SEN. CHRISTOPHER J. DODD HOLDS A HEARING ON THE RESPONSE BY FEDERAL FINANCIAL REGULATORS TO ONGOING TURMOIL IN U.S. CREDIT AND MORTGAGE MARKETS AND THE NEAR COLLAPSE OF BEAR STEARNS. COMMITTEE HEARING

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SENATE COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS HOLDS A HEARING ON THE RESPONSE BY FEDERAL FINANCIAL REGULATORS TO ONGOING TURMOIL IN U.S. CREDIT AND MORTGAGE MARKETS AND THE NEAR COLLAPSE OF BEAR STEARNS

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WITNESSES: FEDERAL RESERVE SYSTEM BOARD OF GOVERNORS CHAIRMAN BEN BERNANKE
SECURITIES AND EXCHANGE COMMISSION CHAIRMAN CHRISTOPHER COX
TIMOTHY GEITHNER, PRESIDENT, FEDERAL RESERVE BANK OF NEW YORK
UNDERSECRETARY OF TREASURY FOR DOMESTIC FINANCE ROBERT K. STEEL
ALAN SCHWARTZ, PRESIDENT AND CEO, BEAR STEARNS
JAMES DIMON, CHAIRMAN AND CEO, JPMORGAN CHASE

[*] DODD: Good morning. The committee will please come to order.

Let me thank all of our witnesses and my colleagues.

And for those of you gathered here this morning, we’re not in our traditional hearing room, and the size of the crowd in the room is evidence of the reason why. So we thank all who are here this morning to participate one way or another in this gathering.

Today, this committee will carefully consider recent actions taken by our federal financial regulators in response to the ongoing turmoil in our markets and our economy. Much of our focus today will center on a period of 96 hours, mostly over the weekend of March 15th and 16th. During this momentous four-day period, the Federal Reserve, the Federal Reserve Bank of New York and the Treasury Department took dramatic and unprecedented action to stabilize our markets, to infuse them with liquidity and to prevent additional financial firms from being swept under the riptide of panic that threatened to have taken hold of our markets.

Along those actions was the decision by these entities to support the acquisition of Bear Stearns by JPMorgan Chase.
As part of the acquisition, the Federal Reserve Bank of New York, with the support and approval of the Federal Reserve Board of Governors and the Treasury Department, committed some $30 billion in taxpayer money to help facilitate the sale of the distressed company to JPMorgan Chase.

And as part of its broader efforts to provide stability to the markets, the Fed's Board of Governors made a historic decision to allow primary dealers, firms which include investment banks, to access billions of dollars of liquidity on a daily basis.

The stunning fall of Bear Stearns, a Wall Street giant and America's fifth largest investment bank, was matched only by the swift and sweeping response to its collapse put together by the New York Fed and the Federal Reserve Board of Governors, which, with the support of the Treasury, exercised powers in some instances that had not been used since the Great Depression and in others were unprecedented in nature.

There can be no doubt that these actions taken in order to calm financial markets that appear to be teetering on the brink of panic have set off a firestorm of debate. They also raised a number of important questions that warrant our consideration.

Was this a justified rescue to prevent a systemic collapse of financial markets or a $30 billion taxpayer bailout, as some have called it, for a Wall Street firm while people on Main Street struggle to pay their mortgages?

What was the role of the Federal Reserve, the Treasury, the New York Fed and the SEC in helping to facilitate a range and set the terms, including the price of the original and amended merger agreement between JPMorgan Chase and Bear Stearns?

DODD: With hindsight -- while hindsight is invariably 20-20, it bears asking if Bear Stearns would have survived if the Fed had opened the discount window to investment banks earlier and what led to the sudden reversal on a policy that the vice chairman of the Fed had openly rejected in response to a question I asked him before this very committee only two weeks earlier?

What was the role of the SEC, the primary regulator of Bear Stearns, during this critical 96 hours and in the weeks of market turmoil leading up to that weekend of merger negotiations?

And why were they seemingly unaware of the potential for market rumors to cause investors to suddenly stop doing business with Bear Stearns until it was too late?

These questions, the series of events leading up to Bear Stearns' rescue, the response by financial regulators, and the implications of those actions will be discussed and debated for years to come.

It would be an overstatement to suggest that what occurred during those fatal 96 hours may have fundamentally altered our financial market landscape and our system of financial market regulation.

Given these considerations, and the highly unusual and unprecedented actions taken by the Federal Reserve Board of Governors, the Federal Reserve Bank of New York, and the support of the Department of Treasury, I believe it is appropriate -- indeed, essential -- that this committee, the Banking Committee, exercise its oversight and investigatory functions to examine the authority, economic justification and the public policy implications of these extraordinary recent actions by our nation's federal financial regulators.

As such, the committee has convened today's hearing, the first congressional analysis with all relevant parties to this issue, to hear the testimony of the public and private principals involved in this unprecedented series of events and to provide committee members and the American taxpayer with a full, public and thoughtful airing of these issues and their implications.

With $30 billion on the line, the public deserves, of course, nothing less.

I want to thank all of the witnesses and my committee members as well for their participation here this morning. We look forward to the testimony of our witnesses. DODD: Let me just say, as well, that I want the witnesses to know, and others, that as a bottom-line consideration, I happen to believe that this was the right decision considering everything that was on the table in the closing hours on that Sunday; that the alternative -- and I don't think this is hyperbole -- could have been devastating, both at home, and around the world for that matter. So I don't question that ultimate decision.

