would lend to the—against that collateral we would lend to those investors in an amount between 85 and 95 percent of the principal value, depending on the risk that we saw in those assets.

So the participants on the investors side may be very much the same, potentially the same group of people, just general investors. And on the issuers side, you have banks and other institutions which create ABS. The difference would be the types of assets which are being securitized, and that would affect different markets like the commercial mortgage market, for example.

Mr. MARCHANT. And one of the largest holders of commercial-backed mortgages are insurance companies. So are insurance companies eligible to come and participate in this TALF program?

Mr. BERNANKE. Yes, they are.

Mr. MARCHANT. And have they been participating to a high degree before—

Mr. BERNANKE. We are not in operation yet. We are still a few weeks away from operation.

Mr. MARCHANT. But a new part of this will be that insurance companies will be—

Mr. BERNANKE. Any investor who wants to purchase ABS on a leveraged basis could come to the Fed's program and do that.

Mr. MARCHANT. And your goal has been, and you testified earlier that about 5 percent of the overall loans are in these forms where you consider there to be a higher risk, in the AIG loan or—

Mr. BERNANKE. Of the Fed's balance sheet, about 5 percent of our loans are related to either AIG or Bear Stearns.

Mr. MARCHANT. And is that an internal target? Do you feel like the expansion of the collateral and the expansion of the definition of who can come and borrow from the Fed in any way endangers that ratio that you are talking about?

Mr. BERNANKE. Well, we like that ratio to be as small as possible.

It got to where it was because of the actions we had to take to preserve those firms. But we are—if we expand the balance sheet further, it is not in order to affect that ratio; it is in order to make credit available for markets where currently the markets aren't working well.

Mr. MARCHANT. But you don't think that the expansion of this will take that number down to where at some point 10 percent of the loans would be over in that category?

Mr. BERNANKE. Well, it is 5 percent now, so it will only go down, and we want to make it as low as possible.

Mr. MARCHANT. Do you feel like—earlier we talked about transparency, and you stated that there was some concern if you issued a—if you revealed those banks that came in on an overnight basis that there would be some kind of reaction to thinking that because they were coming in, they might not be a safe institution.

Are there some criteria for banks that are in every night with the same assets and you are, in effect, rolling over every night the same asset and the same loan? Is that—at what point is it not an overnight loan, but it, in fact, is a longer-term commitment?

Mr. BERNANKE. Well, we always make sure of two things: first, that the bank is sound, which means that we either have our own supervisory staff there or we are in touch with the primary regulator of that bank; and the other thing is that we reevaluate the collateral each time it comes in. If it declines in value, for example, we would insist on a different piece of collateral.

But otherwise, certainly through—there was a time when the Fed would have said, No, stop. But, frankly, through this crisis, we feel that we need to make liquidity available to banks, that they can feel comfortable that if there is a drain on their deposits, for example, that they will have access to the Fed's window to make up that liquidity.

Mr. MARCHANT. The last question is the AAA rating, and I think that the public reached some conclusions about the validity of this AAA rating.

Has the Fed come to where—

Mr. WATT. The gentleman's time has expired.

Mr. MARCHANT. —they feel like the AAA rating is a real AAA rating now?

Mr. WATT. The gentleman's time has expired. You will have to answer in writing.

The gentleman from the other part of Texas.

Mr. GREEN. Thank you, Mr. Chairman.

And it is good to see you again, Mr. Bernanke. I do keep you in my prayers.

Mr. BERNANKE. Thank you.

Mr. GREEN. Mr. Bernanke, I would like to discuss with you very briefly the efficacy of mark-to-market and a possible modification. My concern with mark-to-market is when we value assets and we write them down as credit losses, which means that we assume that they are losses because the borrower cannot perform or is not performing, as opposed to liquidity losses, which assumes that performance does not necessitate a writing-down of the asset at the current time.

My concern is this: If we buy these assets, we do have to assign some value. If we utilize mark-to-market to assign the value, we can create an even greater problem because there is no real market. We write down the assets.

When we write down the assets, we find ourselves having to introduce more capitalization. By introducing more capitalization, we find ourselves—also the banks have a liquidity problem in the sense that they don't use that capitalization to lend money. They use the money that they have—they are making on loans to lend money, or they come to your discount window and they borrow to lend money.

Now, having said all of that—and I hope it made sense to you—if it did make sense, would you kindly acknowledge so that I know—

Mr. BERNANKE. I thought it was a very good question. I appreciate it.

Mr. GREEN. Okay.

Having said all of that, one proposal is to split the assets—what are called "troubled assets," "toxic assets," "bad loans"—split them into credit losses and liquidity losses. In so doing, you don't take all of what I will call—in highly technical terminology, you don't "take all of the hit at one time;" you kind of spread your losses over some period of time because you only have to now deal immediately with the bad credit as opposed to potentially bad credit.

Your thoughts on that type of modification, such that you don't eliminate mark-to-market, but what you do is you modify it such that it may be efficacious and not create a bigger problem?

Mr. BERNANKE. There is an idea very similar to that which would have only the credit loss and not the liquidity loss going to the income statement and showing up as profit and loss. And my understanding is that FASB, the accounting board, and the SEC reviewed that proposal late last year and found it sufficiently promising that they were going to look at it again in 2009.

So I think it is an interesting idea and it is getting attention from the accounting authorities. But it makes—it makes sense to try to—particularly for assets which are going to be held for a period, to make a distinction between the credit losses and the liquidity premium that you are referring to.

Mr. GREEN. Thank you.

Now, a quick comment and a response from you. All banks are not bad banks; and somehow all banks are getting the rap of being bad banks because of what is happening, but they are not. Some desire to lend, but they are not fully capitalized to the extent that they would like to be, or if they are, they are having problems with making loans because of, one, not getting good applicants, two, because they don't have the money to lend. While they received money to capitalize, to be capitalized—the money that we, for example, placed in banks; that money was to take an equity position, and they used that money for capitalization—they don't use that money for lending.

So since they have that money—and the public believes by the way, Mr. Bernanke, and I am sure you are aware of this, that they could have taken that money and immediately started to lend it, which is a mistake; and somehow we have to communicate that message that there are rules that require that they be fully capitalized or capitalized to the extent that they can make loans at a certain ratio.

So here is my concern: If we don't get this message out—and I think this is what one of the chairpersons has talked about earlier in another way. But if we don't get this message out, the public continues to believe that the banks are getting money, and they are just holding on to it because they just like holding money, which is highly unusual for banks. They kind of like to lend at a high rate and borrow at a cheap rate, if they have to borrow, and prefer not to borrow if they can help it.

So now would you kindly comment on how we can deal with this perception that the public has about banks?

Mr. WATT. The gentleman may have to submit his comments in writing.

Mr. BERNANKE. Can I take 30 seconds just to say I think it is again a very good question; and that is one of the reasons it is hard to judge whether a bank is increasing its lending as it should, or not, because it may have funding issues. It may have difficulty finding creditworthy borrowers. They may have other sources of credit. It makes these kinds of measurements very difficult. But it is a very good question.

Mr. WATT. The gentleman from the Vice President's State is recognized.

Mr. CASTLE. Thank you, Mr. Chairman.

Chairman Bernanke, first of all, I am delighted you are here. I am delighted we are having this hearing. I had written to the chairman of the committee some time ago asking for it, and I think all of us looked forward to it, and I think it is very valuable.

You made a statement earlier—and you have made it before, I have seen it before at least; and that is that only half of loans at normal times are from banks.

Can you briefly summarize where the other—what the percentages might be on the other half, where they might come from?

And let me tell you why I am asking the question. We are concerned about not just the liquidity and the capitalization, all of which you are concerned about; it is part of your job. But we are also concerned about what is happening in terms of lending practices and the economy in general; and I am just concerned about what the other lending outlets might be, if you know that.

Mr. BERNANKE. Yes, of course.

There are securities markets basically. You have corporate bonds and other kinds of commercial debt like commercial paper. A very important category is asset-backed securities where it could be that the bank sort of ultimately makes the initial loan. It makes an auto loan, for example. But rather than holding it on its books against its own capital, it combines it with other auto loans, makes a security called an asset-backed security, and sells it directly to investors.

Another big area is mortgages, which are mostly securitized either from Fannie and Freddie or from private-label mortgage securitizers.

So a very—something on the order of half of all credit goes through either the securitization market or through other securities markets; and although banks may be involved at some point in the process, they do not hold that—those assets on their portfolios, and their capital is not forced to bear that risk.

So the closing down of the securitization markets has put a lot more pressure on the banks, because they haven't got the capacity to make up the difference between the losses in the securitization markets.

Mr. CASTLE. Thank you.

What criteria are you looking at to determine the effectiveness of the various programs, not only your regular lending to the banks, but to the other institutions, the AIGs and Bear Stearnses? I mean, do you look at just the capitalization and liquidity, or are you looking at what they are doing with it and how they are conforming to their normal lending practices or whatever?

What criteria do you look at?

Mr. BERNANKE. Again, we are not involved in TARP-type activities to healthy banks. We were involved collaboratively with the Treasury and the FDIC in trying to stabilize a small number of large, systemically critical institutions; and there the major criterion is to prevent them from being involved in disorderly failure and to allow them to be stabilized, and that was the main criterion in those cases.

Mr. CASTLE. So as part of your criteria you are not really looking at what they are doing, other than being stabilized and—

Mr. BERNANKE. In order to decide if a company is systemically critical, we need to look at their books and see what kinds of activities are they engaged in and, if they were to fail, what would be the contagion effects across other institutions and other markets around the world.

But that, again, as I have said several times, is 5 percent of our activity, and 95 percent of our activity is trying to get markets going again, like the commercial paper market where rates have come down considerably or the mortgage market where rates have come down.

Mr. CASTLE. Should section 13(3) of the Federal Reserve Act be amended to ensure proper oversight of emergency activities to require congressional approval or Government Accountability Office review, GAO review?

Mr. BERNANKE. Well, there is substantial oversight, including a monthly report on each activity to the Congress; and the GAO, of course, can evaluate that. We have an IG as well.

But as I have mentioned, this is not a business we want to be in. We want to get out of this business, and if Congress can develop a good resolution regime to address this issue, the Federal Reserve is happy to work with you in any way that can be constructive.

We would like to—we would like to make stabilization of systemically critical firms a very rare event; and when it is done, it should be done in as systematic and clear and as well specified a way as possible.

Mr. CASTLE. Thank you.

I will yield back the balance of my time.

Mr. WATT. Mr. Cleaver is recognized.

Mr. CLEAVER. Thank you, Mr. Chairman.

Mr. Chairman, very quickly, before I get to my question, I think we made a tactical mistake and I think we are making it again. When you use the term "bailout," I think that—and I know the media connected with that and ran with it, and so you automatically are going to have a large number of people against a bailout no matter what it is.

And then we started talking about the "bad bank," and we are setting ourselves up again. And I don't know who created the word in this context, but whoever did it, it is not helpful. I mean, we ought to use something like the "Damascus Road Bank" where Paul was bad and had an experience, stayed in that experience 3 days, and came out good.

But whatever it is, you ought to get your linguists or somebody— we need to—this "bad bank" idea is bad.

Mr. BERNANKE. The official terminology is "aggregator bank."

Mr. CLEAVER. It won't work, Mr. Chairman.

Mr. BERNANKE. That is not going to make it?

Mr. CLEAVER. It won't work. We need a 3-year-old to come up with it.

I have two automobile manufacturing plants in my district, Ford and GM. And the question that I am very much concerned about is funding for the auto dealers' floor plans. And in the TALF, there does not appear to be funding except for securitized activities, which is also troublesome because—and Mr. Marchant, the gentleman from Texas, kind of went here, but, you know, why should the securities be required to have a AAA rating when the agencies that had all the toxic-backed mortgages also were AAA rated by the rating agencies?

So I guess I have a couple of questions. One is auto dealer floor plans. And then the second one is securitized activity.

Mr. BERNANKE. Just to interject, the floor plans are eligible for the TALF under current rules.

As far as securitization is concerned, even if the underlying credit isn't perfect, the AAA tranche, the more senior tranche, would still be eligible for financing through the TALF. We really couldn't—just procedurally and legally and operationally would have a great deal of difficulty financing individual loans. It is much more effective and efficient to have them in securitizations; and it is common practice to securitize those loans, as I understand.

Mr. CLEAVER. But the AAA rating, is that necessary?

Mr. BERNANKE. Well, I mean, a lot of people here today have been concerned about the Federal Reserve taking on too much credit risk. So I want to respond to that concern about minimizing that risk.

Again, it doesn't have to be a—the underlying credit doesn't have to be, necessarily, AAA so long as the ABS is structured in such a way that the AAA component of it is financed.

Mr. CLEAVER. Let me change direction quickly. What if unemployment, God forbid, goes to 12 percent or higher? How are the institutions going to pay back their loans to the Fed with unemployment soaring and the credit market frozen.

Mr. BERNANKE. Well, I certainly hope that doesn't happen, but our collateral, our loans are very short term. Our collateral is continually reevaluated. So even if the economy gets very bad, banks will almost certainly be able to make those short-term loan repayments. We are not concerned about that, we are concerned about the effects of such a situation on the banking system as a whole.

Mr. CLEAVER. Thank you, Mr. Chairman.

Mr. WATT. The Chairman had advised us that he had to leave at 4:00, so I want to inquire of his schedule.

Mr. BERNANKE. You have three more people; is that right?

Mr. WATT. Four more people; 1, 2, 3, 4.

Mr. BERNANKE. Certainly.

Mr. WATT. We have to go vote in 10 minutes anyway.

Mr. BERNANKE. All right. I will be glad to stay.

Mr. WATT. Mr. Royce.

Mr. ROYCE. Chairman, I served on the agency subcommittee, and there is a history in terms of what happened in Japan that was interesting to me. Between 1992 and 1999, you had a series over 8 years of stimulus bills that were passed by the Japanese Legislature in an effort to get them out of recession, and during that period of time, it ended up being about $1.3 trillion U.S. that they spent on this, but they ended up doubling their debt to GDP. It went from something like 60 percent to 128 percent during that period of time.

And we had a meeting with Junichiro Koizumi, who was the prime minister. He finally pushed through some reforms that did two things. He basically privatized a lot of the parastatals. But the other thing he did was he leaned on the banks and got them to write off their toxic loans, their bad assets, and that, he always felt, was what finally in 1999 brought them out, rather than the spending stimuluses.

And in light of that, and also in light of what happened in Scandinavia, with the Swedish experiments in the 1990's, when they had the subprime problem, and they developed a system where they had the aggregator bank take those assets out of the system so that their banking management were spending their time on generating new loans instead of worrying about these assets that were segregated; and then the assets, of course, were held, and it was 5 or 6 years or whatever, and eventually the price came back up and sort of netted out—I guess it cost a couple of GDP points to their economy, but they got through it without the type of crash that they had feared.

And so I was going to ask basically wasn't it the act of addressing the toxic assets that really worked for Japan and worked for the Swedish government at the time? Getting those financial institutions to move those off of their books on to a different write-down concept, isn't that what eventually probably had most to do with those countries' economic recovery?

