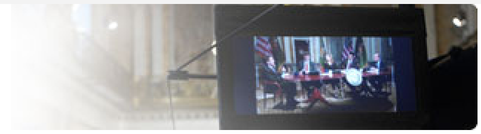

Remarks of Assistant Secretary Massad at the University of Arkansas on "Wrapping up the TARP: What will its legacy be?"

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As prepared for delivery

WASHINGTON - Good evening. I'd like to thank Skip Rutherford for that kind introduction and I'd like to thank the Clinton School for inviting me.

As Skip mentioned, I oversee the Troubled Asset Relief Program, or "TARP" as you probably know it. That means I have the honor of overseeing one of the most unpopular government programs in recent memory. I recall when we were still in the dark days of the crisis and a poll came out that said the word TARP was less popular than Guantanamo.

But while it may be unpopular, TARP was one of the most effective government programs in recent memory. It was also one of the most necessary.

I would say TARP is a perfect example of the values that President Clinton wanted this school and his library to embody. He said that he wanted people of all political persuasions – and especially young people – to see that, "public service is noble and important, that the choices and decisions leaders make affect the lives of millions of Americans and people all across the world."

Next week marks the five year anniversary of the Emergency Economic Stabilization Act, the law that created TARP. And so it is a good time to review the record and legacy of TARP.

Even though the pain from this terrible recession is still with us in many ways, as a result of the actions taken through TARP and other measures, the impact of the financial crisis on families and communities was much less than it might have been. Our financial system did not collapse. The economy is growing again.

And although growth is not as robust as we would like, we are in a much better place than we would have been without TARP.

So tonight, I plan to talk about three things –

1. Why TARP was necessary
2. What it did
3. What its legacy should be

WHY TARP WAS NECESSARY

First, let's look back on why TARP was created at all. I wasn't in government when the crisis began. But during the events of September 2008, I was reminded about the stories I heard as a child, as many of you might have been.

I was born not far from here in Louisiana. My parents grew up during the Great Depression. They were the children of poor immigrants who settled in Oklahoma and Kansas. I recall hearing stories from my parents and my grandparents about how hard life was during the Depression.

The experience of growing up during the Great Depression fundamentally shaped their perspective and their values for the rest of their lives. They never forgot the tragedy of that period in our history. Nor should any of us.

Anyone who lost their job, their home, or their savings during this recession does not need a reminder that this was a terrible crisis.

But the idea that our financial system almost collapsed, that we almost fell into another Great Depression – and what that would've meant to our modern economic way of life – is not so easy to comprehend. The worst did not happen. But can we even imagine what almost happened?

In September of 2008, our nation was in the worst financial crisis since the 1930s. These are just a few of the headlines from those days.

Several major financial institutions had already failed – including Bear Stearns, Indy Mac, and Washington Mutual bank. On September 15th, Lehman Brothers filed for bankruptcy.

The next day, a money market fund "broke the buck" – which meant that one of the safest kinds of investments was no longer safe. This triggered the start of a run on money market funds generally.

The day after that, AIG – one of the largest and most complex financial firms in the world – was on the verge of failure. Confidence in the financial system was eroding. Panic was spreading. The stock market dropped by more than 770 points in a single day. And the financial wildfire was quickly spreading far beyond Wall Street.

Credit markets that provide financing for credit cards, auto loans, student loans, mortgage loans, small business loans, and other types of financing – had basically stopped functioning.

For the first time in generations, Americans were questioning the safety of their money in banks. For the first time in more than 80 years, we faced the very real possibility of a generalized run on the nation's entire financial system.

Only this time it would not have been like that famous scene from *It's a Wonderful Life* with Jimmy Stewart, where farmers must go into town and line up outside the local bank to withdraw their money. This time it would have happened practically all at once – and all at the speed of a mouse click.

The crisis was causing our economy to collapse. And by the time President Obama took office, we were losing almost 800,000 jobs a month. Between December 2007 and December 2008, household wealth fell by 17 percent – more than five times the decline in 1929.

