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Remarks by

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to

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On behalf of the Federal Reserve, I am pleased to join Secretary Paulson and my fellow bank supervisors today.

Financial markets continue to show the ill effects of turmoil triggered by mortgage losses. The real economy is underperforming in terms of growth and job creation, a result in part of financial strains. And financial institutions themselves are affected by the generalized pullback in liquidity and deteriorating credit quality. Nearly one year after the onset of financial market distress, many financial institutions have retreated from certain business lines, limited their participation in markets for some financial products, delevered their balance sheets, and taken other actions aimed at balance sheet repair. These developments are both necessary and expected.

But, the path to a new financial market architecture, however uneven and improvised, will not only be marked by the forces of retrenchment. The path should equally, in my view, be distinguished by the creative impulses that drive product and market innovation. It is perhaps too convenient to denigrate the attributes of dynamism and ingenuity, particularly late in economic cycles, when the forces of innovation can disappoint and weaken the real economy. Policymakers and market participants alike should recognize that innovation--in our product markets, labor markets, and yes, our financial markets--is likely to prove a necessary net contributor to economic growth in the coming period. We should also be reminded that financial innovation need not be equated with product complexity.

While some take comfort in the presumption that global economies have decoupled, I would note that our global financial markets are more integrated than ever. Financial products successfully developed in a single geography often can be readily exported to another; readily, that is, if the new product export befits investor preferences and policymakers remove barriers to their adoption. Today's introduction of the Treasury Covered Bond Framework may be illustrative of the benefits of product innovation in globally connected financial markets.

Treasury's discussions with market participants suggest that a covered bond framework may attract investor interest and facilitate greater access to mortgage credit. High-quality assets might be financed if banks are allowed to manage pools of loans, substituting new loans into the pool as others become delinquent. Newly issued covered bonds backed by high quality mortgage loans and issued by strong financial institutions may find a growing investor base in the United States.

The Federal Reserve has long accepted a broad range of high-quality collateral from depository institutions at its discount window. Highly rated, high-quality covered bonds would generally fall within that broad range as eligible collateral. Private lenders also are likely to find such bonds attractive as collateral for credit extensions.

Financial innovation, properly understood, can increase the diversity of funding sources, improve the distribution of risks, and provide incentives to monitor such risks--all helping to promote economic growth. The Federal Reserve seeks to encourage new and innovative sources of funding, and will continue to work with other policymakers and market participants to accomplish this important objective.