But I think it's appropriate that we look at the rationale leading up to it, why decisions were made and not made earlier and later during the process, what was a part of that negotiation. Were there alternatives? Is this a model for the future? If so, what are the implications? What do the taxpayer get back for the $30 billion that we're putting on the line, or the $29 billion here?
Those are the kinds of questions I think all of us are interested in pursuing, and many, many more.

But on the bottom-line issue, at least to this member goes, I think fundamentally the decision was the right one in the final analysis. But I think it's appropriate we look at what else went on here to determine the wisdom of this step and what the implications are.

With that, let me turn to my colleague from Alabama, Senator Shelby.

SHELBY: Thank you, Mr. Chairman. Thank you for calling today's hearing.

The collapse of Bear Stearns and the unprecedented regulatory response led by the Federal Reserve call for a thorough examination of this committee, so I commend you, Mr. Chairman, for bringing this committee together today.

In deciding to commit $29 billion to help finance JPMorgan Chase's takeover of Bear Stearns, the Fed has set a new precedent on the type of response that the federal government may provide during financial panics.

It may be that the Fed's actions were warranted by the unique financial condition pervading in our markets. However, such policy decisions must be fully considered by this committee. After all, the ultimate responsibility for financial regulations rests with this committee and the Congress. In examining the events of the past few weeks, we must certainly be mindful that regulators and market participants had to make prompt decisions using available tools in the midst of a financial storm.

This will not be the last time that we face financial upheavals in our history. However, I think it would be unwise if we did not take this opportunity this morning to thoroughly examine what transpired, including how Bear Stearns was regulated, what caused its collapse, whether any other institutions face similar risks, and if there are any shortcomings in our regulatory structure.

SHELBY: Two aspects of the Fed's response deserve particular attention.

First, for the first time since the last -- Great Depression, the Fed has funded a bailout of an investment bank. Previously, assistance by the Fed had been extended to only FDIC-insured depository institutions.

But by expanding the federal safety net to an institution not supported by an explicit federal guarantee, the Fed's actions may create expectations that any major financial institution experiencing difficulties might be eligible for a federal bailout.

I think we must guard against creating a moral hazard that encourages firm's to take excessive risk based on the expectations that they will reap all the profits while the federal government stands ready to cover any losses if they fail.

A second point of concern is the legal authority for the Fed's actions. The financial assistance extended by the Federal Reserve was provided under the Federal Reserve's emergency lending authority, which allows the Fed to lend to any entity -- not just banks -- in, and I quote, "unusual and exigent circumstances," with the approval of five members of the Board of Governors.

This unilateral regulatory authority is in sharp contrast to the regulatory scheme set forth under FDICIA for bank failures involving systemic risk, which includes roles for the FDIC, the Fed, the treasury secretary and the president of the United States.

The Fed's recent actions may have been warranted.

SHELBY: Nonetheless, the committee here today needs to address whether the Fed or any set of policy-makers should have such broad emergency authority going forward.

And if the evolution of our markets leads to the federal safety net being extended to nonbanks, attention should be given here, I believe, to ensure that the proper decision-making process is here and safeguards are in place.

I look forward to exploring these and other issues with our witnesses today.

And I appreciate, again, Mr. Chairman, you calling the hearing.
DODD: Thank you very much, Senator Shelby.

And let me just -- for the purpose of the committee members, as you know that we've also got a major bill on the floor dealing with the housing issue, so this is going to create somewhat of an awkward moment or two here and there as we go back and forth.

And what I'd like to do, if I could, at the outset -- and we want to get to our witnesses, but I also know that all of my colleagues have some feelings about this matter. And so, I'm going to take a step here and ask any member that would like to make an opening brief comment on this matter to be able to do so before we get to our witnesses. And then we'll hear from the witnesses themselves and set up a question period as well.

But let me ask if anyone would like to be heard.

I'll begin with Senator Johnson, if he has any brief comments, or anyone else would like to be heard at the outset here, I'd like to give you that opportunity to be heard.

Senator Johnson?

JOHNSON: Thank you, Chairman Dodd, for holding this hearing today.

There appears to be (inaudible) consensus the effects of the recent Fed action in the purchase of Bear Stearns.

There has been criticism voiced from a large number of people. I have received letters from my constituents with concerns that it is a bailout of the big bank that creates a moral hazard. Others wonder if it is appropriate to offer help to Wall Street firms while insisting on market discipline for troubled homeowners.

There has also been applause for the decision from some quarters. The U.S. markets responded favorably. Other investment banks believed to be in trouble saw their stock rise.

Foreign governments applauded this as a move -- as a positive move for global markets. And other analysts suggested that the Fed actions averted would could very well have been a modern-day run on the bank.

The reality of the situation is probably somewhere near the middle.

I thank you, Chairman Dodd. And I submit my whole statement for the record.

DODD: All statements, by the way, of members, and any supporting data and information they'd like to have included, will be included in the record during the entire hearing.

Senator Bennett?

BENNETT: Thank you, Mr. Chairman.

I agree with the position you and the ranking member have taken. The only thing I would quibble with in your statement, when you said hindsight is always 20/20.