Mr. BERNANKE. So specifically under fiscal policy in Japan, I won't take you through it, but there is a lot of controversy. Some say that it didn't work; others say it wasn't tried in a sufficiently sustained way.

The lesson I do take, and exactly the one you just stated, is that if we don't get the financial system working, and that involves very likely both taking bad assets and injecting capital, that other steps to restore the economy will probably not be effective.

Mr. ROYCE. I appreciate that.

I have a second question, and it has to do with a speech last month by the president of the Richmond Federal Reserve Bank, Jeff Lacker. He said, "The critical policy question of our time is where to establish the boundaries around the public-sector safety net provided to financial market participants, now that the old boundaries are gone. In doing so, the prime directive should be that the extent of regulatory and supervisory oversight should match the extent of access to central bank credit in order to contain moral hazard effectively."

And he said, "The dramatic recent expansion of Federal Reserve lending, and government support more broadly, has extended public-sector support beyond existing supervisory reach, and thus could destabilize the financial system if no corrective action is taken. Restoring consistency between the scope of government support and the scope of government supervision is essential to a healthy and sustainable financial system."

Is this a long-term question of moral hazard, how you offset it, how you overcompensate for that? I talked to you about that before, but I would just like your thoughts, if I could, on that.

Mr. BERNANKE. I think that is a critical principle for the longer term, but we are in the middle right now of an extraordinary crisis.

Mr. ROYCE. I understand that.

Mr. BERNANKE. We need to get through that crisis, but I very much agree with Mr. Lacker that we need to clarify regulatory responsibilities, and that lending and other such interventions ought to be aligned with those authorities and with congressional intent.

Mr. ROYCE. I thank you very much. My time has expired.

Mr. WATT. Mr. Perlmutter.

Ms. Bean, I am sorry.

Ms. BEAN. Thank you, Mr. Chairman.

And thank you, Chairman Bernanke, for your patience with us today. Your testimony has been helpful. Even when we are not here, we are watching from our office. It has been very helpful.

In follow-up to Congressman Royce's comments, given that you are an expert in the history around the world in these types of situation, wasn't it also true, to go back to Japan, that part of the challenges they had were that they were slow in their response, and it wasn't sizable enough in what they did; that they tightened their monetary policy, where your approach has been just the opposite;

and that much of their stimulus was very transportation- and infrastructure-specific, and it was not broad-based, as our own stimulus proposals are?

Mr. BERNANKE. Well, there are a lot of issues there. They did have zero interest rates; in fact, they still have essentially zero interest rates.

I do think that speed of response is very important. As you have all experienced firsthand politically, it is not easy to bring the public along to try to address problems in the banking system. And in Japan the political resistance was one of the reasons why it took a very long time to address the problem.

American people have complained a lot, and I don't blame them. On the other hand, I think people understand that something needs to be done, and these steps that are being taken, as distasteful as they are in some cases, are essential. And I think it speaks well of the Congress that you did act to take these steps, and that we are moving in a reasonably expeditious way, given the speed of events and all that has happened, to begin to tackle our problems. We are much better off addressing them quickly than letting them fester.

Ms. BEAN. Thank you.

I have a few other questions. One is you have spoken before about the use of tax dollars, both some that have involved congressional involvement with TARP, and some of the things you have been able to do without our involvement to stabilize our system. We have also spoken to the fact that the government has the unique ability to hold certain assets that may presently be illiquid and undervalued until a point when we might get a better return on those dollars.

How much has that picture changed, in your mind, from when you testified in the past about how much of that is likely to come back? Are you feeling better, worse moving forward? Are you going to have to hold onto certain things longer? What is your feeling?

Mr. BERNANKE. Well, I do think that there are big liquidity premiums and risk premiums in the market, and that eventually, in all likelihood, those premiums will at least become more normal, which would—otherwise everything else being equal, would tend to improve asset prices.

With that being said, I think one of the big issues right now is that markets are very uncertain about where the economy is going. They have a sense of what is likely to happen, but they fear a small probability, a very bad outcome, and that makes them very reluctant to take on risk.

To the extent the government has more capacity to bear risk and more capacity to hold assets for a longer period, there is some benefit for the government to take assets via the asset purchase facility or some similar mechanism.

Ms. BEAN. You also, in response to a question from Congressman Miller earlier, talked about Secretary Geithner's proposal and how he certainly wants to move what we are now calling legacy assets instead of illiquid assets off the book of many of our financial institutions so that we can better also then evaluate how solvent many of these institutions are.

I just want to clarify whether I understood your comments in response to that; that you felt the good news about that is while some institutions will be proven nonviable, and that there may be some fallout, it should attract more capital than sitting on the sidelines waiting to have better confidence in reentering the market.

Mr. BERNANKE. Well, we hope that very few institutions will actually be insolvent, but the main issue here is not insolvency or solvency per se, but rather the uncertainty about whether institutions are insolvent. And clarifying our policies and taking bad assets through some mechanism would be one step towards making it easier for investors to understand what it is they are buying if they invest capital in an institution.

Ms. BEAN. My next question is had the Fed not acted—and certainly you can act more quickly than when Congress is involved—where would we be now had you not gotten involved?

Mr. BERNANKE. I think we have worked on a number of different fronts. I think we were very aggressive in cutting interest rates and using expansionary monetary policy. I think that that has been helpful. We have worked on a variety of markets, like the commercial paper market. We think we have seen some progress and stabilization, but obviously it has not been enough. I realize it is the most controversial and difficult issue, but I do believe—

Mr. WATT. The gentlelady's time has expired.

Mr. BERNANKE. —that if we had allowed some of the systemically critical firms to fail, that that would have had very big ramifications.

Ms. BEAN. Thank you. I yield back.

Mr. WATT. Mr. Perlmutter, I am advised by Ms. Kilroy that she has a 1-minute quick question. So if you will be so kind as to be expeditious, but you are recognized.

Mr. PERLMUTTER. I will be very quick, Mr. Chairman.

Chairman Bernanke, it has been a heck of a roller coaster for the last 18 months. I am just thinking about your testimony back last July where you came in and gave the semiannual report, and there has been a lot of ups and downs. I just want to thank you for your service, sir.

Mr. BERNANKE. Thank you.

Mr. PERLMUTTER. It has been a difficult time for all of us, but you have definitely been on the front line.

So here are my questions to you: We have been in triage, we have been in the emergency room. We have systemic risk here and systemic risk here, and automakers, Fannie Mae, banks, investment banks and insurance companies. Is there something wrong with the system—not all these little things; is there something wrong with the system? And if you could go back in time, would you change one thing; Glass-Steagall, branch banking, securitizing loans? If you could go back in time, what would it be?

Mr. BERNANKE. I would greatly strengthen the public- and private-sector risk controls.

Mr. PERLMUTTER. Like what?

Mr. BERNANKE. Well, by strengthening supervisory oversight over the risk management, making banks responsible for strengthening those controls. I think the system just got carried away by the credit bubble, and the risk management systems didn't succeed in protecting the system from that.

There are also a lot of gaps in the regulatory system, places where there is duplicate oversight, places where there is not enough oversight. So we have a lot of work to do.

Mr. PERLMUTTER. I am putting it out there. You don't have to respond to it, but part of me longs for the good old days of smaller banks or institutions, that in the event they were to fail, it doesn't affect the system, which is what we have had here, and in too many places and in too many spots, number one.

Second question, and then I will yield to the gentlewoman from Ohio. Dr. Price kept talking about private capital on the sidelines. I have heard that a lot, private capital on the sidelines. It will come rushing in when we do something.

First of all, I want to compliment you; I think we staved off the collapse of a banking system, given what was going on in September. But how much private capital is there to come roaring in after the economy has dropped by 30 or 40 percent?

Mr. BERNANKE. I think there is a good bit. There has been a huge rush away from credit markets in general, money going into very safe assets, Treasury bill rates being driven even negative for a short period, certainly less than it was before, and there have been a lot of losses. But there is still plenty of capital if the environment improves in a way that makes it attractive.

Mr. PERLMUTTER. I have a million questions, but I yield to the gentlelady from Ohio.

Mr. WATT. Ms. Kilroy.

Ms. KILROY. Thank you, Mr. Perlmutter.

Thank you, Chairman Bernanke, for accommodating us.

The questions and answers have certainly been instructive. And, like Mr. Perlmutter, I would like to engage in a great deal more on risk controls or robust resolution regime, transparency. But right now the Dow is down over 400 points. What can you tell my constituents in Ohio that will increase their confidence that their 401(k)s, that their children's college funds, that their life savings won't continue to suffer because of the uncertainty that you indicated was one of the problems and—their concerns, the uncertainty in the financial markets?

Mr. BERNANKE. Well, I wouldn't make any assessment of the Treasury's proposal, for example, based on 1 day's market reaction. It is clearly very early. Secretary Geithner and the President and the Federal Reserve and other authorities are going to work with Congress and try to make sure that this thing is fleshed out in a way that will meet all the concerns about transparency and efficiency and do the important work of stabilizing our financial system. There are many components to that.

I think that this plan touches on the many components: removing bad assets; injecting capital; doing something about the securitization markets, which is, again, close to half of the credit extent in the United States; foreclosure mitigation, which will soon be described; increasing the guarantee of liabilities. All the key steps that seem to make a whole are there, and details need to be worked out, but I believe this is, broadly speaking, the right direction. And I know there will be a lot of work done over the coming weeks as the Treasury, the Administration, and the Congress work together to try to figure out the appropriate details.

Ms. KILROY. Thank you, sir.

Mr. WATT. Let me express thanks for the Chair and the full committee for your appearance. I don't think anybody can go away saying you were not fully transparent in your testimony today. So we thank you so much, and we will look forward to having you back soon for the Humphrey-Hawkins hearing.

Mr. BERNANKE. Thank you.

Mr. WATT. The committee is adjourned.

[Whereupon, at 4:17 p.m., the hearing was adjourned.]

A P P E N D I X

February 10, 2009

Statement by Rep. Michele Bachmann
House Financial Services Committee Hearing
"An Examination of the Extraordinary Efforts by the Federal Reserve Bank to Provide Liquidity in the Current Financial Crisis"

February 10, 2009

Thank you, Mr. Chairman.

After the Federal Reserve's first $29 billion bailout for Bear Stearns last March, the American people have watched Congress put more than $1 trillion of their hard-earned tax dollars out on a limb. This tab includes $200 billion to bailout Fannie and Freddie, $300 billion for a failing loan mitigation program that's helped only 25 people, $85 billion for AIG, and of course, $700 billion for the giant financial service sector bailout -- plus $110 billion in "sweeteners" that were added to pass that bailout plan.

Many of us here in Congress fought tooth and nail for consideration of alternatives to these bailouts which exposed taxpayers so dramatically and have so far been unaccountable and inefficient. And yet, without a single vote from Congress, the Federal Reserve has quietly created six different lending facilities that are financed by U.S. taxpayers, the most recent of which will total $200 billion to entice investors to purchase securities backed by credit card, auto and student loans.

Congress voted on the $700 billion Troubled Asset Relief Program (TARP). It voted on "Stimulus I" which comprised $168 billion in tax cuts and rebate checks. And, this week, it will vote on another so-called "stimulus" that amounts to another $1 trillion. But it didn't vote on the $8 trillion in lending and guarantee programs enacted over the past year by the Fed and the FDIC. These programs were established under existing authorities and have more or less flown under the radar screen.

When all of these programs are combined, the taxpayers' coffers are exposed to more than $9.7 trillion. $9.7 trillion of the taxpayers' hard-earned money is at risk, Mr. Chairman, and it's hardly even discussed in such naked terms. That is astounding.

Bloomberg News reported yesterday that that is "enough to pay off more than 90 percent of the nation's home mortgages." It goes on and states, "The $9.7 trillion in pledges would be enough to send a $1,430 check to every man, woman and child alive in the world. It's 13 times what the U.S. has spent so far on wars in Iraq and Afghanistan, according to Congressional Budget Office data, and is almost enough to pay off every home mortgage loan in the U.S., calculated at $10.5 trillion by the Federal Reserve."

The Fed's authority to take such actions is broad and loosely defined. Section 13.3 under the Federal Reserve Act is a short provision, often referred to as the discount window, which gives the Fed it's most expansive power to open the taxpayers' wallets to anyone it chooses, so long as the Board deems such action is necessary due to "unusual and exigent" circumstances.

While I understand the need for emergency response tools, I am concerned that this provision is so broad and unaccountable that it has the potential to really harm the taxpayers over the long run.

This is truly an extraordinary power. Our Committee should seriously examine whether it should be scaled back or reformed to instill more transparency and accountability and to avoid unintended consequences.

Chairman Bernanke, I appreciate you being here to discuss this important issue.

Thank you, Chairman Frank, and I yield back the balance of my time.

Opening Statement

Committee on Financial Services
Hearing on
"An Examination of the Extraordinary Efforts by the Federal Reserve Bank to Provide Liquidity in the Current Financial Crisis"

February 10, 2009

The Honorable Tom Price
[Georgia-6th District]

Lately, it seems as though every few weeks we see the creation of a new Federal Reserve lending facility. In an attempt to take on the troubled market head first, the Fed seems to have morphed its role as the manager of monetary policy into the more activist role – lender of first resort.

The Fed has exposed itself to an unprecedented amount of risk in these facilities by increasing its balance sheet and expanding its definition of acceptable collateral. In fact, the Fed has doubled its balance sheet since August, going from less than $1 trillion to approximately $2 trillion in the span of 5 months.

The Fed has taken extraordinary action to prevent large institutions from failing, but in the wake of these actions, we must consider the effects on our market based system. We are politicizing our economy by allowing the government to designate certain institutions as "too big to fail." In a political economy, where we currently find ourselves, the government picks winners and losers, decides who is propped up and who fails. In this political economy, losses are socialized while profits are privatized. This is NOT the type of economy that has allowed America to become the leader of the world and it is not the type of economy the American people want.

While I firmly believe the Fed's ability to respond to the market is crucial, it is equally crucial that Congress and the American public have a solid understanding of why the Fed takes certain actions and why these actions are absolutely necessary to stabilize the economy.

Ultimately, it is imperative that we examine any way in which government intervention in the market is keeping private capital on the sidelines. As long as the government is picking winners and losers, deciding who gets rescued and who fails, private investors will make the decision that makes the most financial sense to them. They will hold onto their funds or invest them elsewhere. How can we expect private capital to participate when their investment may be diluted, or their competition may be propped up by the government?

My constituents want to know what the exit strategy for all this government intervention looks like. My concern, however, is that in the wake of the administration's announcement this morning, we are moving in the wrong direction. With more taxpayer dollars on the line and more risk being assumed by the government, we need the justification for why "more" is going to work, when everything we have done to this point has not. When will we allow the wonders and responsiveness of our market economy to work, to guide our way forward for the betterment of all?

OPENING STATEMENT OF REP. MELVIN WATT

Financial Services Committee Hearing Entitled, "An Examination of the Extraordinary Efforts by the Federal Reserve Bank to Provide Liquidity in the Current Financial Crisis"

Tuesday, February 10, 2009

In these difficult economic times which, by all accounts are unprecedented at least since the Great Depression, the Federal Reserve has had to consider every lever and tool at its disposal. We are here today to review some of these extraordinary levers and tools.