In September 2008, the government had limited options. The Federal Reserve and Treasury were taking whatever actions they could under existing law.

But they could not get ahead of the crisis, nor contain the damage. They did not have sufficient tools to do that. Our nation was literally on the edge of falling into a second Great Depression. That is why TARP was necessary.

RESTORING FINANCIAL STABILITY

So what did TARP do? Its purpose was to restore stability to the nation's financial system. The financial system is like the circulatory system for the nation's financial health.

It enables people to have checking accounts and savings accounts, to get payroll deposits, purchase a home, finance a college education or save for retirement. It enables businesses to get credit to grow and expand.

Think of it this way. If you are in a serious accident, you can't survive much less heal, unless your circulatory system is functioning. And so it is with our economy.

TARP was part of a response to the financial crisis that was massive in scope. The response spanned both a Republican and a Democratic Administration. It involved actions taken by the Federal Reserve, Treasury, and other federal agencies. Here are some of the ways that TARP helped restore the nation's financial stability.

Banking Investments

First, TARP stabilized the nation's banking system. Capital was invested in the nation's largest banks as you probably know. But TARP also provided capital to banks of all sizes, including more than 650 small and community banks across the nation – including 12 here in Arkansas.

The banks that took TARP funds held 98 percent of all the assets of all banks in the country.

That was important, because the purpose was not to save any individual bank but to protect the economy and financial system. The government did not give grants; it made investments so that taxpayers would receive a return as the banks recovered. Now even after this, some said we should nationalize the major banks; others had said all along, do nothing and hope that the problem would fix itself.

President Obama chose a different path--and that was to get the banking system to raise private capital. And to do that, we required the big banks to go through stress tests, so the world would know whether they could withstand further adverse conditions.

We were prepared to provide additional capital, but we didn't need to, because this process enabled the banks to raise private capital, so that the government could get out.

And today, banks have far more capital and we have almost completed that exit. We hold investments in some small banks that represent less than one percent of the assets of the system.

Credit Market Programs

Second, TARP helped to restart the secondary credit markets. In today's world, banks are only part of the picture.

There is something we call the shadow banking system, which includes large secondary markets that enable you to get a credit card, a loan to buy a car or a house, or finance a college education. When the Obama Administration took office, these markets had essentially frozen.

And so we launched a series of programs to restart the flow of credit. The programs worked, and that recovery continues today. While credit is still somewhat constrained, conditions are much better than before.

AIG

Third, TARP prevented the collapse of AIG.

Supporting AIG was one of the most difficult decisions made by the government. The outrage that it caused is understandable. Treasury and the Federal Reserve provided a total of $182 billion in commitments to a single company. It is hard to fathom that.

By September of 2008, AIG had grown to become the largest insurance company in the world. At its peak, it had more than $1 trillion in assets and provided conventional insurance to 75 million individual and corporate customers in more than 130 countries. It had a substantial presence in many critical financial markets including municipal bonds. Unfortunately, it used the strength of its insurance subsidiaries to engage in some very risky derivatives transactions.

How AIG was able to do that, without any federal agency looking at the risk such activity posed, is the nub of the problem, but it is a larger discussion beyond the scope of my remarks. But the simple fact is that AIG's sudden collapse would have dramatically accelerated the speed and intensified the severity of the financial crisis. The crisis would have likely spread to the entire insurance industry.

Corporate and municipal bond markets and derivatives markets would have been destabilized further. Investors would have likely pulled back from funding other major financial institutions.

That is why the government acted. It acted because in that time, and in those circumstances, the sudden collapse of AIG would've likely had catastrophic consequences.

HELPING MAIN STREET

The actions we took under TARP were designed to protect the economy and keep credit flowing to consumers and businesses.

Many have still questioned whether TARP did enough to help Main Street, or the middle class, who bore the brunt of the recession.

The evidence of TARP's impact is not always apparent to many Americans. That's in part because many of the TARP programs were about investments in institutions and markets, and had complex details and odd acronyms. This made them seem remote from everyday lives.

And after all, most Americans who've known economic hardship these past several years don't think about the collapse of Lehman Brothers when they think about the recession.