BENNETT: At this point, hindsight has not yet reached that level of accuracy, because we are viewing these events through the lenses of previously strongly held ideological positions. And it's important for us to have this hearing so that we can perhaps move away from some of those strongly held ideological positions and find out what really happened.

So I endorse what you've had to say, and thank you for calling the hearing.

DODD: I'll so modify my opening statement to reduce the 20/20 to a (inaudible).

(LAUGHTER)

Senator Reed?

REED: Well, thank you very much, Mr. Chairman.

And the dramatic intervention by the Federal Reserve with regard to Bear Stearns raises significant questions.
What are the consequences of this implicit guarantee on these institutions by the Federal Reserve and financial markets?

What regulatory authority should be exercised over these institutions?

What are the steps being taken to minimize taxpayer exposure?

And what are the steps being taken to ensure that there is improved risk management, both by the financial institutions and regulators alike, going forward?

I think all of these questions begin with a careful analysis of what happened, a sober and highly detailed analysis of the actions of the agency: not just their authorities, but also how they implemented their authorities, how they cooperated and communicated with other regulatory agencies.

It's not finger pointing. It is the kind of after-action report that is owed to the American public since you're using their resources to stabilize this market.

We have, I think, an obligation to encourage you -- in fact more than encourage you -- to conduct this sober, no-holds-barred analysis of what happened, because the bottom line is to prevent a repetition and to strengthen our markets.

I think the greatest competitive factor in our financial markets is the confidence that Americans and the world has that these markets are well regulated and transparent. And if there's any question about the regulatory sufficiency or transparency, that makes us less competitive marketplace and it doesn't help us, doesn't help the taxpayers that are supporting these efforts.

Thank you, Mr. Chairman.

DODD: Thank you, Senator Reed.

Senator Allard?

ALLARD: Thank you, Mr. Chairman.

I'm anxious to hear from the witnesses and get into the question period, so I'd just ask that my statement be made a part of the record.

DODD: Thank you.

Senator Schumer?

SCHUMER: Thank you for holding this hearing, Mr. Chairman. I appreciate it.

You can see by the fact that this room is full that the economy has moved front and center when even the behind-the-scenes moves of regulators and institutions gets the attention it does.

I have three -- my questions fall into three areas: the before, the after and the who.

I think everyone agrees that the Fed had no choice and the actions had to be done. But the question is, first, before, how long before this happened should the regulators have known what happened?

Bear Stearns had trouble. Two of their hedge funds went under due to mortgages in summer. Where were the regulators?

SCHUMER: Was someone asleep at the switch? Or is that our regulatory structure doesn't work?

The SEC has jurisdiction over Bear Stearns, but mainly looks at investor protection and disclosure. The Fed has responsibility for safety and soundness of the system, but no jurisdiction over investment banks. I think that things fall between the cracks.

The after -- what are we going to do now? How are we guarding against a future Bear Stearns?

And what rules are set in place so that things are done in a fair way? The response to Bear Stearns was
necessary, but ad hoc. If the Fed is going to be a stabilizer of last resort, it would be best if the stabilizing efforts were by the book instead of on the fly.

And, finally, the who. Everyone agrees that Bear Stearns was staring into the abyss. What about homeowners who are also staring into the abyss?

It is true that a large institution creates systemic risk problems (inaudible) individual homeowner does not. But as an aggregate, homeowners certainly do. They create -- thousands and thousands and thousands of foreclosures create as much systemic risk as one investment bank.

And I worry that as quickly as the federal government moved to save Bear Stearns from complete failure, it has moved at a snail's pace, if at all, to save homeowners from foreclosures, where the same types of moral hazards like and not existed.

So I thank you for this hearing, Mr. Chairman. It's necessary. It's the beginning of a long road we have to face so that our system of regulation catches up to the financial system that is on the ground today.

DODD: Thank you, Senator Schumer.

Senator Bunning?

BUNNING: Thank you, Mr. Chairman. I'll be brief.

First of all, I want to know -- first question: How big do you have to be to be too big to fail? That's the question I ask first.

I am very troubled by the failure of Bear Stearns, and I do not like the idea of the Fed getting involved in a bailout of that company.

But before making a final judgment, I want to hear from our witnesses why they thought it was necessary to stop the invisible hand of the market from delivering discipline.

BUNNING: That is socialism -- at least that's what I was taught, and I would imagine everybody at that table was taught the same thing -- and it must not happen again.

I am also troubled that the regulators who were supposed to be watching the types of mortgages being written did not do their job. Neither did the regulators who were supposed to make sure one firm did not become exposed to too much risk.

Other questions need to be asked. Does anyone else think they will get Fed intervention if they get into trouble? Who let our financial system become so fragile that one failure jeopardizes the health of the entire system? I am sure many other questions will come up as well.

I look forward to the hearing, and will follow up during the questioning.

DODD: Thank you, Senator.

Senator Carper?

CARPER: Mr. Chairman, thanks for pulling us together.

I just want to say -- start off by thanking you and Senator Shelby for the leadership you've provided in recent days and weeks to try to make sure that we -- our action here in the United States Senate matches the action on the part of the Federal Reserve and on the part of the Treasury and others to try to restore confidence in our markets, to restore liquidity as well.