The tools being used by the Fed are authorized by Section 13(3) of the Federal Reserve Act which allows the Fed in "unusual and exigent" circumstances to lend broadly to individuals, partnerships or corporations in any industry, if the Board determines that such entity cannot secure adequate financing from other banking institutions, and that entity has produced collateral to the Board's satisfaction. Using this authority, starting in 2008 and continuing this year, the Federal Reserve has set up emergency lending facilities to address severe market strains in commercial paper by activating a Commercial Paper Funding Facility, to address severe strains related to money market funds by activating a Money Market Liquidity Facility, and announced earlier today that it plans a substantial expansion of its Term Asset-Backed Securities Loan Facility.

In a recent lecture at the London School of Economics, Federal Reserve Chairman Bernanke described three policy tools (other than reducing the federal funds rate) that he reaffirmed that the Federal Reserve has the authority to use to directly extend credit or purchase securities: (1) the provision of short-term liquidity to sound financial institutions; (2) the provision of liquidity directly to borrowers and investors in key credit markets; and (3) the direct purchase of longer-term securities to support the credit markets. The use of each of these tools will, of course, expand the balance sheet of the Federal Reserve and subject the Fed to more attention, scrutiny, second guessing and oversight. Otherwise, we run the risk that authority granted in a 1933 statute could be "out of control" or subject to abuse.

The use of each of these tools also raises the question: what happens when the "unusual and exigent circumstances" are over? What is the "exit strategy" for winding down the various Fed lending programs when we return to normal times?

Today's review of the Fed's power under Section 13(3) of the Federal Reserve Act is the first in a series of hearings and other actions that we must take to evaluate steps that certainly appear to be necessary to combat the economic crisis that confronts us. I trust that our evaluation will be transparent, open and fair and welcome Chairman Bernanke's testimony.

For release on delivery
1:00 p.m. EST
February 10, 2009

Statement of

Ben S. Bernanke

Chairman

Board of Governors of the Federal Reserve System

before the

Committee on Financial Services

U.S. House of Representatives

February 10, 2009

Chairman Frank, Ranking Member Bachus, and other members of the Committee, I appreciate this opportunity to provide a brief review of the Federal Reserve's various credit programs, including those relying on our emergency authorities under Section 13(3) of the Federal Reserve Act. I will also discuss the Federal Reserve's ongoing efforts to inform the Congress and the public about these activities.

Federal Reserve Programs to Strengthen Credit Markets and the Economy

As you know, the past 18 months or so have been extraordinarily challenging for policymakers around the globe, not least for central banks. The Federal Reserve has responded forcefully to the financial and economic crisis since its emergence in the summer of 2007. Monetary policy has been especially proactive. The Federal Open Market Committee (FOMC) began to ease monetary policy in September 2007 and continued to ease in response to a weakening economic outlook. In December 2008, the Committee set a range of 0 to 25 basis points for the target federal funds rate.

Although the target for the federal funds rate is at its effective floor, the Federal Reserve has employed at least three types of additional tools to improve the functioning of credit markets, ease financial conditions, and support economic activity.

The first set of tools is closely tied to the central bank's traditional role of providing short-term liquidity to sound financial institutions. Over the course of the crisis, the Fed has taken a number of extraordinary actions, including the creation of a number of new facilities for auctioning short-term credit, to ensure that financial institutions have adequate access to liquidity. In fulfilling its traditional lending function, the Federal Reserve enhances the stability of our financial system, increases the willingness of financial institutions to extend credit, and helps to ease conditions in interbank lending markets, reducing the overall cost of capital to banks. In addition, some interest rates, including the rates on some adjustable-rate mortgages, are tied contractually to key interbank rates, such as the London interbank offered rate (Libor). To the extent that the provision of ample liquidity to banks reduces Libor, other borrowers will also see their payments decline.

Because interbank markets are global in scope, the Federal Reserve has also approved bilateral currency liquidity agreements with 14 foreign central banks. These so-called swap facilities have allowed these central banks to acquire dollars from the Federal Reserve that the foreign central banks may lend to financial institutions in their jurisdictions. The purpose of these liquidity swaps is to ease conditions in dollar funding markets globally. Improvements in global interbank markets, in turn, promote greater stability in other markets at home and abroad, such as money markets and foreign exchange markets.

The provision of short-term credit to financial institutions exposes the Federal Reserve to minimal credit risk, as the loans we make to financial institutions are generally short-term, overcollateralized, and made with recourse to the borrowing firm. In the case of the currency swaps, the foreign central banks are responsible for repaying the Federal Reserve, not the financial institutions that ultimately receive the funds, and the Fed receives an equivalent amount of foreign currency in exchange for the dollars it provides foreign central banks.

Although the provision of ample liquidity by the central bank to financial institutions is a time-tested approach to reducing financial strains, it is no panacea. Today, concerns about capital, asset quality, and credit risk continue to limit the willingness of many intermediaries to extend credit, notwithstanding the access of these firms to central bank liquidity. Moreover, providing liquidity to financial institutions does not directly address instability or declining credit availability in critical nonbank markets, such as the commercial paper market or the market for asset-backed securities.

To address these issues, the Federal Reserve has developed a second set of policy tools which involve the provision of liquidity directly to borrowers and investors in key credit markets. For example, we have introduced facilities to purchase highly rated commercial paper at a term of three months and to provide backup liquidity for money market mutual funds. In addition, the Federal Reserve and the Treasury have jointly announced a facility--expected to be operational shortly--that will lend against AAA-rated asset-backed securities collateralized by recently originated student loans, auto loans, credit card loans, and loans guaranteed by the Small Business Administration. Unlike our other lending programs, this facility combines Federal Reserve liquidity with capital provided by the Treasury. If the program works as planned, it should help to restart activity in these key securitization markets and lead to lower borrowing rates and improved access in the markets for consumer and small business credit. This basic framework could also be expanded to accommodate higher volumes as well as additional classes of securities, as circumstances warrant.

These special lending programs have been set up to minimize credit risk to the Federal Reserve. The largest program, the commercial paper funding facility, accepts only the most highly rated paper. It also charges borrowers a premium, which is set aside against possible losses. As just noted, the facility that will lend against securities backed by consumer and small-business loans is a joint Federal Reserve-Treasury program; capital provided by the Treasury from the Troubled Asset Relief Program will help insulate the Federal Reserve from credit losses (and the Treasury will receive most of the upside from these loans).

The Federal Reserve's third set of policy tools for supporting the functioning of credit markets involves the purchase of longer-term securities for the Fed's portfolio. For example, we recently announced plans to purchase up to $100 billion of the debt of government-sponsored enterprises (GSEs), including Fannie Mae, Freddie Mac, and the Federal Home Loan Banks, and up to $500 billion in agency-guaranteed mortgage-backed securities (MBS) by midyear. The objective of these purchases is to lower mortgage rates, thereby supporting housing activity and the broader economy.

The Federal Reserve is engaged in an ongoing assessment of the effectiveness of its credit-related tools. Measuring the impact of our programs is complicated by the fact that multiple factors affect market conditions. Nevertheless, we have been encouraged by the responses to these programs, including the reports and evaluations offered by market participants and analysts. Notably, our lending to financial institutions, together with actions taken by other agencies, has helped to relax the severe liquidity strains experienced by many firms and has been associated with considerable improvements in interbank lending markets. For example, we believe that the aggressive liquidity provision by the Fed and other central banks has contributed to the recent declines in Libor and is a principal reason that liquidity pressures around the end of the year--often a period of heightened liquidity strains--were relatively modest. There is widespread agreement that our commercial paper funding facility has helped to stabilize the commercial paper market, lowering rates significantly and allowing firms access to financing at terms longer than a few days. Together with other government programs, our actions to stabilize the money market mutual fund industry have also shown some measure of success, as the sharp withdrawals from funds seen in September have given way to modest inflows. And our purchases of agency debt and MBS seem to have had a significant effect on conforming mortgage rates, with rates on 30-year fixed-rate mortgages falling close to a percentage point since the announcement of the program. All of these improvements have occurred over a period in which the economic news has generally been worse than expected and conditions in many financial markets, including the equity markets, have worsened.

We evaluate existing and prospective programs based on the answers to three questions: First, has normal functioning in the credit market in question been severely disrupted by the crisis? Second, does the Federal Reserve have tools that are likely to lead to significant improvement in function and credit availability in that market, and are the Federal Reserve's tools the most effective methods, either alone or in combination with those of other agencies, to address the disruption? And third, do improved conditions in the particular market have the potential to make a significant difference for the overall economy? To illustrate, our purchases of agency debt and MBS meet all three criteria: The mortgage market is significantly impaired, the Fed's authority to purchase agency securities gives us a straightforward tool to try to reduce the extent of that impairment, and the health of the housing market bears directly and importantly on the performance of the broader economy.

The Use of Authorities Under Section 13(3) of the Federal Reserve Act

Section 13(3) of the Federal Reserve Act authorizes the Federal Reserve Board to make secured loans to individuals, partnerships, or corporations in "unusual and exigent circumstances" and when the borrower is "unable to secure adequate credit accommodations from other banking institutions." This authority, added to the Federal Reserve Act in 1932, was intended to give the Federal Reserve the flexibility to respond to emergency conditions. Prior to 2008, credit had not been extended under this authority since the 1930s.[1] However, responding

[1] The Federal Reserve invoked this provision twice in the 1960s to authorize lending but no credit was drawn.

to the extraordinarily stressed conditions in financial markets, the Board has used this authority on a number of occasions over the past year.

Following the Bear Stearns episode in March 2008, the Federal Reserve Board invoked Section 13(3) to make primary securities dealers, as well as banks, eligible to borrow on a short-term basis from the Fed.[2] This decision was taken in support of financial stability, during a period in which the investment banks and other dealers faced intense liquidity pressures.[3] The Fed has also made use of the Section 13(3) authority in its programs to support the functioning of key credit markets, including the commercial paper market and the market for asset-backed securities. In my view, the use of Section 13(3) in these contexts is well justified in light of the breakdowns of these critical markets and the serious implications of those breakdowns for the health of the broader economy. As financial conditions improve and circumstances are no longer "unusual and exigent," the programs authorized under Section 13(3) will be wound down, as required by law. Other components of the Federal Reserve's credit programs, including our lending to depository institutions, liquidity swaps with other central banks, and purchases of agency securities, make no use of the powers conferred by Section 13(3).

In a distinct set of activities, the Federal Reserve has also used its Section 13(3) authority to support government efforts to stabilize systemically critical financial institutions. The Federal Reserve collaborated with the Treasury to facilitate the acquisition of Bear Stearns by JPMorgan Chase & Co. and to prevent the failure of the American International Group (AIG), and we worked closely with the Treasury and the Federal Deposit Insurance Corporation to help to stabilize Citigroup and the Bank of America. In the cases of Bear Stearns and AIG, as part of a

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[2] Primary dealers are broker-dealers that trade in U.S. government securities with the Federal Reserve Bank of New York. The New York Fed's Open Market Desk engages in trades on behalf of the Federal Reserve System to implement monetary policy.

[3] Most other major central banks already provide short-term credit to a broader range of financial institutions, so in making this change, the Fed was conforming to international practice for the period of the financial emergency.

strategy to avoid impending defaults by the companies, the Federal Reserve made loans against pools of collateral.

Activities to stabilize systemically important institutions seem to me to be quite different in character from the use of Section 13(3) authority to support the repair of credit markets. The actions that the Federal Reserve and the Treasury have taken to stabilize systemically critical firms were essential to protect the financial system as a whole, and, in particular, the financial risks inherent in the credits extended by the Federal Reserve were, in my view, greatly outweighed by the risks that would have been faced by the financial system and the economy had we not stepped in. However, many of these actions might not have been necessary in the first place had there been in place a comprehensive resolution regime aimed at avoiding the disorderly failure of systemically critical financial institutions. The Federal Reserve believes that the development of a robust resolution regime should be a top legislative priority. If the specification of this regime were to include clear expectations of the Federal Reserve's role in stabilizing or resolving systemically important firms--a step we very much support--then the contingencies in which the Fed might need to invoke emergency authorities could be tightly circumscribed.

Transparency and Disclosure

I would like to conclude by discussing the Federal Reserve's ongoing efforts to inform the Congress and the public about its various lending programs.

I firmly believe that central banks should be as transparent as possible, both for reasons of democratic accountability and because many of our policies are likely to be more effective if they are well understood by the markets and the public. During my time at the Federal Reserve, the FOMC has taken important steps to increase the transparency of monetary policy, such as moving up the publication of the minutes of policy meetings and adopting the practice of providing longer-term projections of the evolution of the economy on a quarterly basis. Likewise, the Federal Reserve is committed to keeping the Congress and the public informed about its lending programs and balance sheet. For example, we continue to add to the information shown in the Fed's H.4.1 release, which provides weekly detail on the balance sheet and the amounts outstanding for each of the Federal Reserve's lending facilities. Extensive additional information about each of the Federal Reserve's lending programs is available online, as shown in the appendix to this testimony. Pursuant to a requirement included in the Emergency Economic Stabilization Act passed in October, the Fed also provides monthly reports to the Congress on each of its programs that rely on the Section 13(3) authorities. Generally, the Fed's disclosure policies are consistent with the current best practices of major central banks around the world.

That said, recent developments have understandably led to a substantial increase in the public's interest in the Fed's balance sheet and programs. For this reason, we at the Fed have begun a thorough review of our disclosure policies and the effectiveness of our communication. Today I would like to mention two initiatives.

First, to improve public access to information concerning Fed policies and programs, Federal Reserve staff are developing a new website that will bring together in a systematic and comprehensive way the full range of information that the Federal Reserve already makes available, supplemented by new explanations, discussions, and analyses. Our goal is to have this website operational within a few weeks.

Second, at my request, Board Vice Chairman Donald Kohn has agreed to lead a committee that will review our current publications and disclosure policies relating to the Fed's balance sheet and lending policies. The presumption of the committee will be that the public has a right to know, and that the nondisclosure of information must be affirmatively justified by clearly articulated criteria for confidentiality, based on factors such as reasonable claims to privacy, the confidentiality of supervisory information, and the effectiveness of policy.

Thank you. I will be pleased to respond to your questions.

Appendix: Online Sources of Information on the Federal Reserve's Balance Sheet and Lending Programs

Information Regarding Recent Federal Reserve Actions

Board of Governors of the Federal Reserve System, "Information Regarding Recent Federal Reserve Actions," website, www.federalreserve.gov/newsevents/recentactions.htm.

H.4.1 Statistical Release

Board of Governors of the Federal Reserve System, H.4.1 Statistical Release, "Factors Affecting Reserve Balances of Depository Institutions and Condition Statement of Federal Reserve Banks," www.federalreserve.gov/releases/h41/Current/h41.pdf.

Open Market Desk Annual Report

Federal Reserve Bank of New York, Markets Group (2009). "Domestic Open Market Operations during 2008," report prepared for the Federal Open Market Committee, January, www.newyorkfed.org/markets/omo/omo2008.pdf.