And it is also because we are still struggling with the damage from this crisis. Growth is too slow, unemployment is too high. And even for those working, median family income isn't rising. We are not where we need to be yet.

But what would have happened without TARP and the government's other emergency measures? While we can never say with certainty, economists can make estimates. And one was a study by two economists, Mark Zandi, who is a former advisor to Senator John McCain, and Alan Blinder, who served in the Clinton Administration.

They said that without TARP and the other financial rescue measures taken by the government, unemployment would have likely topped 16 percent, we would have lost 8.5 million more jobs on top of the millions we had already lost.

We would've had much higher deficits and the nation would have likely entered "a 1930s-like depression." The fact that it could have been much, much worse may not be much comfort to those who are still struggling, but it is the reality of what we have just been through.

I also want to highlight two programs in particular where the impact of TARP on everyday life is more obvious.

Auto Investments

One was our action to help protect the broader economy by stabilizing the American auto industry.

The auto industry was in decline before the crisis. But the decline became a potential free fall.

In 2008, the auto industry shed more than 400,000 jobs. By December, the situation was dire. With a deepening recession, credit markets frozen, and Americans unable to get car loans, auto sales were evaporating. And GM and Chrysler were quickly running out of cash.

With no options for private financing available, the government under TARP stepped in as a lender of last resort to prevent the collapse of GM and Chrysler and the devastating impact that would have had on our economy, which was already on the ropes.

The actions not only saved GM and Chrysler. They saved businesses up and down the auto industry supply chain, and even helped Ford, as its CEO has acknowledged.

Some experts have estimated that as many as one million American jobs were saved as a result of the government's auto investments. Today the auto industry has come roaring back. GM, Chrysler, and Ford are all profitable. They are adding thousands of jobs, and selling more cars. And Treasury is exiting our remaining investments in auto companies under TARP.

Housing Programs

Another way that TARP directly impacts middle class Americans is by helping people keep their homes. Not since the 1930s have we seen a housing crisis on this scale.

The housing crisis had many causes. Buying a home had always required responsibility on everyone's part. But in the years before the crisis, responsibility too often gave way to recklessness by lenders who sold loans to people who couldn't afford them and buyers who knew they couldn't afford them. We tried to help responsible homeowners, though it has been a far more complex challenge than anticipated.

Despite these challenges, as a result of TARP's housing programs, millions more families have avoided foreclosure than otherwise would have and many families are spending less each month on their mortgage payments. And the good news is that the housing market is recovering with home prices rising at their fastest pace in seven years.

EXPECTED COST OF TARP

But what about the cost of all of this? The true cost of the financial crisis is not the fiscal cost of the programs. The true cost will always be measured in terms of the financial impact on Americans generally – the millions of jobs that were lost, the thousands of small businesses that were closed, the homes that were lost to foreclosure, and the retirements or college educations that were deferred. And the most important measure of success is whether the program helped stop the crisis and contain the damage.

As former Treasury Secretary Henry Paulson said in late 2008, the most important goal for TARP was "to stabilize a financial system that is integral to the everyday lives of all Americans." But the fiscal cost of TARP is nevertheless something in which a lot of people are interested. And the answer may surprise you.

Congress authorized up to $700 billion for TARP. That is still the number that most people associate with it. Today, many probably think that money went up in smoke, or was paid to big banks which paid it out in bonuses. And there were many predictions that most or all of the TARP funds would not be recovered, and the final cost of all the government interventions would run into the trillions of dollars.

Perhaps we should remember the advice of Yogi Berra, who famously said, "It's difficult to make predictions, especially about the future."

In fact, we disbursed about $420 billion—a huge amount, but not the full $700 billion. About $245 billion of that was invested in the banking system. Today we have recovered $272 billion—a gain of $27 billion for taxpayers.

Treasury and the Federal Reserve provided a staggering $182 billion in commitments to AIG. Today we have recovered all of that plus a gain of $23 billion. In terms of TARP's investment programs, it is only on the auto investments where we will lose money, though far less than originally estimated and far less than it would've cost had we not acted. Funds dispersed under TARP to help homeowners avoid foreclosure were never intended to be recovered.