We'll be taking up when we leave here today -- the chairman and Senator Shelby will be leading a debate in accepting amendments -- debating amendments as to what our responsibilities are to follow up on the actions that you've taken.

I agree with Senator Dodd: At the end of the day, I think, Chairman Bernanke, what the Fed's done will probably pass muster and we will end up thanking you for that.

I'm going to ask you -- when it comes time for me to ask questions, I'm going to be asking you to give us your advice, your informed advice, into the package that we're about to consider, that we're going to debate.
And we're taking on ourselves the ability to criticize or comment on what you've done, and I want welcome
you to do the same in terms of what we expect to do later today and maybe to tomorrow and next week.

The other questions I'm going to ask, a bunch of my colleagues have already indicated, telegraphed their
pictures -- I telegraph mine as well -- in terms of looking and reflecting on the steps you've taken. But among
the questions I want to ask, Chairman Bernanke, why did the Fed take the action that you've done?

How did the Fed actually intervene? Just to, sort of, give us glimpse behind the curtain as to how you
actually intervened.

What are the probable repercussions of the action?

CARPER: What are the possible repercussions if you haven't -- or had not chosen to act?

Could this intervention be seen as a model of what to do or not to do in the future? And if it's maybe the
latter, what steps should be taken to reduce the likelihood that similar intervention will not be needed in the
future?

Those are the kinds of questions that I'll be throwing your way.

But one of the first questions I'll ask is what advice would you have for us as we take up our legislative
actions on the floor.

Thank you very much.

DODD: Thank you very much.

Senator Dole?

DOLE: Chairman, in the interest of time, I'll submit my statement for the record.

DODD: Thank you very much.

Senator Menendez?

MENENDEZ: Thank you, Mr. Chairman. I appreciate you calling this hearing.

And, Chairman, no one questions the necessity of having acted to stop the Bear Stearns crisis. We can only
imagine what would have happened to our broader economy at the end of the day.

But the catch about this deal is that much of it is riding on faith, as I see it, and our faith can't be blind, which
means it's time to pull back the curtains and examine the details.

If we don't learn from the chain of events that led to Bear's demise, then we're doomed to see a repeat in the
future.

I hope the answers we'll hear today will provide insight into some key questions, including how we ended up
blindsided by the sudden tanking of a firm as large as this one on Wall Street; how the specifics of this
unprecedented deal were hammered out; what are the consequences of sticking taxpayers with a $29 billion
loan that could fail; and, lastly, how do we continue to look at struggling homeowners in the eye when we
pull out all the stops to help a sinking ship on Wall Street but homeowners are still adrift at sea, drowning in
foreclosure.

The Bear Stearns crisis reared its head and it was solved in a matter of days. The foreclosure crisis has
been going on for a year with no end in sight. And both pose, I think, significant, if not equal, threats to our
economy.

So I'll look forward to getting to the bottom of exactly how the decision to rescue Bear Stearns came about
and why their crisis is so different from the crisis still raging in neighborhoods across the country.

Thank you.

DODD: Thank you very much.
Senator Martinez?

Pass on that.

Senator Tester?

TESTER: Yes, thank you, Mr. Chairman.

I welcome committee members.

You’ve got a lot of questions to answer, and I appreciate you being here. This is a big issue.

You know, I had a hearing the day after this merger was announced. I had a forum on financial investments. The first question from the crowd didn’t go to the experts, it went to me. And the question was, “Why $30 billion? Why was it invested? I’m a homeowner. I’m in trouble. How come nobody steps up to plate to help me?” Many of the same questions that were asked here.

I guess if I was to add to this list of questions is, have we set precedents, is this going to be this policy from now on, is this a direction we’ve headed in -- is this the right direction to be heading in.

With that, Mr. Chairman, I just want to thank you for the hearing. And I do have many questions, more than that, when my time comes.

(CROSSTALK)

DODD: Senator Corker?

CORKER: Mr. Chairman, I don't have an opening statement. And I hope that y'all -- y'all have shown tremendous leadership, especially over the last few days. I hope we can move toward the leader and the ranking member only making opening comments in the future somehow so we could get to the witnesses.

But I've been greatly illuminated, and look forward to certainly hearing our witnesses.

DODD: We're glad you have a chair at the table and not in the closet back there, as well.

(LAUGHTER)

And we've all been in that seat at one point or another.

Senator Bayh?

BAYH: I'll wait for the witness.

DODD: Senator Crapo?

CRAPO: Thank you, Mr. Chairman. I'll be brief as well.

I believe that the members of the panel who've spoken already have already raised a number of critical issues. I think there's on more that we need to pay attention to as we look at this situation.

Congress is -- or the Senate literally today looking at issues relating to the housing market and the mortgage industry. And we are going to today in this hearing be looking very closely at what happened with the Bear Stearns situation and how the Fed and the Treasury and the SEC responded there.

I think as we look at these issues and as the hearing moves forward we also need to look at our competitiveness, frankly, in capital markets and whether we need to look at an entirely new restructuring of how we regulate our financial markets in this country.

This issue has also been raised recently by the -- by Secretary Paulson and many others have raised it before he did.

CRAPO: But I believe that what we are looking at in today's hearing clearly brings forward the question of
how is our regulatory structure in the United States set up and how should it be set up as we look forward to moving into this next century, and how can we make ourselves as competitive as possible in today's global economy.