Agency Discount Notes

Federal Reserve Bank of New York (2008). "Statement Regarding Planned Purchases of Agency Debt," press release, September 19, www.newyorkfed.org/newsevents/news/markets/2008/rp080919.html.

Agency Purchase Program

Federal Reserve Bank of New York (2008). "FAQs: Purchasing Direct Obligations of Housing-Related GSEs," website, December 3, www.newyorkfed.org/markets/gses_faq.html.

Agency Mortgage-Backed Securities Purchase Program

Federal Reserve Bank of New York (2008). "FAQs: MBS Purchase Program," website, December 30, www.newyorkfed.org/markets/mbs_faq.html.

Term Primary Credit

Board of Governors of the Federal Reserve System (2007). "Federal Reserve Board Discount Rate Action," press release, August 17, www.federalreserve.gov/newsevents/press/monetary/20070817a.htm.

Term Auction Facility

Board of Governors of the Federal Reserve System (2007). "Federal Reserve and Other Central Banks Announce Measures Designed to Address Elevated Pressures in Short-Term Funding Markets," press release, December 12, www.federalreserve.gov/newsevents/press/monetary/20071212a.htm.

------------ (2009). "Term Auction Facility Questions and Answers," website, January 12, www.federalreserve.gov/monetarypolicy/taffaq.htm.

Primary Dealer Credit Facility

Federal Reserve Bank of New York (2008). "Federal Reserve Announces Establishment of Primary Dealer Credit Facility," press release, March 16, www.newyorkfed.org/newsevents/news/markets/2008/rp080316.html.

------------ (2008). "Primary Dealer Credit Facility: Frequently Asked Questions," website, December 8, www.newyorkfed.org/markets/pdcf_faq.html.

Term Securities Lending Facility

Federal Reserve Bank of New York (2008). "Term Securities Lending Facility: Frequently Asked Questions," website, December 2, www.newyorkfed.org/markets/tslf_faq.html.

TSLF Options Program

Federal Reserve Bank of New York (2008). "SOMA TSLF Options Program: Frequently Asked Questions," website, December 2, www.newyorkfed.org/markets/top_faq.html.

Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility

Board of Governors of the Federal Reserve System (2008). "Board Approves Two Interim Final Rules in Connection with Initiative to Provide Liquidity to Markets by Extending Loans to Banking Organizations to Finance Their Purchases of High-Quality Asset-Backed Commercial Paper (ABCP) from Money Market Mutual Funds," press release, September 19, www.federalreserve.gov/newsevents/press/monetary/20080919a.htm.

Commercial Paper Funding Facility

Federal Reserve Bank of New York (2009). "Commercial Paper Funding Facility: Frequently Asked Questions," website, January 23, www.newyorkfed.org/markets/cpff_faq.html.

Money Market Investor Funding Facility

Federal Reserve Bank of New York (2009). "Money Market Investor Funding Facility: Frequently Asked Questions," website, January 7, www.newyorkfed.org/markets/mmiff_faq.html.

Term Asset-Backed Securities Loan Facility

Federal Reserve Bank of New York (2009). "Term Asset-Backed Securities Loan Facility: Frequently Asked Questions," website, February 6, www.newyorkfed.org//markets/talf_faq.html.

Bear Stearns

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HEARING REGARDING

"An Examination of the Extraordinary Efforts by the Federal Reserve Bank to Provide Liquidity in the Current Financial Crisis."

FEBRUARY 10, 2009

The undersigned groups, representing a broad sector of the commercial real estate industry, appreciate the opportunity to present our views regarding the liquidity crisis in the commercial real estate credit markets and the need for policy action to address this issue as part of the overall national economic recovery plan. While the commercial and multifamily real estate industry plays a vital role in the economy, it now faces its worst liquidity challenge since the Great Depression. It is estimated that the commercial real estate sector supports more than 9 million jobs and generates hundreds of millions of dollars in federal, regional and local tax revenue. As the title for today's hearing indicates, efforts undertaken by the Federal Reserve, indeed by a number of the financial regulatory agencies, have been extraordinary. The economic crisis our nation faces demands no less. Along those lines, we applaud the Federal Reserve's implementation of a number of innovative lending facilities as part of a broader strategy of "sustained easing." In particular, the agency mortgage backed securities (MBS) program appears to have helped trigger a decline in residential mortgage rates, helping housing affordability. We encourage the expansion of this program to include agency multifamily MBS and ultimately commercial mortgage backed securities (CMBS) to aid the commercial real estate sector. Despite these constructive efforts, it is important to take additional measures immediately to enhance liquidity and renew credit capacity to a broad range of the economy, including commercial real estate. It is to this end, we offer our assistance and recommendations.

Over the past year, the broader credit crisis has permeated through the world's capital markets and has severely curtailed commercial lending activity. This problem is negatively impacting the $6 trillion commercial real estate market, which is financed in part through more than $3 trillion of debt. Currently, banks and the CMBS market represent 75% of all outstanding commercial real estate loans. However, banks have tightened their credit standards and reduced loan volume in reaction to pressure to increase reserve levels and decrease commercial real estate exposure. The CMBS market has ceased to function with respect to new issuance, and existing bonds trade at highly excessive spreads, all of which points to systemic dysfunction. In fact, the CMBS market provided approximately $240 billion in financing in 2007 (nearly 50% of all commercial lending), but provided less than $13 billion in issuance in 2008, despite enormous demand for capacity from borrowers. Hundreds of billions of dollars of commercial real estate loans from a variety of sources are expected to mature in 2009 and over $1 trillion in the next few years. However, under current conditions, there is insufficient credit capacity to refinance this wave of loan maturities. With no liquidity, commercial borrowers face a growing challenge of refinancing maturing debt and the threat of rising delinquencies and foreclosures, which could result in widespread systemic damage.

We are encouraged by the establishment of the Term Asset-Backed Securities Loan Facility (TALF) program. Under the TALF program, the U.S. Treasury Department -- under the Troubled Assets Relief Program (TARP) of the Emergency Economic Stabilization Act of 2008 -- will provide $20 billion of credit protection to the Federal Reserve Bank of New York (FRBNY). Through this facility, the FRBNY will lend up to $200 billion on a non-recourse basis to holders of certain highly rated securities (AAA) backed by newly and recently originated loans from eligible asset classes. No TARP funds will be ultimately spent or allocated unless losses occur. While this facility will soon become operational for a variety of securitized consumer loans, we think that that it is important to take steps immediately to expand the program to include as eligible collateral securitized newly originated secured and unsecured loans on commercial and multifamily real estate properties.

Extending the "Term Asset-Backed Securities Lending Facility (TALF)" to commercial and multifamily real estate would be a vital and proactive measure aimed at providing liquidity and facilitating lending in the private commercial mortgage market. Such a move would ease the lending crisis that has exacerbated the downturn in the U.S economy and is now negatively impacting commercial real estate market conditions. By taking this important action now, a larger impact on the real estate sector and the national economy can be prevented, forestalling the need for broader government intervention in the future."

In conclusion, having a sound and well functioning commercial and multifamily real estate sector is critical to our country's economic growth and development, and to millions of U.S. businesses of all sizes that provide local communities with jobs and services. The expansion of the TALF program to commercial and multifamily real estate is the most effective way to immediately address the crisis in the commercial credit markets with the least exposure to the taxpayer, and it should be instituted as soon as possible to stem the tide of issues facing the real estate market.

We would encourage policymakers to work with the private sector to consider additional long term solutions to ensure the private market is able to meet ongoing commercial borrowing demands. We thank you for considering our views and we remain ready to assist Congress as it continues to consider various policy options that will restore order to the credit markets and the economy.

American Hotel & Lodging Association
American Land Title Association
American Resort Development Association
Appraisal Institute
American Society of Farm Managers and Rural Appraisers
American Society of Appraisers
Building Owners and Managers Association International
The CCIM Institute
Commercial Mortgage Securities Association
The Institute of Real Estate Management
International Council of Shopping Centers
Mortgage Bankers Association
NAIOP, the Commercial Real Estate Development Association
National Association of Real Estate Investment Managers
National Association of Real Estate Investment Trusts
National Association of Realtors
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STATEMENT OF THE

NATIONAL ASSOCIATION OF REALTORS®

SUBMITTED FOR THE RECORD TO THE

UNITED STATES HOUSE COMMITTEE ON FINANCIAL SERVICES

HEARING REGARDING

FEDERAL RESERVE BANK LIQUIDITY EFFORTS

FEBRUARY 10, 2009

Introduction

On behalf of the 1.2 million members of the NATIONAL ASSOCIATION OF REALTORS® (NAR), who are involved in residential and commercial real estate as brokers, sales people, property managers, appraisers, counselors, and others engaged in all aspects of the real estate industry, thank you for holding this hearing on the Federal Reserve Bank's liquidity efforts.

NAR applauds the initial success of the Federal Reserve Board initiatives to reduce mortgage interest rates through the purchase of mortgage backed securities (MBS) issued by the government sponsored enterprises (GSEs), Fannie Mae and Freddie Mac. When the Federal Reserve announced its decision to purchase GSE debt and MBSs, on November 28, 2008, just the announcement spurred a significant reduction in mortgage interest rates, an initial decrease of 61 basis points. During that period, many REALTORS® reported a significant increase of consumer interest in "for sale" properties. The revival of consumer interest due to a small decrease in mortgage interest rates confirms our belief that a significant reduction in mortgage interest rates will bring a substantial number of consumers back to the housing market.

NAR urges the Federal Reserve to continue its efforts to restore the normal spread between interest rates on Treasury obligations and mortgages. Keeping rates low, and pushing them lower, will restore vibrant housing and mortgage markets that will benefit both home buyers and homeowners seeking fair and affordable mortgages.

Stimulating the Residential Real Estate Market

NAR strongly believes that maintaining low mortgage interest rates, with the ultimate goal of having them within the normal 160 to 180 basis points spread over 10-year Treasury notes, will provide a near immediate impact to the housing market and the overall economy. The Honorable James Lockhart, Director of the Federal Housing Finance Agency, has made public statements acknowledging the link between lower rates in helping homeowners and home buyers. Moreover, NAR estimates that a one percentage point decrease in mortgage interest rates would increase home sales by 500,000.

NAR believes that the Federal Reserve's undertaking of this type of initiative will bring buyers back into the housing market, quickly reduce inventory, and thereby stabilize home prices. It is estimated that the increase in home sales, as spurred on by a one percentage point reduction in mortgage interest rate, will reduce the supply of inventory to about 7.5 months – a level consistent with no further home price declines. Moreover, the impact of this type of effort is felt almost immediately.

Providing Liquidity to the Commercial Mortgage Market

As the Federal Reserve continues to take positive steps towards fostering a recovery in the residential housing market, attention also must be afforded the commercial mortgage space and the serious consequences that the national economy will face if its liquidity continues to wane.

The commercial real estate sector plays a vital role in the economy. Real estate encompasses approximately $20 trillion in owner-occupied housing and $5 trillion in income-producing commercial property. It is estimated that the commercial real estate sector supports more than 9 million jobs and generates millions of dollars in federal, regional and local tax revenue.

Currently, banks and the Commercial Mortgage-Backed Securities (CMBS) market represent 75% of all outstanding commercial real estate loans. Unfortunately, banks are tightening their credit standards and reducing loan volume. At the same time, the CMBS market, which provided approximately $240 billion in financing in 2007 (nearly 50% of all commercial lending), extended less than $13 billion of credit in 2008. Investment activity in commercial real estate sectors is nearly at a standstill because commercial lending has essentially halted.

In 2009, hundreds of billions of commercial real estate mortgage loans will come due. Under current conditions, there will be insufficient capacity to refinance the performing commercial real estate loans that are maturing, which could result in significant loan defaults. It is expected that widespread loan defaults could seriously impact commercial property values, which are already weakened due to the overall downturn in the economy.

NAR strongly urges Congress, and the Department of Treasury, that any policy solutions being considered to correct current economic crisis also include these key principles for commercial real estate:

- In the current economic environment, it is extremely difficult to value assets. Mark-to-market accounting rules need to be modified so as not to further exacerbate the credit crisis.

- The Treasury and Federal Reserve should exercise their authority to implement and/or expand the Term Asset-Backed-Securities Loan Facility (TALF). The TALF should be encouraged to accept commercial mortgage-backed securities and conventional commercial real estate loans as collateral.

- Federal tax policies that strengthen the commercial real estate market need to be maintained and/or enhanced. For example, current capital gains rules as they apply to appreciated property, like-kind exchanges and carried interests need to be retained while passive loss rules should be suspended.

Additional Measures to Ensure a Successful Housing Recovery

Maintaining low mortgage interest rates and improving liquidity in the commercial mortgage markets will only go so far to relieve the current real estate crisis if the federal government, the Federal Reserve, and the mortgage lending industry do not address additional fundamental operational issues that are impeding the delivery of mortgage credit and increasing real estate foreclosures. To successfully facilitate a recovery of the real estate and financial markets, the following issues must be acted upon:

- The Treasury Department should provide additional TARP funds subject to agreement by the recipients to make additional loans for housing and other consumer purposes, establish foreclosure prevention programs, modify more mortgage loans to prevent foreclosures to the maximum extent possible, establish an efficient and effective short sales process, or a combination of these activities.

- All mortgage lenders, their servicers, the GSEs (Fannie Mae and Freddie Mac), and investors in mortgage assets should adopt and implement aggressive policies that result in more mortgage loan modifications to prevent as many foreclosures as possible. Where keeping the family in the home is not possible, these entities should facilitate short sales that will benefit all parties: owners, buyers, neighbors, communities, and lenders/servicers/GSEs/investors.

- Mortgage lenders and private mortgage insurers should (1) reexamine underwriting standards to determine whether they have over-corrected in response to abuses in the mortgage market, and (2) remove unnecessarily strict underwriting standards (such as (i) requiring excessively high credit scores that result in qualified borrowers being arbitrarily turned down for a loan, and (ii) coupling much tighter investor underwriting criteria with a lower cap on the number of financed properties an investor may own).

- Consumer reporting agencies (credit bureaus) should improve compliance with the Fair Credit Act, including prompt responses to consumers who seek to correct files and prompt correction of errors.

- Reform Hope for Homeowners. This program was designed to allow homeowners with troubled mortgages to refinance and get a new 30-year fixed FHA mortgage. However, due to its very restrictive provisions, this program has not been utilized. Reforms including providing great incentives for servicer/investor participation, expanding consumer eligibility, and lessening costs will make the program a much more effective tool for preventing foreclosure.

- FHASecure should be reinstated. HUD's FHASecure program successfully helped more than 450,000 families modify their mortgages and stay in their homes. However, this valuable program was allowed to sunset on December 31, 2008. The Hope for Homeowners program, which was expected to take the place of FHASecure, has not yet achieved the same levels of success. We urge HUD to reinstate FHASecure, so that homeowners have all the tools available to them to avoid foreclosure.