Indeed, if we include all of Treasury's profits from its investment in AIG, we have already recovered more from TARP than has been disbursed.

And when you look at all of the government's financial stability programs as a whole, taxpayers are likely to realize a significant gain.

LESSONS FROM TARP

Finally, what should the legacy of TARP be? And particularly for those of you preparing for careers in public service, what are some of the lessons from TARP that may be valuable to you as future policymakers?

Acting Forcefully

I believe the most important lesson from the government's response is that it acted with overwhelming force and speed to confront the crisis. The response wasn't perfect; no doubt there are things that could have been done better. But I think the government got it right by acting so quickly, and on so many fronts to combat the problem.

Some might nevertheless say that a big part of TARP's legacy is moral hazard, and that it worsened the 'too big to fail' problem. By moral hazard, I mean that other large firms may start to believe that the government will always be there to help them out, should they get into trouble in the future. But I think that confuses what we had to do to respond to the crisis from what we must do to address the problems revealed by the crisis.

Think of it this way. If your neighbor's house is burning down in the middle of the night because he fell asleep smoking in bed, and the fire is threatening your house as well as the whole neighborhood, do you want the fire department to put it out, or do you say, no, I'd rather let it burn so we teach everyone not to smoke in bed?

TARP was like the fire department, called to put out the fire. There is no question that anytime the government saves a private company with taxpayer dollars, we create a risk of moral hazard. But one must stop and contain the panic first, and deal with the reform next.

The crisis made clear that our regulatory system is out of date. We did not identify risks building up in the system nor did we have the tools to deal with the crisis.

That's why the Obama Administration took up the mantle of financial reform and fought to pass the Dodd-Frank Wall Street Reform and Consumer Protection Act and other measures. The financial reforms now being implemented will:

- Give us better tools to monitor risk and wind down large financial firms whose failure could threaten the system.
- They will require the largest financial institutions to hold more capital and undergo regular stress tests to determine if they can withstand severe economic conditions;
- They will bring more transparency to the derivatives market; and
- They will create stronger safeguards for consumers when it comes to financial products.

There is still more work to do. The system is safer and stronger today, but the job is not finished.

And the crisis reminds us that the financial system is dynamic and is constantly changing. As sources of risk change, our regulation and oversight must keep pace.

A third way to think about lessons, and the legacy of TARP, is as a lesson in public service itself. As I mentioned earlier, the crisis response was carried out over both a Republican and Democratic Administration.

My own experience, from the spring of 2009, is that decisions were made on the basis of what people thought was the right economic strategy. Decisions were not driven by polling data or political calculus.

The President, Secretary Geithner, and others focused on what was the right response, and then how to deal with the political constraints. And while I was not in government in the fall of 2008, I believe the same to be true for the people faced with making the tough decisions then.

And so I would like to close with some words of Treasury Secretary Geithner, in his advice to students of Johns Hopkins as he reflected on the crisis. He said:

"You will find lots of people in public life who worry more about how they appear than what they accomplish, who fear the risk in any action, who let perception and politics get in the way of doing the right thing…. if you are going to make a difference, you need to be willing to get close to the flame. <u>You need to be willing to take risk and feel the heat.</u>"

The courage shown during the crisis wasn't just at the top. There were hundreds of men and women—not just at the Treasury Department but across federal government—who were involved in the crisis response.

They chose to serve the public during a very difficult time, they tried to do what they thought was best, and they worked extremely hard under very difficult conditions. And it is their combined effort that helped the government to succeed.

As TARP moves into the history books, it's my hope that TARP's greatest legacy will be this – that when the nation was confronted with an extraordinary challenge – in this case, the potential collapse of our entire modern financial way of life – <u>government rose to the occasion</u>.

If we remember these lessons, I believe those of you entering public service will be better able to make valuable contributions, and we as a nation will be better able to confront the great challenges we face in the years ahead.

Thank you.

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