With that, Mr. Chairman, I will...

DODD: Thank you. Thank you very much, Senator.

And, again, I want to thank our witnesses for being here. We have, of course, the chairman of the Federal Reserve, Ben Bernanke; the Honorable Christopher Cox, the chairman of the Securities and Exchange Commission; the Honorable Robert Steel, who's the undersecretary for domestic finance at Treasury; and Tim Geithner, who's the president of the Federal Reserve Bank of New York.

And we thank all four of you once again for being here.

Chairman Bernanke, you've spent quite a bit of time in Congress these last few days.

I often -- I suggested in private before the hearing that we might find an office up here for the chairman, he's been here so often over the last number of days.

We're grateful to you, all of you, for being here, as well as our other witnesses we'll hear in the second panel.

We're begin with you, Mr. Chairman. And I'd like you to take five or six minutes. I don't want to hold you to any specific time, but you'd try and keep it in that framework. And also any other information you think that would be valuable for the committee to have, we'll of course agree to accept that testimony, as well as the documentation.

And with that, welcome to the committee.

BERNANKE: Mr. Chairman, I do want to thank you for this hearing, which I think is absolutely appropriate and necessary, and we welcome your oversight.

Chairman Dodd...

BENNETT: Mr. Chairman, would you pull that mike closer? Thank you. BERNANKE: How's that?

BENNETT: That's great.

BERNANKE: Chairman Dodd, Senator Shelby, and other members of the committee, I appreciate this opportunity to discuss the economic and financial context and the actions the Federal Reserve has taken to stabilize financial markets and the economy.

Although the situation has recently improved somewhat, financial markets remain under considerable stress. Pressures in short-term bank funding markets, which had abated somewhat beginning late last year, have increased once again.

Many lenders have been reluctant to provide credit to counterparties, especially leveraged investors, and increased the amount of collateral they require to back short-term security financing agreements.

To meet those demands, investors have reduced their leverage and liquidated holdings of securities, putting further downward pressure on security prices.

Credit availability has also been restricted because some large financial institutions, including some commercial and investment banks and the government-sponsored enterprises, have reported substantial losses and write-downs, reducing the capital they have to support new lending.

Some key securitization markets, including those for nonconforming mortgages, continue to function poorly, if at all.

BERNANKE: These developments in financial markets -- which themselves reflect, in part, greater concerns about housing and the economic outlook more generally -- have weighed on real economic activity.

Notably, in the housing market, sales of both new and existing homes have generally continued weak, partly as a result of the reduced availability of mortgage credit, and home prices have continued to fall.
Private payroll employment fell substantially in February, after two months of smaller job losses, with job cuts in construction and closely related industries accounting for a significant share of the decline. But the demand for labor has also moderated recently in other industries.

Overall, the near-term economic outlook has weakened relative to the projections released by the Federal Open Market Committee at the end of January.

Inflation has also been a source of concern. We expect inflation to moderate in coming quarters, but it will be necessary to continue to monitor inflation developments carefully.

Well-functioning financial markets are essential for the efficacy of monetary policy and, indeed, for economic growth and stability.

Consistent with its role as the nation's central bank, the Federal Reserve has taken a number of steps in recent weeks to improve market liquidity and market functioning. These actions include reducing the cost and increasing the allowable term of discount window credit to commercial banks; increasing the size of our Term Auction Facility, through which credit is auctioned to depository institutions; initiating a Term Securities Lending Facility, which allows primary dealers to swap less-liquid mortgage backed securities for more-liquid Treasury securities; and creating the Primary Dealer Credit Facility, which is similar to the discount window but accessible to primary dealers.

Although these facilities operate through depository institutions and primary dealers, they are designed to support the broader financial markets and the economy by facilitating the provision of liquidity by those institutions to their customers and counterparties.

With respect to monetary policy, at its March meeting the FOMC reduced its target for the federal funds rate by 75 basis points to 2.25 percent.

It was in this context of intensifying financial and economic strains that, on March 13th, Bear Stearns advised the Federal Reserve and other government agencies that its liquidity position had significantly deteriorated and that it would have to file for bankruptcy the next day unless alternative sources of funds became available.

This news raised difficult questions of public policy.

Normally, the market sorts out which companies survive and which fail, and that is as it should be. However, the issues raised here extended well beyond the fate of one company.

Our financial system is extremely complex and interconnected, and Bear Stearns participated extensively in a range of critical markets. The sudden failure of Bear Stearns likely would have led to a chaotic unwinding of positions in those markets and could have severely shaken confidence.

BERNANKE: The company's failure could also have cast doubt on the financial positions of some of Bear Stearns' thousands of counterparties and perhaps of companies with similar businesses.

Given the exceptional pressures on the global economy and financial system, the damage caused by a default by Bear Stearns could have been severe and extremely difficult to contain.

Moreover, and very importantly, the adverse impact of a default would not have been confined to the financial system but would have been felt broadly in the real economy through its effects on asset values and credit availability.

To prevent a disorderly failure of Bear Stearns and the unpredictable but likely severe consequences for market functioning and the broader economy, the Federal Reserve, in close consultation with the Treasury Department, agreed to provide funding to Bear Stearns through JPMorgan Chase.