- As families consider buying a foreclosed home, they find that many properties need work in terms of rehabilitation or renovation. FHA's section 203(k) program is a valuable tool that allows homeowners to obtain one insured mortgage to rehabilitate a property in need of repair. However, this program is not available to investors, who may be interested in purchasing these homes and repairing them so they are ready for sale or for conversion to rental units. If the program were made available to them, vacant, dilapidated homes will be renewed and provide safe, comfortable homes for families. Investors will be able to access credit that is unavailable because of the current economic crisis. Finally, neighborhoods will be stabilized and previously vacant homes will contribute to the local property tax base. We urge HUD to once again open the section 203(k) program to investors, with appropriate safeguards and oversight.

Conclusion

NAR believes that focusing on real estate finance, in particular, initiatives aimed at lowering mortgage interest rates and providing liquidity to the commercial market will encourage potential real estate purchasers to enter the marketplace. We encourage the Federal Reserve to continue pursuing new avenues that will bring liquidity to the real estate market, as well as opening existing facilities (i.e. TALF) to the commercial real estate market sector that is in dire need of relief.

NAR thanks you for this opportunity to share our thoughts on the Federal Reserve Bank's liquidity efforts. The 1.2 million residential and commercial real estate practitioners of the National Association of REALTORS® stands ready to work with Congress and our industry partners to facilitate a housing recovery, and lift our nation's economy out this quagmire.

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(on leave of absence, 110th Congress)

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February 3, 2009

Limit Executive Compensation Abuse

Deadline for Original Cosponsors: 3 PM, Wednesday, February 4th

Last week, the New York State Comptroller, Thomas P. DiNapoli, announced that the securities and financial services industry paid an estimated **$18.4 billion in bonuses** last year, at a time when the federal government intervened with billions of taxpayer dollars to prevent collapse of our financial market system. The Comptroller correctly noted, "Taxpayers have invested billions of dollars to stabilize the nation's banks and financial institutions and there are plans to make additional investments to shore up the banking system. There needs to be greater transparency and accountability in the use of these funds."

This is not the only example of disrespect to the American taxpayer that has been in the headlines. You may recall:

"Bailed Out Bank of America Sponsors Super Bowl Fun Fest, Morgan Stanley Hosts Conference at 5-Star Resort in Palm Beach"

[ABC News, 02/02/09]

"Merrill's Thain Said to Pay $1.2 Million to Decorator"

[Bloomberg, 01/23/09]

"After Bailout, AIG Execs Head to California Resort -- Rescued by Taxpayers, $440,000 for Retreat Including 'Pedicures, Manicures'"

[ABC News, 10/07/08]

Please join me in putting an end to a major example of this excessive behavior and cosponsor the Limit Executive Compensation Abuse Act. This bill, which was originally introduced in the Senate by our colleague, Claire McCaskill of Missouri, would limit the annual executive compensation – salary, bonuses, stock options – for recipients of TARP assistance so these executives, supported with taxpayer funds, will not receive more compensation than is paid to the President of the United States.

To join me as an original cosponsor, please see me or contact Glen Sears [glen.sears@mail.house.gov, 5-2865] in my office.

Very Truly Yours,

Dennis Moore
Member of Congress

Let's restore public confidence in our efforts to stabilize our economy!!

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Original Cosponsors of the Limit Executive Compensation Abuse Act

1. Emanuel Cleaver
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3. Gabrielle Giffords
4. David Scott
5. Travis Childers
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7. Patrick Murphy
8. Tim Ryan
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20. Gene Green
21. Jim McGovern
22. Chet Edwards
23. Rush Holt
24. John Conyers
25. Bruce Braley
26. Ben Chandler
27. Mark Schauer
28. Russ Carnahan

Updated 02/04/09

Chairman Bernanke subsequently submitted the following in response to written questions received from Congressman J. Gresham Barrett in connection with the February 10, 2009, hearing before the House Financial Services Committee:

Like many of my colleagues, I have expressed concern about the implementation of the first $350 billion of the Troubled Asset Relief Program (TARP). As Congress oversees both the TARP and the Federal Reserve's extraordinary actions, I would like to know if it is possible to separate the effects of the TARP from the effects of the Federal Reserve's measures in unfreezing the credit markets.

It would be difficult to separate these effects cleanly, partly because the TARP and the Federal Reserve's programs have, in many cases, been motivated by the same objective--namely, to contribute to the restoration of financial stability, without which a solid and durable economic recovery will not be possible. In some cases, the TARP and Federal Reserve actions literally cannot be disentangled. For example, the Federal Reserve has recently launched the Term Asset-Backed Securities Loan Facility (TALF). Under the TALF, the Federal Reserve is protected from credit risk by a layer of insurance provided by the TARP. Thus, in the case of the TALF, the Federal Reserve and the TARP both play essential roles.

- **What portion of domestic credit is provided by commercial banks? What portion is provided by non-banking financial institutions?**

As of the fourth quarter of 2008, depository institutions (defined as commercial banks, thrifts, and credit unions) directly funded about 40 percent of credit outstanding to nonfinancial businesses and households; non-depository financial institutions (including such entities as insurance companies, finance companies, and pension funds) directly funded around 20 percent; and capital markets funded about 40 percent.

- **Over the past year, have you seen a greater constriction in credit from commercial banks or non-banking financial institutions?**

It is difficult to know the answer to this question with certainty, but we know that the constriction of credit at banks has been severe. The reason why it is difficult to know the answer with certainty is that at the same time as credit conditions have been tightening, demand has been falling. Thus, one cannot infer whether the constriction in credit conditions has been increasing or decreasing based solely on the volume of credit extended. We do know that there has been a tremendous tightening in credit availability at banks. For example, according to the Federal Reserve's most recent Senior Loan Officer Opinion Survey on Bank Lending Practices, roughly 70 percent of respondents reported having tightened standards for commercial and industrial loans during the fourth quarter. We do not have comparable systematic evidence for finance companies, insurance companies, mutual funds, or pension funds, but anecdotal evidence suggests that many of these institutions have not tightened their lending stance as much as banks have. One piece of evidence corroborating that view is that many of the non-bank institutions are major purchasers of corporate bonds, and, while bond spreads have widened a great deal, investment-grade bond issuance has been solid.

We also know that the constriction of some forms of credit that previously had been provided by capital markets has been very severe. For example, many securitization markets (with the main exception of the agency-backed market that is used to fund conforming residential mortgages) have been severely impaired since last fall. It is this impairment that the TALF is aimed at addressing. As you know, eligible collateral under the TALF currently consists primarily of AAA-rated asset-backed securities backed by loans to households and small businesses, and the range of eligible collateral is likely to be expanded to include other types of securitized assets.

- **What role does the TARP play in helping these non-banking financial institutions extend credit? Has the TARP been effective in this market?**

One way in which the TARP has helped non-bank financial institutions extend credit is in helping to prevent a broad collapse of the financial system. There is no doubt that had the system collapsed, these institutions would not have been able to obtain funding and extend credit to their customers. In addition, the credit operations of non-bank financial institutions rely on liquidity and credit support provided by banks. The TARP capital injections have improved banks' abilities to provide these services.

Moreover, as noted above, the Federal Reserve in collaboration with the Treasury has recently launched the Term Asset-Backed Securities Loan Facility (TALF). The TALF is intended to help restart new lending by providing investors ready access to term financing that would allow them to purchase selected asset-backed securities, including securities issued by non-bank financial institutions. This program should facilitate the funding of new credit by both banks and non-bank financial institutions.

The capital that was provided to banking organizations under the TARP was directed, in the first instance, predominantly to bank holding companies (BHCs), including many with significant non-banking operations. Those BHCs were permitted to allocate the capital across their organizations, consistent with the purposes of the program, including to non-bank subsidiaries.

We believe that TARP capital has been a significant stabilizing influence on the nation's financial system at a time of severe stress. Stabilizing the financial system and strengthening financial institutions are critical first steps to returning to more normal conditions that are supportive of lending to households and businesses.

- **What role do Federal Reserve facilities have in helping these non-bank financial institutions extend credit? Have these lending facilities been effective in this market?**

The Federal Reserve also used its emergency authority to establish the Primary Dealer Credit Facility and the Term Securities Lending Facility to provide liquidity back-stops for primary dealers, which are non-bank financial institutions. These facilities provided reassurance to secured creditors of primary dealers that those firms had sufficient access to liquidity and thus contributed to improved functioning in short-term funding markets.

The Federal Reserve has also established programs to provide liquidity to money market mutual funds. These funds faced sharp outflows last fall after one prominent fund "broke the buck"--that is, was unable to maintain a net asset value of $1 per share. The Federal Reserve programs, along with a program under which the Treasury provides a guarantee for money fund investors, helped restore investors' confidence to the funds, which are important purchasers of commercial paper--which is a key source of short-term financing for both financial and nonfinancial firms.

In addition, as already noted, the Federal Reserve has recently launched the Term Asset-Backed Securities Loan Facility (TALF), and the TALF should facilitate the provision of credit outside the banking channel.

Chairman Bernanke subsequently submitted the following in response to written questions received from Congressman Bill Foster in connection with the February 10, 2009, hearing before the House Financial Services Committee:

1) Is the Federal Reserve maintaining a historical record of the debate and data relevant to emergency decisions made under section 13(3), so that future academic study and public discussion can identify the lessons learned as well as appropriate modifications to the legislative authority? As a former professor expert in financial crises, do you feel there a useful role for a real-time archivist, as well as explicit policies and time scales for making public the full record of what was done, the financial data (including proprietary data) driving the decisions, and the reasoning behind the actions?

The Federal Reserve follows comprehensive records retention policies that should provide historians with a good picture of the policy deliberations. In addition, the Board has a full staff of records management professionals who are responsible for overseeing and maintaining records of the Board in accordance with federal law.

The Federal Open Market Committee keeps a lightly edited transcript of each of its meetings, so the full policy discussion itself is preserved. Similarly, the substantive staff memos and other background documents (for example, the Greenbook and the Bluebook) that are circulated to the Committee in preparation for each meeting are also retained permanently, as are any materials distributed to the members during the meeting.

The public release of information from an FOMC meeting begins with the statement that is issued after each regularly scheduled meeting, which includes information on the policy decision and the individual votes cast. Three weeks later, the minutes are released; they contain a summary of the economic and financial information available to the Committee at the time of the meeting and a summary of the Committee's discussion. After a lag of about five years, FOMC meeting transcripts are released to the public. Any particularly sensitive information is redacted before release, but such deletions have been relatively few. Greenbooks, Bluebooks, and other documents are also made available. Many of these documents are posted on the Federal Reserve Board's website at http://www.federalreserve.gov/monetarypolicy/fomc.htm.

At present, FOMC meetings are being organized as joint meetings with the Board of Governors, and in the case of those Board meetings, the same classes of documents are being preserved as for other FOMC meetings. For Federal Reserve Board meetings more generally, staff memos and other background documents that are either circulated to the Board in preparation for the meetings or distributed at the meetings, including recommendations and rationales for possible Board actions, are also retained permanently. However, in some cases Board meetings must be scheduled on very short notice, and in such cases there may be little or no documentation. In recognition of the widespread interest in its actions, the Board recently issued a press release and posted on its public website the minutes of its meetings in 2008 concerning Federal Reserve liquidity facilities and other matters related to the financial crisis.

2) Will policies of over-collateralization be maintained when the new facilities to lend against a variety of asset-backed securities are activated? Who will set the standards for (over-) collateralization, and will the standards be publicly revealed before the facilities are activated?

The policy to require that borrowers post collateral in excess of the loan amount is being maintained in the TALF. The haircuts are set by the Federal Reserve Board, the Federal Reserve Bank of New York, and Treasury jointly, subject to Board oversight and approval. The haircuts are published on the website of the Federal Reserve Bank of New York.

3) Do you believe the fact that many large bank and non-bank institutions were relying on short term credit was a contributing factor to the instability of our financial system, and if so, what limitations or disincentives might be appropriate to limit this behavior in the future?

Financial as well as nonfinancial corporations use short-term credit for a variety of business reasons, including the funding of operating expenses and the bridging of cash inflows and outlays. Many firms also rely on short-term credit for liquidity management purposes. One lesson learned in the current episode of financial stress is that several key sources of liquidity may not be available in a crisis. For example, Bear Stearns collapsed in part because it could not obtain liquidity even on a basis fully secured by high-quality collateral, such as U.S. government securities. Other firms have found that back-up lines of credit are not made available for use when most needed. These lessons have heightened the Federal Reserve's concern about liquidity management practices. The Federal Reserve and other U.S. supervisors are monitoring the major firms' liquidity positions on a daily basis and are discussing key market developments with the firms' senior management. Supervisors are also conducting additional analysis of firms' liquidity positions to examine the impact of various stress scenarios on the firms' liquidity and funding profiles.

The ongoing financial crisis also revealed weaknesses in the structure of markets for short-term credit, and measures are being taken to improve the ability of those markets to withstand severe stresses. For example, the Federal Reserve and other authorities are focusing on enhancing the resilience of the triparty repurchase agreement (repo) market, in which the primary dealers and other major banks and broker-dealers obtain very large amounts of secured financing from money market mutual funds and other short-term, risk-averse sources of funding. The Federal Reserve's Primary Dealer Credit Facility, launched in the wake of the Bear Stearns collapse and expanded in the aftermath of the Lehman Brothers bankruptcy, has stabilized this critical market, and market confidence has been maintained. However, this program was adopted under our emergency powers to address unusual and exigent circumstances. Therefore, more-permanent reforms are needed. For example, it may be worthwhile considering the costs and benefits of a central clearing system for this market, given the magnitude of exposures generated and the vital importance of the market to both dealers and investors.

4) On December 30, 2008, it was announced that the New York Federal Reserve had selected four investment managers to help implement the agency's MBS program. The investment managers selected were BlackRock Financial Management Inc., Goldman

Sachs Asset Management, L.P., Pacific Asset Management Co. LLC, and Wellington Management Company, LLP. Despite unanimous passage of an amendment to the House of Representatives (H.R. 384, Roll Call Vote #22) demanding that the Federal Reserve disclose details of these contracts, the Fed has refused to release this information (Market Watch 1/16/2009). Mr. Bernanke, will the Federal Reserve abide by this bipartisan measure? Including the following steps: (1) disclosing the details of the request process used to select the investment managers; (2) disclosing the details of the contracts reached with these four investment managers, including the contract price; and, (3) disclosing the stops that each investment manager has taken to insure that the MBS program is effectively and appropriately segregated from other advisory and proprietary trading activities undertaken by the investment manager. If not, what the basis for this unfortunate and unprecedented level of secrecy?

We have attempted to comply fully with the House Resolution. Because of the size and complexity of the Federal Reserve's Agency Mortgage Backed Securities Purchase Program ("MBS Program"), a competitive request for proposal ("RFP") process was employed to select the four investment managers and a custodian. This is a public process. The selection criteria were based on the institution's operational capacity, size, overall experience in the MBS market and a competitive fee structure. The RFP was sent to 20 firms, 16 of which responded. A copy of the RFP is attached hereto. As a result of this process, BlackRock Financial Management Inc., Goldman Sachs Asset Management, L.P., Pacific Asset Management Co. LLC, and Wellington Management Company, LLP were selected as investment managers for the MBS Program.

