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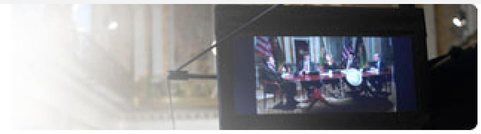

Treasury Secretary Tim Geithner Opening Statement as Prepared for Delivery before the House Committee on Financial Services

4/20/2010

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To read the written testimony, visit link.

Chairman Frank, Ranking Member Bachus, Members of the Committee, thank you for the opportunity to testify.

On September 15, 2008, Lehman Brothers became the largest bankruptcy in American history. And in the days that followed, it helped push our financial system to the brink of collapse.

Lehman's failure illustrates many of the fundamental flaws in our financial system.

These problems are exposed with great care and force in the Valukas report.

The report tells the story of the ways in which our system allowed large institutions to take on excessive risks without effective constraints.

In particular, it allowed the emergence of a parallel financial system, what many have called the "shadow" banking system."

This system operated alongside - and was almost as big as - the regulated banking system, but it lacked the protections and constraints necessary to protect the economy from classic bank failures.

Imagine building a national highway system with two groups of drivers.

The first group has to abide by the speed limit, wear seatbelts, and buy cars with anti-lock brakes.

The second group can drive as fast as they want, with no safety features, and without any fear of getting pulled over by the police.

And imagine both groups are driving on the same road.

That system would inevitably cause serious collisions.

And drivers following the rules would inevitably get hit by the drivers who weren't.

A system like that makes no sense. We would never allow it on our roads. So why did we allow it in our economy?

Our financial system allowed risk to move towards areas where regulations were most lenient.

And as you would expect, when there's a lot of money to be made by avoiding regulation, there's going to be a lot of activity and risk where the constraints are weak.

In the lead-up to this crisis, we saw a complete breakdown in basic checks and balances in the system.

Credit rating agencies failed to do an adequate job of assessing the risks in structure credit products and disclosing their ratings methodologies.

Boards of directors failed to exercise critical judgment and address critical weaknesses in risk management.

Accounting and disclosure regimes did not adequately inform investors of material risks in a timely fashion.

Executive compensation rewarded short-term gains with little attention to the risk of long-term loss.

The derivatives market, operating largely in the dark without oversight, grew to enormous scale, with firms able to write hundreds of billions of dollars in commitments without the capital needed to back them up.

And, tragically, when we saw when firms mismanage themselves to the edge of failure, the government had limited ability to step in and protect the rest of the financial system.

It certainly didn't have any ability - as we do with banks – to step in and - in an orderly and safe way - wind down major investment banks like Lehman or major insurance companies like AIG.

Failure is inevitable in financial systems. The challenge for government is to design a system in which failures of private firms cannot cause catastrophic damage to the economy.

In our system, the Federal Reserve was the fire station, a fire station with important if limited tools to put foam on the runway, to provide liquidity to markets in extremis.

However, the Federal Reserve, under the laws of the land, does not have any legal authority to set or enforce limits on risk taking by a large global financial firm that was structured as an independent investment bank like Lehman, or an insurance company like AIG, or Fannie and Freddie, or the tens and hundreds of non bank financial firms that operated outside the constraints the banking system.

The sweeping financial reforms that this Committee has embraced, that the House has passed, and that the full Senate is about to consider are designed to deal with the vulnerabilities in our system exposed by crisis, and illustrated by the Lehman example.

First, with financial reform, an investment bank like Lehman will no longer be able to escape consolidated supervision because of its corporate form.

In fact, large firms like Lehman will be subject to tougher prudential requirements – such as higher capital and higher liquidity – and more exacting oversight than other firms, reflecting the greater risk they pose.

Second, with financial reform we will bring the derivatives markets out of the dark.

We will establish transparency so that regulators can more effectively monitor risks of all significant derivatives players and financial institutions.

And we will bring standardized derivatives into central clearing houses and trading facilities, reducing the risk that the derivatives market will again threaten the system.

Third, with financial reform, if a firm like Lehman still mismanages itself into failure, the government will have the ability to wind it down with no exposure to the taxpayer. This is bankruptcy designed for banks. It is essential to deal with moral hazard - the risk that investors and executives will take risks in the expectation the government will step in to bail them out.

And finally, with financial reform we will establish stronger protections for investors and for consumers, with clear rules, enforced across the financial market.

We need a system in which regulators can act preemptively to protect, not be left to come in after the fact to clean up the mess.

The failures in our financial system were devastating.

When a conservative Republican President – a President with abiding faith in markets – is forced by a financial crisis to put Fannie Mae and Freddie Mac into conservatorship;

to ask Congress for $700 billion in authority to stabilize the financial system and then to invest taxpayer money into banks that account for three quarters of the entire U.S. banking system *;*

to lend billions of dollars to two of our largest auto makers;

when he does all that – and he was right to do it – it is undeniable that our system is broken.

The question we face is not whether to fix it but how best to fix it.

Any strategy that relies on market discipline to compensate for weak regulation and then leaves it to the government to clean up the mess is a strategy for disaster.

Instead, the best strategy is to force the financial system to operate with more transparency and with clear rules that set unambiguous limits on leverage and risk so that taxpayers never have to come in and protect the economy by saving firms from their mistakes.

That is the strategy behind the reforms proposed last June by the Administration; the reforms passed last December by the House; and the reforms currently under debate in the Senate.

Thank you.

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