Over the following weekend, JPMorgan Chase agreed to purchase Bear Stearns and assumed Bear's financial obligations.

The purchase (sic) of our actions, as with our other recent actions -- including our provision of liquidity to financial firms and our reductions in the federal funds rate target -- was, as best as possible, to improve the functioning of financial markets and to limit any adverse effects of financial turmoil on the broader economy.

BERNANKE: We will remain focused on those objectives.
Clearly, the U.S. economy is going through a very difficult period. But among the great strengths of our economy is its ability to adapt and to respond to diverse challenges. Much necessary economic and financial adjustment has already taken place, and monetary and fiscal policies are in train that should support a return to growth in the second half of this year and next year. I remain confident in our economy's long-term prospects.

Thank you. And I would be pleased to take your questions.

DODD: Thank you very much.

Senator Cox? Excuse me, Chairman Cox?

COX: Thank you, Chairman Dodd, Senator Shelby and members of the committee, for inviting me to testify today on behalf of the Securities and Exchange Commission about recent events in the financial markets, and in particular the merger agreement between JPMorgan and Bear Stearns.

The recent actions by the Federal Reserve, as Chairman Bernanke has just described, are unprecedented and of unquestioned significance. They include not only the extension of guarantees in credit in connection with JPMorgan's acquisition of Bear Stearns, but also the opening of the discount window to every one of the major investment banks.

What happened to Bear Stearns during the week of March 10th was likewise unprecedented. For the first time a major investment bank that was well capitalized and apparently fully liquid experienced a crisis of confidence that denied it not only unsecured financing, but even short-term secured financing.

And even when the collateral consisted of treasuries and agency securities which had a market value in excess of the funds to be borrowed, counterparties would not provide securities lending services and clearing services. Prime brokerage clients moved their bank -- pardon me -- moved their cash balances elsewhere.

These decisions in turn influenced others to also reduce their exposure to Bear.

Over the weekend of March 15th and 16th, Bear Stearns faced a choice between filing for bankruptcy on Monday morning or concluding an acquisition agreement with a larger partner.

COX: In the cauldron of these events, the actions that the Federal Reserve took -- in particular, extending access to the discount window, not only to Bear Stearns, but to the other major investment banks -- were addressed at preventing future occurrences of the run-on-the-bank phenomenon that Bear endured.

It remains, however, for regulators and Congress to consider what other steps, if any, are necessary to harmonize this significant new safeguard with other aspects of the existing legislative and regulatory structure.

The SEC, of course, does not have the function of extending credit or liquidity facilities to investment banks or to any regulated entity. Instead, through our consolidated supervised entities program, the commission exercises oversight of the financial and operational condition of Bear Stearns, Goldman Sachs, Lehman Brothers, Merrill Lynch and Morgan Stanley, at both the holding company and the regulated entity levels.

Our oversight of the CSEs includes monitoring for firm-wide financial and other risks that might threaten the regulated entities within the CSEs, especially the U.S. regulated broker-dealers and their customers.

In particular, the SEC requires that firms maintain an overall Basel capital ratio at the consolidated holding company level of not less than the Federal Reserve's 10 percent well-capitalized standard for bank holding companies.

At all times during the week of March 10th through 17th, up to and including the time of its agreement to be acquired by JPMorgan, Bear Stearns had a capital cushion well above what is required to meet the Basel standards.

Specifically, even at the time of its sale, Bear Stearns' consolidated capital and its broker-dealers net capital exceeded relevant supervisory standards.

Even prior to the experience with Bear Stearns, the SEC's supervision of investment bank holding companies has always recognized that capital is not synonymous with liquidity.
COX: A firm can be highly capitalized while also having liquidity problems.

So in addition to a healthy capital cushion, the firm needs sufficient liquid assets in the form of cash and high-quality instruments such as U.S. Treasury securities that can be used as collateral for loans in times of stress.

For this reason, the CSE requirements are designed to ensure that an investment bank holding company can meet all of its cash needs even in the face of a complete cutoff of unsecured financing that lasts for a full year.

In these ways, the CSE supervisory model has focused on the importance of both capital and liquidity.

But what neither the CSE regulatory approach nor any existing regulatory model has taken into account is the possibility that secured funding, even if it's backed by high-quality collateral such as U.S. treasury and agency securities, could become unavailable.

The existing models for both commercial and investment banks are premised on the expectancy that secured financing would be available in any market environment, albeit perhaps on less favorable terms than normal.

For this reason, the inability of Bear Stearns to borrow against even high-quality collateral on March 13th and 14th was an unprecedented occurrence. And that is what's prompted the Fed's action to open the discount window to investment banks.

Beyond this obviously powerful that the Fed has taken, the Bear Stearns experience has challenged the measurement of liquidity in every regulatory approach, not only here in the United States, but around the world.

It was in this connection that I conveyed to the Basel Committee my strong support for extending their capital adequacy standard to deal with liquidity risks of the kind that materialized for Bear Stearns.

The Fed's other important decision to provide funding to Bear Stearns through JPMorgan was made because, as you've heard Chairman Bernanke testify, Bear's extensive participation in a range of critical markets meant that a chaotic unwinding of its positions not only could have cast doubt on the stability of thousands of the firm's counterparties, but also created additional pressures well beyond the financial system throughout the real economy.