Copies of the contracts between each of the investment managers and Federal Reserve Bank of New York ("FRBNY") have been posted on the FRBNY's public web site at http://www.newyorkfed.org/aboutthefed/vendor_information.html. The contracts require each of the investment managers to have in place conflict of interest policies and procedures that are designed to identify material conflicts of interest, require reporting of such conflicts, and prevent the use of confidential information obtained in the course of the engagement from being used outside of the engagement. These provisions are integrated into each contract as enforceable terms. The conflicts of interest provisions are addressed both in the body of each contract and in Exhibit G thereto. While the body of the contract is uniform across vendors, Exhibit G is unique to each vendor. Certain information relating to investment guidelines, contact information, and fees has been redacted in light of confidentiality concerns. The FRBNY monitors each investment manager's compliance with the terms of its contact, as appropriate.

Attachment

FEDERAL RESERVE BANK OF NEW YORK

REQUEST FOR PROPOSALS
FOR
INVESTMENT MANAGEMENT OF A
MORTGAGE-BACKED SECURITIES PORTFOLIO

ISSUE DATE: December 4, 2008

NOTICE OF INTENT DUE: December 5, 2008

PROPOSALS DUE: December 10, 2008

CONFIDENTIAL

FEDERAL RESERVE BANK OF NEW YORK
Investment Management of a Mortgage-Backed Securities Portfolio
Request for Proposals

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LIST OF ATTACHMENTS

1. INTRODUCTION

1.1 Overview

The Federal Reserve Bank of New York (the "FRBNY") is issuing this Request for Proposals ("RFP") to provide investment management firms ("Offerors") with sufficient information to prepare and submit formal competitive proposals ("Proposals") for a contract to acquire, manage and service a portfolio of U.S. dollar denominated mortgage-backed securities (the "MBS Portfolio"). As announced on November 25, the securities eligible for the MBS Portfolio include MBS pass-through securities and potentially other securities issued and/or fully guaranteed as to principal and interest ("P&I") by the Federal Home Loan Mortgage Corporation ("Freddie Mac"), the Federal National Mortgage Association ("Fannie Mae"), and the Government National Mortgage Association ("Ginnie Mae") (together "Issuers").[1] The MBS Portfolio will be included in the Federal Reserve's System Open Market Account ("SOMA"), which is managed by the FRBNY, and the execution of purchases / sales for said portfolio will be considered part of the FRBNY's open market operations. Purchases of up to $500 billion in MBS will be conducted, with a goal of beginning these purchases before year-end. Purchases are expected to take place over several quarters. The FRBNY may choose to select and enter into contract with more than one Offeror, at the FRBNY's sole discretion. If more than one Offeror is selected, the MBS Portfolio will be divided among the successful Offerors in a manner that the FRBNY deems appropriate, which may or may not be proportional.

Selected Offeror(s) (the "Manager(s)") will be expected to follow investment guidelines to be established by the FRBNY in its sole discretion, which may be periodically modified by the FRBNY upon notice to the Manager(s). Portfolio management is expected to be relatively passive. The FRBNY will establish guidelines and/or instruct the Manager(s) to re-invest MBS Portfolio cash flows or to remit them to the FRBNY, depending on reserve management considerations. Over a longer term, the FRBNY may opt to rebalance, mature, or liquidate the MBS Portfolio. The FRBNY plans to fund the MBS Portfolio by transferring cash to a custodial account in the name of the FRBNY that will be established for purposes of this program. Trades executed by the Manager(s) will be conducted as agent for the FRBNY. The FRBNY will need to approve the list of eligible trading counterparties. Proposals should assume that trading is limited to primary dealers but trades with other counterparties may be allowed at the FRBNY's discretion.

This RFP specifies the MBS Portfolio management and trade execution, operational, and other administrative services (together "Services") sought by the FRBNY, lists the factors that will be considered in selecting the winning Proposal(s), and presents the required response format. **All parties receiving this RFP are asked to submit an Acknowledgement of Receipt and Notice of Intent form (Attachment I), which includes an explicit acknowledgement of the confidential nature of this RFP, no later than the deadline specified in Section 2.1.** To be considered responsive, Proposals should include all the information requested in this RFP and be submitted in the format specified in the response format (Attachment II), including all supplemental documents indicated in the response format, no later than the deadline specified in Section 2.1. Proposals should specifically address each of the requirements stated in Section 1.2, and specifically answer each question stated in Section 1.3.

1.2 Requirements

To be considered responsive, a Proposal must satisfy the requirements identified in this section and in other respects be responsive to the RFP:

(A) MBS Portfolio Management and Trade Execution Requirements:
The Offeror must:

[1] While Freddie Mac and Fannie Mae are commonly referred to as "agencies" of the U.S. government, they are corporate instrumentalities of the U.S. government known as government-sponsored enterprises (GSEs). For purposes of this RFP, Freddie Mac, Fannie Mae, and Ginnie Mae will be referred to as "agencies". Note that the pass-through securities issued by Fannie Mae and Ginnie Mae are called mortgage-backed securities, while the pass-through securities issued by Freddie Mac are called participation certificates. For purposes of this document, all references to MBS will be deemed to include all types of pass-throughs.

(1) Commit to provide Services in accordance with appropriate investment objectives for the MBS Portfolio, to be determined by the FRBNY in its sole discretion.

(2) Devise an investment strategy appropriate for a sizeable portfolio of MBS assets of the type to be included in the MBS Portfolio.

(3) Define, in collaboration with the FRBNY, a benchmark that will meaningfully measure the MBS Portfolio's performance.

(4) Adhere to standards for best execution, and measure and report on quality of execution to the FRBNY.

(5) Execute trades at market prices as agent for undisclosed principal with approved counterparties. Trades executed on a disclosed principal basis may also occur, but disclosure of the FRBNY's name in its capacity as principal is not to occur unless specifically directed by the FRBNY.

(6) Be able to execute multi-billion dollar trades on a single day using approved counterparties.

(7) Provide a dedicated team of individuals to undertake the portfolio management services requested in this RFP, subject to appropriate ethical walls between this activity and other such activity being conducted for other clients of the firm.

(8) Have expertise in managing multi-billion dollar portfolios of residential mortgage-related products issued by and/or fully guaranteed by the Issuers.

(B) Operational Requirements:
The Offeror must:

(1) Promptly confirm all trades with approved counterparties.

(2) Track and maintain records of (i) trades executed, including all pertinent financial and settlement information; (ii) assignments of pools to TBA trades; (iii) notifications of P&I payments; and (iv) cash flow projections, encompassing settlement of new trades and P&I payments.

(3) Track, maintain records of, and promptly resolve notification and settlement fails.

(4) Maintain settlement tolerance thresholds for cash and securities that are consistent with best practices.

(5) Have the ability to properly interface with a custodian that is capable of (i) providing segregated custody and cash accounts in the name of the FRBNY (or in the name of the Offeror as agent for the FRBNY) in connection with the MBS Portfolio; (ii) processing the type and volume of transactions to be conducted; (iii) recording and safe keeping all asset positions; (iv) collecting income and principal distributions for assets held; (v) disbursing aggregated cash flows upon request by Fedwire to the FRBNY; and (vi) providing transaction, holdings, and cash flow reporting (e.g., custody statements, cash statements, anticipated P&I activity, etc.).

- Offerors may provide a response to the above based on their current custodial relationships in accordance with Section 1.3E, but please note that ultimate designation of a custodian is at the FRBNY's discretion, which may be a custodian other than that indicated by the Offeror.

(6) Accept FRBNY's payment for the purchase of assets on settlement date and, upon request, remit funds to the FRBNY by Fedwire transfer via the designated custodian.

(7) Reconcile, on a daily basis, FRBNY's custody account(s) and cash account(s) at the custodian with its own books and records.

(8) Transmit activity on a daily basis to the FRBNY.

(9) Make records associated with Operational Requirements 2 and 3 available to the FRBNY for insertion into their own database (e.g., online via download, excel, txt file, etc.) and reporting purposes.

(C) Portfolio Analytics and Reporting:
The Offeror must provide to the FRBNY:

(1) Portfolio reports showing (i) securities holdings; (ii) positions in MBS; and (iii) transaction activity.

(2) Forecasts of expected P&I payments given a range of interest rate scenarios using an industry standard prepayment model.

(3) MBS Portfolio valuation reports, incorporating pricing and relative value measures from external sources and models (as appropriate).

(4) Risk management reporting that enables monitoring and assessment against specified risk constraints and metrics. Such metrics would include, for example, actual position versus concentration limits, relative value measures, duration, convexity, etc.

(5) Reports showing MBS Portfolio performance against the agreed upon benchmark.

(6) SAS No. 70 *Service Organizations* reports on an annual basis for services utilized, in sufficient detail to be accepted for Sarbanes-Oxley (SOX) testing purposes (type II reports).

1.3 Information Requests

(A) Organizational Background:

(1) Describe your corporate and organizational structure, showing services offered by entity or organizational unit. Identify which entities or organizational units would provide the requested Services for the MBS Portfolio.

(2) Provide an organizational chart showing the composition of your staffing. Specify the staffing dedicated to fixed income, specifically MBS portfolios, for activities like portfolio management, research and analytics, trade execution, operations, administrative roles, etc. Indicate staff turnover rates.

(3) Describe the composition of staffing that would provide the various Services to manage the MBS Portfolio, including their associated responsibility levels. Specify whether individuals would be dedicated full or part-time to the MBS Portfolio. If part-time, describe what other portfolios and/or clients they would service.

(4) Provide a table showing in detail assets under management ("AUM") by asset class with relevant totals and sub-totals. Within fixed income, break out AUM by sub-class and sector. Within MBS, provide sub-totals for securities of the Issuers eligible for the MBS portfolio and break out AUM by Issuer and type (e.g., pass-throughs, adjustable rate mortgages, CMOs, etc.). Provide indications of daily trading volume for the above.

(B) Portfolio Management Approach:

(1) Describe the investment management strategies used to manage MBS portfolios in your organization. Consider (i) the types of clients serviced; (ii) approaches to identifying value; (iii) approaches to managing risk; (iv) approaches to assessing market liquidity; and (v) your firm's history in management of MBS portfolios.

(2) Describe the anticipated interactions among your portfolio managers, traders, and analysts in determining what trades to execute in connection with an agency MBS mandate with a passive management strategy. Describe the process, if different, under an active management strategy.

(3) Describe your recommended approach for measuring, monitoring, and assuring best execution in connection with the mandate suggested in (2) above.

(4) Describe the systems and workflow processes used to manage MBS portfolios in your organization.

(C) Risk Management with respect to the Investment Process:
Describe for MBS portfolios in your organization:

(1) Your control processes for assuring that portfolio composition and risk limits comply with clients' investment objectives and guidelines.

(2) Your risk control processes for assuring that individual trades are in compliance with clients' mandates.

(3) The risk metrics employed in managing portfolios (e.g., duration and convexity by security, sector, portfolio basis, etc.) and how limits are set.

(4) The use of stress testing or scenario analysis applied in managing portfolios.

(5) The use of any forward-looking risk models used in managing portfolios (i.e., prepayment model, relative value model, proprietary model, etc.). For prepayment model, describe from which sources and at what frequency you receive factor and rate information. State how often you calibrate the model.

(6) The use of any other quantitative tools or models (not covered above) used in managing and monitoring portfolios.

(D) Performance Measurement, Benchmarking, and Fees:

(1) Describe what method(s) and price source(s) your firm uses to value MBS portfolios.

(2) Provide historic performance information for managed MBS funds on a gross and net fee basis. The aforementioned information should be presented on an annualized basis and conform to the Global Investment Performance Standards.

(3) Provide a table showing the best and worst returns for your MBS portfolios for each of the past 5 years ending June 30, 2008.

(4) Describe your fee schedule for managing an agency MBS portfolio. Provide information on whether your fee schedule differs depending on the investment strategy (i.e., active versus passive management). Include, if applicable, a basis point scale tied to the amount of assets under management, as well as any limits on overall fees under each investment strategy, if different. Include any ancillary fees that would be passed through to the FRBNY, including trading and administrative fees. Indicate what, if any, additional information would be required from the FRBNY to provide a detailed fee schedule. Please note that the FRBNY will not pay for any of your legal expenses related to establishing the investment management relationship.

(E) Custody and Operations:

(1) List the custodians with whom you have arrangements to process MBS. As applicable, indicate any special considerations that might create an operational advantage with respect to any particular custodian.

(2) Describe approaches that your firm uses to assess performance of custodians.

(3) Describe the systems and workflow processes for MBS portfolios used to (i) confirm trades and allocate pools; (ii) settle and clear trades (including links to custodians); (iii) manage cash position; (iv) reconcile transactional activity with custodians; and (v) maintain accounting records.

(4) Describe your internal controls for assuring that client's securities holdings and cash balances maintained at custodians match your internal records.

(5) Provide sample reports of cash projections and holdings statements.

(6) Provide a flowchart showing the life cycle of purchasing an MBS from analysis to settlement showing who at your firm performs each activity, approves each step, and reviews the step for accuracy, completeness, and compliance.

(F) Client Servicing, and Reporting:

(1) Describe the services you provide to disseminate transaction, holdings, and income information to feed a client's general ledger system.

(2) Describe other accounting services that you provide to clients.

(4) Describe the client service framework. Indicate whether clients are assigned primary contacts. Describe the frequency of in-person client meetings and with who said meetings will be conducted.

(5) Describe how quickly your firm is able to provide accurate final asset and transaction statements following month-end. Provide samples of client reports.

(6) Describe the media (e.g., direct electronic interfaces, web interfaces, etc.) you have available for providing reporting information (e.g., portfolio, operational, risk, accounting, etc.) in connection with the MBS Portfolio. Describe the security mechanisms to protect the transfer of this information to the FRBNY.

(7) Describe any information or reporting capabilities you make available to your clients associated with the management of an MBS portfolio (i.e., trades, prepayment, relative value, accounting, etc.). Include the frequency and means with which said information or reporting can be accessed (i.e., online, e-mail or another electronic form, hard copy, etc.).

(8) Explain what additional information (e.g., newsletters, economic reviews, etc.), training services, and seminars you make available for clients to increase their understanding of the MBS investment process (e.g., portfolio oversight, operations, reporting, technology, etc.) particularly as it pertains to your firm and more broadly.

(9) Provide a copy of your latest SAS 70 reports.

(G) Compliance:

(1) Describe your risk oversight framework and strategy. Indicate if you have a risk oversight officer who operates independently from your portfolio managers and/or other investment-policy decision makers.

(2) Describe how you measure and monitor risk to ensure that risk parameters are in line with the benchmark and within client guidelines and who is responsible.

(3) Specify what regulatory or industry organizations perform audits or have authority over your firm, including what area(s) each oversees.

(4) Describe the scope of responsibility of your internal audit function and its role in the review of the requested Services for the MBS Portfolio.

(5) Describe your counterparty review process. Explain how "best execution" is evaluated. Describe what credit risk management you have in place for counterparties.

(6) Describe the role you play in the oversight of your custodians.

(7) Describe your contingency plan.

(8) Describe your internal controls for assuring client confidentiality and fair dealing.

2. ADMINISTRATION OF THE RFP PROCESS

2.1 Schedule of Events

The following Schedule of Events will govern this RFP:

Event	Date
Distribution of RFP to Offerors	December 4, 2008
Deadline for receipt of Acknowledgement and Notice of Intent forms	December 5, 2008 (5:00 p.m. ET)
Q&A conference call with FRBNY and Offerors	December 8, 2008 (Please dial 888-232-0366 and use code 207064 at 11:00 a.m. ET)
Deadline for submission of Proposals	December 10, 2008 (11:00 a.m. ET)
Offeror to be available by phone for follow-up questions from FRBNY	December 11, 2008 (10:00 a.m. to 12:00 p.m. ET)
Contract Negotiations	December 12, 2008 to December 22, 2008*
Final Award	December 22, 2008*
Initial Purchase of MBS Securities for Portfolio	December 30, 2008*

* Dates are subject to change

The FRBNY reserves the right, in its sole discretion, to modify the Schedule of Events as necessary. Offerors will be notified of any change in the Schedule of Events. An Offeror whose Proposal is selected will be notified of the exact initial purchase date which, at the FRBNY's discretion, may be different from the date specified in the foregoing schedule.

2.2 Questions about this RFP

It is the Offeror's responsibility to seek clarification of any inconsistencies, ambiguities, errors, or other issues that the Offeror does not fully understand regarding this RFP. All questions should be raised on the Q&A conference call listed in the Schedule of Events. Important questions after the call may be directed to the following:

FRBNY Contact:

Michele Walsh
Assistant Vice President
Federal Reserve Bank of New York
Markets Group
33 Liberty Street - 9th Floor
New York, NY 10045
Phone Number: 212-720-6424
Fax Number: 212-720-2690
E-mail Address: michele.walsh@ny.frb.org

With respect to any questions received after the Q&A conference call, the FRBNY may respond orally to questions that, in the FRBNY's view, are about insignificant matters that affect only a single Offeror. Responses to questions that may affect Offerors other than the inquirer, however, will be made in writing and distributed to all Offerors.

Substantive questions about the RFP should be submitted in writing as soon as possible and in no event later than the time specified in Section 2.1 of this RFP. No other discussion or communication between an Offeror and an officer, employee, or agent of the FRBNY is permitted and no information gained from any such communication may be considered a binding communication of the FRBNY.

2.3 Acknowledgement of Receipt and Notice of Intent

Each Offeror **must submit**, by the date specified in Section 2.1 of this RFP, a written statement indicating whether the Offeror intends to submit a Proposal responding to this RFP using the Acknowledgement of Receipt and Notice of Intent (Attachment I). The FRBNY, in its sole discretion, may refuse to consider a Proposal submitted by an Offeror that did not submit a timely statement of intent.

2.4 Submission of Proposals

Each Offeror must submit an electronic copy of its Proposal by email, as well as three (3) copies of its Proposal via certified or registered mail, or via overnight delivery by a nationally recognized courier, or via hand delivery to the contact designated in Section 2.2 of this RFP. The Proposal must reach the FRBNY no later than the time and date specified Section 2.1 of this RFP.

The FRBNY has no obligation to consider Proposals received after the exact deadline for submission provided in Section 2.1. The only acceptable evidence of the time of receipt is the time/date stamp of the FRBNY on the Proposal envelope or other documentary evidence of receipt maintained by the FRBNY (e.g., an email time stamp).

Each copy of the Proposal must be properly executed, with any alterations formally explained and initialed by the Offeror. All three (3) physical copies must be submitted in a sealed envelope within a sealed envelope. The inner envelope must be clearly labeled "**MBS INVESTMENT MANAGEMENT RFP, DECEMBER 2008 - DO NOT OPEN**." Proposals will not be reviewed prior to the deadline specified for receipt. **Submission of Proposals via fax is not acceptable.**

An Offeror, by submitting a Proposal, represents that:

A. The Offeror has examined and understands this RFP;
B. The Proposal is based upon the requirements described in this RFP;
C. All terms and conditions set forth in this RFP, including all appendices, attachments, exhibits and addenda are accepted and incorporated, unless the Proposal explicitly takes exception to them; and
D. The Offeror possesses the technical capabilities, equipment, financial resources, and personnel to provide the Services offered by the Offeror.

Because the FRBNY may select a Proposal or reject all Proposals without further discussions with Offerors, Offerors should present their Proposals initially in the most favorable possible terms from both a technical and price viewpoint.

2.5 Amendment or Withdrawal of this RFP or Offeror Proposal

Corrections or clarifications to this RFP will be issued in the form of written addenda to this RFP and will be sent by email or certified or registered mail or via overnight delivery by a nationally recognized courier to all Offerors who have indicated intent to submit a Proposal. Receipt of all addenda should be acknowledged in the Proposal. If an Offeror fails to acknowledge receipt of any addenda, the Proposal will nevertheless be construed as though the addenda had been received and acknowledged. No interpretation, correction, clarification, or amendments to this RFP made by other than written addenda will be binding on the FRBNY.

The FRBNY reserves the right to negotiate with selected Offerors and request revised written Proposals during evaluation. Offerors may modify or withdraw their proposals up to the deadline for submission but not after that time. Proposals may not be withdrawn for thirty (30) days following the deadline for submission.

2.6 Award of Contract

Prior to final selection of one or more Offerors, the FRBNY may negotiate a contract with any Offeror. **As required by the response format provided in Attachment II, an Offeror must include in its Proposal the Offeror's proposed contract for the services described in the Proposal, including any modifications to the Offeror's standard contract for investment management services.** Once negotiations on a contract have begun, if an agreement acceptable to the FRBNY is not reached within a reasonable period of time, such period to be determined in the FRBNY's sole discretion, the FRBNY reserves the right to disqualify the prospective Offeror's Proposal and reevaluate other Proposals previously submitted.

The final contract is contingent upon approval by the senior management of the FRBNY and the concurrence of the Board of Governors of the Federal Reserve System and/or the Federal Open Market Committee, as applicable. Absent such approval or concurrence, any award or contract may be canceled without liability on the part of the FRBNY.

Upon selection of one or more Offerors, the FRBNY will notify all Offerors of the selection. The FRBNY will indicate in general terms the reason unsuccessful Proposals were not accepted.

2.7 Determination of Responsibility

The FRBNY will only select an Offeror that is deemed responsible, in the sole discretion of the FRBNY. The FRBNY makes its determination of responsibility based on the following factors, judged as of the time of Offeror selection and with reference to the date specified for the start of contract performance:

A. The availability of adequate financial resources to perform the contract;
B. Ability to comply with all required or proposed Services, taking into consideration all existing business commitments;
C. Record of satisfactory performance with the FRBNY, any other entity of the Federal Reserve System, or other entities;
D. Satisfactory record of integrity and business ethics;
E. Necessary organization, experience, accounting and operational controls, and technical skills;
F. Necessary systems, technical equipment and facilities, licenses, and operating authority and insurance coverage; and
G. Other qualifications necessary for eligibility to receive an award under applicable laws and regulations.

Where, in the sole judgment of the FRBNY, a substantial portion of the contract is to be performed by a subcontractor, the FRBNY will make a similar determination about the responsibility of the subcontractor. The Offeror remains responsible for the performance of the subcontractor.

A Proposal must provide financial information about the Offeror and any affiliated company upon which the financial strength of the Offeror depends, including financial statements as of the end of the previous three (3) fiscal years, the last three (3) annual reports, and if applicable, Section 10-K reports filed with the Securities and Exchange Commission for the previous three (3) years. The financial statements provided by the Offeror should be audited. If unaudited financial statements are provided, the FRBNY may conclude that the Offeror is not responsible, even if the financial statements appear to show financial strength. The Offeror should also include other information that it believes demonstrates that the Offeror is responsible. The burden is upon the Offeror to demonstrate clearly that it is responsible. The FRBNY reserves the right to require such additional information concerning the Offeror's responsibility as the FRBNY deems necessary.

Because of the sensitive and confidential information about the FRBNY's business affairs, operations, and security procedures which the Offerors may be given or have access to during the proposal process, the FRBNY may conduct background investigations, at the Offeror's expense, on all Offerors and their affiliated companies. Such investigations may include, but not be limited to: (i) researching the Offeror's history/ownership; and (ii) fingerprinting and/or drug testing of the Offeror's personnel who will have access to the FRBNY's premises, if any. In the FRBNY's sole discretion, no award of a contract will be made to, or if an award has already been made, such award may be withdrawn from any Offeror: (i) that fails to promptly cooperate to the FRBNY's satisfaction with any background investigations; or (ii) whose background investigation by the FRBNY produces results that are not, in the FRBNY's sole determination, satisfactory to the FRBNY. In the event the FRBNY fails to make an award to an Offeror or withdraws an award from an Offeror in connection with an unsatisfactory background check, the FRBNY shall have no obligation to inform the Offeror of the specific results of the background check or why the FRBNY deemed those results unsatisfactory.

2.8 Confidential Information

If the FRBNY receives a request for information regarding a Proposal, the FRBNY may disclose bottom-line amounts of any individual Offeror and other information from a Proposal to other Offerors or to members of the public after a Proposal has been selected. In deciding on disclosure, the FRBNY will consider whether the Offeror has requested confidentiality and whether disclosure of the information would likely result in substantial competitive harm to the Offeror. **If an Offeror wishes to request confidential treatment of certain information, the request must be in writing and submitted with the Proposal or other document containing the information.** The request must discuss in detail the justification for the confidential treatment of each item of information for which confidential treatment is requested. This justification must demonstrate that harm would result from the public release of the commercial or financial information; simply stating that the information would result in competitive harm is not sufficient. The Offeror must also state whether the information is available to the public from another source.

The distribution of this RFP, and any and all information contained in this RFP or otherwise received in connection with this RFP, is considered to be strictly confidential by the FRBNY and shall not be disclosed outside the Offeror's organization nor duplicated, used or disclosed in whole or in part for any purpose other than to evaluate this RFP and prepare a response. Under no circumstances shall any information received in connection with this RFP be disclosed to any third party without the express prior written consent of the FRBNY.

2.9 Reservation of Rights

The issuance of this RFP and the FRBNY's receipt of any information or Proposals will not, in any manner, obligate the FRBNY to perform any act or otherwise incur any liabilities. The FRBNY assumes no obligation to reimburse or otherwise compensate any Offeror or recipient of this RFP for losses or expenses incurred in connection with this RFP. The FRBNY shall have the right to use, for any purpose, any information submitted in connection with this RFP.

The FRBNY reserves the right: (1) to modify or withdraw this RFP at any time prior to the execution of a contract; (2) to decide not to award a contract to any Offeror; (3) to reject a Proposal without inviting the Offeror to submit a new Proposal; (4) to negotiate with any source considered qualified; (5) to request, orally or in writing, clarification of or additional information concerning Proposals that are considered competitive; (6) to waive minor informalities or irregularities, or a requirement of this RFP; (7) to accept any Proposal in part or in total; (8) to select a Proposal other than the low cost Proposal; and (9) to reject a Proposal that does not conform to the specified format or other requirements of this RFP.

Prior to any award, the FRBNY may require the Offeror to submit or identify in writing certain information bearing on the reasonableness of the Proposal. The FRBNY reserves the right to have its authorized representatives inspect the facilities and examine any books, documents, papers, records, or other data of the Offeror that pertain to and involve transactions relating to the Proposal for the purpose of evaluating the accuracy, completeness, and currentness of information supplied.

The FRBNY reserves the right to make an award without further negotiations with the successful Offeror.

3. EVALUATION OF PROPOSALS

3.1 Objective

The objective of the FRBNY in soliciting and evaluating Proposals is to ensure that the MBS Portfolio is managed and serviced in the safest, most secure, most confidential and most cost effective manner possible. The result of the process will be the selection of the Proposal that, in the view and at the sole discretion of the FRBNY, is most advantageous to the FRBNY.

3.2 Evaluation Process

Only Proposals received from Offerors that the FRBNY has determined to be responsible under Section 2.7 of this RFP will be considered for award. All Proposals of responsible Offerors will then be examined to determine responsiveness to the FRBNY's requirements. To be considered responsive, a Proposal must:

A. Satisfy all the mandatory requirements specified in Section 1.2 of this RFP and elsewhere;
B. Provide all the information requested in Section 1.3 and in the response format (Attachment II); and
C. Be received by the FRBNY's submission deadline set forth in Section 2.1 of this RFP.

A nonresponsive Proposal will be set aside. If the FRBNY determines that none of the Proposals is responsive, the non-responsive Proposals, at the FRBNY's option, may be reexamined. All responsive Proposals of responsible Offerors will be further evaluated based on the evaluation criteria stated in Section 3.3 of this RFP.

3.3 Evaluation Criteria

Responsive Proposals will be evaluated based on the following nonexclusive criteria, which are listed in descending order of relative importance:

A. The Offeror's operational capacity, size and overall experience in the MBS market;

B. The Offeror's specific experience managing portfolios comparable to the MBS Portfolio;

C. The Offeror's all-in fees and costs;

D. The Offeror's creditworthiness and overall financial stability; and

E. The Offeror's willingness to enter into an investment contract on terms acceptable to the FRBNY.

Attachment I
Page 1 of 1

ATTACHMENT I: ACKNOWLEDGEMENT OF RECEIPT AND NOTICE OF INTENT

Please complete this form and return it by 5:00 p.m. on December 5, 2008 to the Federal Reserve Bank of New York's Contact Officer identified below:

The organization I represent acknowledges receipt of the MBS Investment Management Request for Proposals distributed on December 4, 2008 (the "RFP"). I have indicated below whether my organization intends to respond to the RFP:

____ Will Respond   ____ Will Not Respond

By signing below, my organization acknowledges and agrees that the distribution of the RFP, and any and all information contained in the RFP or otherwise received in connection with the RFP, is considered to be strictly confidential by the FRBNY and shall not be disclosed outside of the organization signing below nor duplicated, used or disclosed in whole or in part for any purpose other than to evaluate the RFP and prepare a response. Under no circumstances shall any information received in connection with the RFP be disclosed to any third party without the express prior written consent of the FRBNY.

Name and Title   Date

Signature

Organization

Address

Telephone Number   Fax Number   E-mail Address

If you answered "yes" to the above question, please attach a list of name(s) and telephone number(s) of the individual(s) within your organization who would be the FRBNY's contact(s). Also, indicate who would serve as the primary contact.

Contact Officer:

Michele Walsh
Assistant Vice President
Federal Reserve Bank of New York
Markets Group
33 Liberty Street - 9th Floor
New York, NY 10045
Phone Number: 212-720-6424
Fax Number: 212-720-2690
E-mail Address: michele.walsh@ny.frb.org

ATTACHMENT II: RESPONSE FORMAT

This attachment specifies the format that must be used to prepare Proposals responding to the RFP. The sole purpose of this format is to facilitate the fair and equitable evaluation of all Proposals received. **At its option, the FRBNY may consider any significant deviation from this format as non-responsive and disqualify that Proposal.** Extensive cross-referencing to other documents may be considered non-responsive.