COX: These are considerations of systemic risk that extend far beyond the SEC's mandate to protect investors, ensure orderly securities markets and promote capital formation through such means as the CSE program.

But it's important to observe, nonetheless, that the SEC's statutory and regulatory framework, including not only our broker-dealer net capital regime, but also the protection provided to investors through SIPC, and the requirement that SEC-regulated broker-dealers segregate customer funds and fully paid securities from those of the firm, worked in this case to achieve the purpose for which it was designed.

Despite the run on the bank to which Bear Stearns was subjected, its customers were fully protected. At no time during the week of March 10th through 17th, up to and including the date of the agreement with JPMorgan, were any of Bear Stearns' broker-dealer customers at risk of losing their cash or their securities.

The question has been asked, "What might have happened if, notwithstanding the Fed's action, the transaction with JPMorgan hadn't been agreed to before Monday, March 17th?"

Unfortunately, unlike a laboratory in which conditions can be held constant and variables changed while the experiment is repeated, in the social science of the market the selection of one course of action forever forecloses all other approaches that might have been taken.

But there is one thing we know with certainty: With or without JPMorgan's acquisition of Bear and with or without a bankruptcy, Bear Stearns' customers are and would have been fully protected from any loss of cash or securities.

COX: Beyond demonstrating the importance of short-term liquidity in the form of available sources of secured funding, the Bear Stearns' experience has highlighted the statutory supervisory gap in this area.

In 1991, when Congress enacted the Federal Deposit Insurance Improvement Act (sic), it recognized the
importance of having a framework for considering the resolution of financial difficulties experienced by commercial banks, but not, unfortunately, by investment banks.

FDICIA, together with the Federal Deposit Insurance Act, reflect Congress' conviction that it is best not to improvise the principles that will guide federal intervention in financial institutions. That's a point that is equally valid not only for depository institutions, but other systemically important institutions as well.

Now, as always, the SEC is working closely with our regulatory counterparts to ensure that our regulatory actions contribute to orderly and liquid markets. These recent events have amply demonstrated that the SEC's mission to protect investors, maintain orderly markets and promote capital formation is more important now than ever it has been.

Thank you, again, Mr. Chairman, for the opportunity to discuss these important issues. And I look forward to taking your questions.

DODD: Thank you very much, Chairman Cox.

Secretary Steel?

STEEL: Thank you.

Chairman Dodd, Ranking Member Shelby, members of the committee, good morning. I very much appreciate the opportunity to appear before you today to represent Secretary Paulson and the United States Treasury Department, and to join the independent regulators leading the Board of Governors of the Federal Reserve System, the Securities and Exchange Commission, the Federal Reserve Bank of New York.

As you know, Secretary Paulson is on a long-scheduled trip to China today.

You invited Treasury here today to discuss the ongoing challenges in our credit markets, and specifically the agreement between JPMorgan Chase & Co. and the Bear Stearns Companies Inc. The Treasury Department continues to closely monitor the global capital markets, and the past several months have presented to us many important issues and situations to evaluate and address.

As Secretary Paulson stated earlier this week, a strong financial system is vitally important: not only for Wall Street, not only for bankers, but for all Americans. When our markets work, people throughout our economy benefit. Americans seeking to buy a car, a home, families borrowing to pay for college, innovators borrowing on the strength of a good idea for a new product or technology, and business financing investments all create new jobs.

When our financial system is under stress, all Americans bear the consequences.

Mr. Chairman, as you've appropriately noted in your letter to Secretary Paulson, quote, "it is important to maintain liquidity, stability and investor confidence in the markets," end quote.

STEEL: The recent events in the credit and mortgage markets are of considerable interest to this committee, other members of Congress and, most importantly, all the citizens of this country.

For several months, our financial markets have gone through a period of turbulence followed by periods of improvement. A great deal of the -- a great deal of deleveraging is occurring, which has created liquidity challenges for financial institutions and thereby compromised our credit markets' ability to be an engine of economic growth.

It took a long time to build up the accesses in our markets, and we're now working through all of the varied consequences. Market participants are adjusting, making disclosures, raising capital and repricing assets.

We have continued to engage with our fellow regulators and market participants so that collectively we work through these challenges to limit the spillover effects to our economy and make our markets even stronger in the future.

During times of market stress, certain issues may hold the potential to spill over to the broader markets and cause harm to the American economy. This was the case, in our view, with the events surrounding the funding capability of Bear Stearns between March 13th, 2008, and March 24th.

The funding condition of Bear Stearns had deteriorated rapidly, and by March 13th, 2008, had reached such a critical stage that the company would have faced a bankruptcy filing on March 14th, 2008, absent an
extraordinary infusion of liquidity.

During this period, regulators were continually communicating with one another, working collaboratively, and keeping each other apprised of the changing circumstances.

The focus was not on this specific institution, but on the more important strategic concern of the implications of a bankruptcy. The failure of a firm at that time that was so connected to so many corners of our markets would have caused financial disruptions beyond Wall Street.

We weighed the multiple risks, such as the potential disruption to counterparties, other financial institutions, the markets, and the market infrastructure.

STEEL: These risks warranted a careful review and thorough considerations of potential implications and responses.