The topical format of all Proposals should be as follows:

I. Executive Summary

This section should contain a clear and concise summary of the information contained in subsequent sections. It also should contain the name, address, and telephone number of the Offeror as well as the name, title and telephone number of any additional representative(s) of the Offeror authorized to receive inquiries from the FRBNY.

II. Requirements and Responses to Questions

This section must demonstrate how the Offeror will satisfy each of the requirements in Section 1.2 of the RFP, and specifically address each of the questions stated in Section 1.3 of this RFP. In general, each of the requirements and questions should be stated as a caption, and information demonstrating compliance, or how the Offeror could achieve compliance, should be placed under the caption. Also, include the nature, time, and cost involved in providing custom modifications to the Offeror's existing investment management infrastructure in order to acquire and manage the assets as requested, if necessary.

III. Financial Background and Responsibility

The Offeror must provide financial information about the Offeror and any affiliated company upon which the financial strength of the Offeror depends, including audited financial statements as of the end of the previous three (3) fiscal years, the last three (3) annual reports and, if applicable, Section 10-K reports filed with the Securities and Exchange Commission for the previous three (3) years. The Offeror must also provide a copy of its SEC Corporate Review and Disclosure Form ADV, Part II.

The Offeror may also include information to demonstrate that the Offeror is "responsible" as described in Section 2.7 of the RFP. This may include examples of similar projects successfully completed, especially for the FRBNY or other Reserve Banks. If submitted, this information should include similar information about any subcontractor that will perform a substantial part of the contract.

IV. Contract Terms

The Offeror must provide a draft of the investment management contract that it proposes to enter into with the FRBNY. This draft may be modeled on the Offeror's standard investment management contract for clients, as long as appropriate modifications have been made to address the requirements stated in this RFP.

V. References

The Offeror should provide as references the names of three (3) clients presently utilizing the Offeror's investment management services, as well as the names of two former clients. It is preferred that these references include clients for whom the Offeror manages residential MBS portfolios in excess of $1 billion. The references from the Offeror should include names, addresses, and telephone numbers of appropriate contacts.

VI. Miscellaneous

The Offeror should include any additional information the Offeror deems useful to the FRBNY in evaluating the Proposal. The Offeror also may request confidential treatment of information in the Proposal in accordance with Section 2.8 of the RFP.

VII. Execution

The Proposal should be signed by an authorized representative of the Offeror and include evidence of the authority of the representative.

ATTACHMENT III: CONTRACT TERMS AND CONDITIONS

The Offeror's proposed contract, which must be included as part of the Offeror's response in accordance with the response format described in Attachment II, must at a minimum include the following provisions, subject to negotiation of specific language between the Offeror and the FRBNY:

1. **Appointment as Investment Manager:** A clause appointing the Offeror as an investment manager, including a representation that the Offeror is duly registered with the Securities and Exchange Commission pursuant to the Investment Advisers Act of 1940, as amended, and that such registration is current and in full force and effect.

2. **Performance of Services:** A provision describing the investment management services to be performed by the Offeror, which shall incorporate or include appropriate references to the FRBNY's investment objectives and portfolio guidelines. The Offeror should also agree to provide the FRBNY with account summaries, performance reports and any other reporting that shall be agreed upon from time to time.

3. **Relationship with Custodian:** Appropriate provisions (i) authorizing the Offeror to give instructions to a custodian duly appointed by the FRBNY; (ii) confirming that sole responsibility for physical possession and safekeeping of all assets shall rest with the custodian; (iii) providing that the Offeror shall reconcile accounting, transaction and other data with the custodian; (iii) providing that the Offeror shall communicate with and seek to resolve significant discrepancies with the custodian.

4. **Execution of Transactions:** A provision stating that the Offeror shall have the authority to act as FRBNY's agent, on an undisclosed principal basis unless otherwise instructed, to select trading counterparties for the FRBNY's portfolio, but that the brokers or dealers so selected shall be expressly limited to the FRBNY's list of primary dealers. This provision should also state the other criteria to be used in the Offeror's selection of trading counterparties (price, overall responsibility, ability to avoid market disruption, etc.).

5. **Compensation:** A provision that describes in detail the Offeror's fee structure, including a description of (i) how the Offeror's compensation shall be calculated; (ii) the timing of invoices and payments; and (iii) how termination fees, if any, shall be determined and paid.

6. **Representations and Warranties:** Appropriate representations and warranties similar to those typically provided in the investment management industry, including representations that (i) the Offeror has all requisite power and authority to enter into the contract; (ii) the Offeror has been duly authorized to enter into the contract; (iii) the terms of the contract do not conflict with any other obligations to which the Offeror is bound; (iv) the Offeror is not subject to any pending or current enforcement actions or insolvency proceedings.

7. **Standard of Care:** A duty of care provision appropriate for a client like the FRBNY, such as a provision stating that the Offeror will act with the highest standard of care in maintaining the FRBNY's portfolio of assets, using a degree of skill and attention no less than that which the Offeror exercises with respect to comparable assets that it manages for itself and others having similar investment objectives.

8. **Conflicts of Interest:** A provision stating that the Offeror agrees to abide by, and has provided the FRBNY with a summary of, its internal ethics policies, which at a minimum shall be designed to (i) identify any material financial conflicts of interest between the Offeror and the FRBNY; (ii) require reporting of any conflicts that develop during the course of the investment management relationship; and (iii) prevent the use of confidential FRBNY information to enter into a trade or transaction unrelated to the Offeror's contract with the FRBNY.

9. **Ethical Wall:** The Offeror shall agree that personnel assigned to the management of the FRBNY's portfolio are adequately segregated from personnel involved with the Offeror's trading, brokerage,

sales, or other activities that may conflict with the duty owed to the FRBNY, and that any information related to the management of the FRBNY's portfolio is not shared with such personnel.

10. **Confidentiality:** Comprehensive confidentiality provisions appropriate for a client like the FRBNY, including, for example, provisions stating that (i) no confidential FRBNY information shall be duplicated, used, or disclosed to third parties without the FRBNY's express prior written consent; (ii) the Offeror shall use the same or greater effort to avoid publication or dissemination of such information as it employs with respect to its own confidential information; and (iii) the Offeror shall require each of its agents, employees, and subcontractors assigned to the proposed arrangement, by means of a written agreement, to keep any such information obtained by them strictly confidential. In addition, the Offeror shall agree not to originate or encourage any written or oral statement, news release, or other public announcement or publication relating to its arrangement with the FRBNY without the FRBNY's express prior written consent.

11. **Books and Records; Audit Rights:** The Offeror shall agree to maintain appropriate books of account and records relating to services performed hereunder, including appropriate documentation of issues arising under the Offerer's conflict of interest policies. On an announced basis, the FRBNY, the Board of Governors of the Federal Reserve System and other governmental oversight entities shall have the right to audit the Offerer's performance to determine whether the Offerer is acting in compliance with all of the requirements of the agreement as well as its valuation methodology.

12. **Compliance with Laws:** A provision whereby the Offeror agrees to abide by all applicable laws and regulations, including anti-money laundering laws and U.S. Office of Foreign Assets Control regulations.

13. **Assignment, Amendment and Termination:** Provisions providing that (i) the Offeror may not assign the agreement with the prior written consent of the FRBNY; (ii) the agreement may not be amended except in a writing signed by both parties; (iii) the FRBNY may terminate the contract at any time for any reason upon notice to the Offeror; and (iv) the Offeror may terminate the contract for any reason upon at least 90 days prior written notice to the FRBNY.

14. **Governing Law and Jurisdiction:** The contract must be governed by Federal law and, in the absence of controlling Federal law, in accordance with the laws of the State of New York, notwithstanding New York's conflict of law rules. The contract must also provide that any legal action, suit, or proceeding arising out of or in connection with the contract shall only be brought in the United States District Court for the Southern District of New York, and that the Offeror explicitly submits to the jurisdiction of that court.

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

BEN S. BERNANKE
CHAIRMAN

July 16, 2009

The Honorable Gary C. Peters
House of Representatives
Washington, D.C. 20510

Dear Congressman:

I am writing in response to your follow-up questions from the February 10, 2009, hearing before the House Financial Services Committee entitled "Troubled Asset Relief Program (TARP) Accountability: Use of Federal Assistance by the First TARP Recipients."

You asked in particular what the Federal Reserve is doing to help support the larger economy. You noted that some businesses in your district are reporting that their banks are no longer lending to them, are recalling their lines of credit, or are making credit so expensive that it is not affordable. My colleagues and I at the Federal Reserve share your concern about the impact of the financial crisis on credit conditions, and we have taken aggressive action to help restart the flow of credit to both businesses and households.

As you know, the Federal Reserve's traditional policy tool for influencing credit conditions and the economy is its control over the federal funds rate. In response to the outbreak of turbulence in financial markets in the summer of 2007 and the deteriorating outlook for the economy, the Federal Open Market Committee (FOMC) reduced the federal funds rate aggressively, and following the intensification of the financial crisis last fall, the FOMC moved the policy rate to its lowest possible level. In addition, the FOMC has made clear that it expects economic conditions to warrant holding the federal funds rate at an exceptionally low level for an extended period of time.

However, given the ongoing problems in credit markets that your constituents have noted, conventional monetary policy actions have not been adequate to provide all the support that financial institutions and the economy need. The Federal Reserve has therefore taken a number of nontraditional steps to help the economy by unclogging the flow of credit to households and businesses. First, in response to strains in short-term funding markets, the Federal Reserve has provided substantial liquidity to banks and other financial institutions on unusually favorable terms. To have the confidence to commit to longer-term loans and investments, financial institutions must be sure that they will have ample access to funding, and the Federal Reserve has made clear that it will provide short-term credit to sound financial institutions as needed. The Federal Reserve's lending to financial institutions has helped to ease conditions in a number of key financial markets, reduced important benchmark interest rates (such as the London interbank offered rate, or Libor, to which payments on some mortgages and other types of loans are tied), and has helped bolster the willingness of banks to make credit available.

A second strategy the Federal Reserve has employed is to use targeted lending to help free up critical credit markets outside of the banking system. A good example of targeted lending is the programs we established last fall to provide liquidity to money market mutual funds and other participants in the commercial paper market. At the peak of the crisis last fall, many people who had invested in money market mutual funds lost confidence in those funds and withdrew their money. This loss of funding forced money market mutual funds to reduce their own investments, which in turn caused serious problems in the commercial paper market, where many businesses obtain funding for routine operations. Through a series of lending programs, and in coordination with steps taken by the Treasury, the Federal Reserve helped restore confidence in both money market mutual funds and the commercial paper market. Over time, withdrawals from money market mutual funds were replaced by modest net inflows, and borrowers in the commercial paper market saw significant improvements in the cost and availability of such funding.

More recently, the Federal Reserve has initiated a lending program, with the cooperation of the Treasury, designed to restart the market for asset-backed securities used by intermediaries to fund credit to households and small businesses. This program has provided support for securities backed by auto loans, credit card loans, student loans, and loans guaranteed by the Small Business Administration; and it appears to have played a key role in returning activity in this market to levels near those seen prior to the financial crisis.

Finally, to provide support to mortgage lending and housing markets and to improve overall conditions and private credit markets, the Federal Reserve has undertaken large-scale purchases of mortgage-related securities and longer-term Treasury securities. The FOMC has approved purchases of well over $1 trillion this year of mortgage-related securities guaranteed by the government-sponsored mortgage companies, Fannie Mae and Freddie Mac, as well as half a trillion dollars of direct agency obligations and Treasury securities. These purchases have contributed to improved functioning in mortgage markets and reduced longer-term interest rates, including mortgage rates.

While it is not possible to determine the specific effects of these Federal Reserve policies on lending in Michigan, I believe that they have contributed to an easing of strains in credit markets for the nation as a whole. Going forward, the Federal Reserve will continue to take steps to support our credit markets and strengthen the economy.

Your second and third questions pertained to the bankruptcy proceedings of General Motors and Chrysler. The Administration, through its Auto Task Force, has taken the lead role in determining the federal government's policy in this area, so I recommend that you direct your concerns to them.

I hope this information is helpful. Please let me know if I can be of further assistance.

Sincerely,

NAFCU
National Association of Federal Credit Unions
3138 10th Street North • Arlington, Virginia • 22201-2149
(703) 522-4770 • (800) 336-4644 • Fax (703) 522-2734

Fred R. Becker, Jr.
President and CEO

February 4, 2009

The Honorable Barney Frank	The Honorable Spencer Bachus
Chairman	Ranking Member
House Financial Services Committee	House Financial Services Committee
2129 Rayburn House Office Building	2129 Rayburn House Office Building
Washington, DC 20515	Washington, DC 20515

Dear Chairman Frank and Ranking Member Bachus:

On behalf of the National Association of Federal Credit Unions (NAFCU), the only trade association that exclusively represents the interests of our nation's federal credit unions (FCUs), I am writing in regards to H.R. 786, legislation that would make permanent the increase in deposit insurance coverage and provide other changes.

NAFCU supports Section 1 of the legislation that would make permanent the increase on deposit insurance coverage effective the date of enactment of the legislation.

NAFCU strongly urges a change to Section 2 of the legislation to add an amendment that would amend the *Federal Credit Union Act* to establish a restoration plan period for the National Credit Union Share Insurance Fund (NCUSIF). This would provide the NCUA Board with the authority to replenish the NCUSIF by restoring the equity ratio through a restoration plan which is consistent with the Federal Deposit Insurance Act and could extend the replenishment over a period of up to five years versus the current one year time frame. We ask for your support for an amendment to be offered by Representative Paul Kanjorski to provide this needed change.

NAFCU also strongly encourages an addition to Section 3 of the legislation to provide the NCUSIF coverage an increase in borrowing authority from the Treasury Department. This change is long due since the current level of $100 million was established in 1971, and has not been modified for the growth of credit unions and their member deposits over time. We ask that you support an amendment being offered by Representative Luis Gutierrez to increase the authority to $6 Billion.

NAFCU encourages changes to Section 4 of the bill to provide systemic risk authority to NCUA, on a similar basis to that provided to FDIC. This would be a very important step to address systemic emergencies when the authority provided under Section 208 of the *Federal Credit Union Act* is inadequate. The FDIC has pointed out specific provisions in its Act to provide

E-mail: fbecker@nafcu.org • **Web site:** www.nafcu.org

The Honorable Barney Frank
The Honorable Spencer Bachus
February 4, 2009
Page 2 of 2

unlimited deposit insurance coverage for non-interest bearing transaction accounts. Providing NCUA with parallel authority to the FDIC to address systemic risk under extreme circumstances is an important step to provide consumer confidence in these very challenging economic times.

We thank you for the opportunity to share our thoughts on this important matter. Should you have any questions or would like to discuss this issue further, please call me or Brad Thaler, NAFCU's Director of Legislative Affairs, at (703) 522-4770.

Sincerely,

Fred R. Becker
President/CEO

cc: Members of the House Financial Services Committee

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