Our role at the Treasury Department was to support the independent regulators and their efforts with private parties, as credit markets were operating under considerable stress, and we believed that certain prudent actions could help to mitigate systemic risk, enhance liquidity, facilitate more orderly markets, and minimize the risk to the taxpayers.

The Treasury Department supports the actions taken by the Federal Reserve Bank of New York and the Federal Reserve. We believe the agreements reached were necessary and appropriate to maintain stability in our financial system during this critical time.

Obviously, each independent regulator had to make its own individual assessment and determination as to what actions it would or would not take. While the Treasury Department was not a party to any agreements, we have a great deal of respect for the leadership of each regulator and appreciate their efforts during this extraordinary time.

Upon assessing the Bear Stearns' situation, the Federal Reserve decided to take the very important and consequential action of authorizing the Federal Reserve Bank of New York to institute a temporary program for providing liquidity to primary dealers.

Recent market turmoil has required the Federal Reserve to adjust some of the mechanisms by which it provides liquidity to the financial system. In (sic) response in the face of new challenges deserves praise.

At the Treasury Department, we will continue to monitor market developments. We remain focused on the issues surrounding recent developments, including the important responsibility of safeguarding government funds.

Recent events underscore the need for strong market discipline, prudent regulatory policies and robust risk management. The Treasury Department and our colleagues comprising the President's Working Group on Financial Markets are addressing the current and strategic challenges and are doing all that we can to ensure high-quality, competitive and orderly capital markets.

We seek to strengthen market discipline, mitigate systemic risk, enhance investor confidence and market stability, as well as facilitate stable economic growth. Thank you, and I look forward to your questions, sir.

DODD: Thank you very much, Mr. Secretary.

Chairman Geithner?

GEITHNER: Thank you, Mr. Chairman, Senator Shelby, members of the committee. Thanks for giving me the chance to be here today.

These are exceptional times. We've taken some very consequential actions. They deserve and require very careful analysis and reflection and oversight. And you're right to begin that process now.

I've submitted very extensive written testimony describing in detail the events that began that evening of, I think, March 13th, but I just want to limit my opening remarks to three things.

One is, I want to explain why we did what we did.

GEITHNER: I want to talk a little bit about the policy challenges ahead and continuing risks to the economy in this financial crisis. And I want to set out some broad objectives for how we think about the future.
Three weeks ago, on March 13th, we learned from the SEC that Bear Stearns was facing imminent bankruptcy, and this presented us with some extraordinarily difficult policy judgments.

Bear Stearns occupied -- occupied a central position in the very complex and intricate relationships that characterize our financial system. And, as important as that, it reached the brink of insolvency at an exceptionally fragile time in global financial markets.

In our judgments, an abrupt and disorderly unwinding of Bear Stearns would have posed systemic risks to the financial system and magnified the downside risk to economic growth in the United States.

A failure to act would have added to the risk that Americans would face lower incomes, lower home values, higher buying costs for housing, education, other living expenses, lower retirement savings and rising unemployment.

We acted to avert that risk in the classic tradition of lenders of last resort with the authority provided by the Congress. We chose the best option available in the unique circumstances that prevailed at that time.

The Federal Reserve has to strike a very careful balance between action to contain risk to the broader economy and actions that might amplify the risk of future financial crises by insulating investors from the consequences of imprudence.

In this context, though, let me just emphasize two things.

A failure to act would have imposed significant damage on those households, on those companies, on those financial institutions that had been comparatively prudent.

And in this particular case, no owner or executive or director of a financial institution can look at the outcome for Bear Stearns and choose to see their firm managed in such a way as to court a similar fate.

The financial arrangement we reached to help avert default was authorized by the chairman and the board of governors, and supported by the secretary of the treasury. It provides -- it's very carefully designed to provide a number of important protections to reduce the risk of any loss.

GEITHNER: First, our loan's backed by a substantial pool of collateral that will be professional managed.

Second, JPMorgan Chase agreed to absorb the first $1 billion of any loss that might occur in connection with this arrangement.

And third, our long-term horizon for holding the collateral will enable assets to be managed in an orderly fashion to minimize the risk of any loss and minimize any disruption to markets.

The risks in this arrangement -- and there are risks in this arrangement -- are modest in comparison to the substantial losses to the economy that could have accompanied Bear's insolvency.

I believe the actions taken by the Federal Reserve on a number fronts in recent months have reduced some of the risk to the economy that is inherent in this adjustment under way in financial markets. By reducing the probability of a systemic financial crisis, the actions taken by the Fed on and after March 14th have helped avert substantial damage to the economy, and they have brought a measure of tentative calm to global financial markets.

Relative to the conditions that existed on March 14th, risk premia have narrowed, foreign exchange markets are somewhat more stable, energy and commodity prices are somewhat lower, perceptions of risk in the financial system have somewhat diminished, and the flight to quality is less pronounced.

Nevertheless -- and I want to emphasize nevertheless -- liquidity conditions in markets are still substantially impaired and the process of deleveraging remains under way.

Financial market participants are still extraordinarily cautious about assuming risk, and this will intensify -- continue to intensify the head winds facing the U.S. in the global economy.

The causes of this crisis took a long time to build up, and they will take some time to work through, and in this context important to underscore the fact that policy-makers, financial market participants are going to need to continue to act proactively, with actions that are proportionate to the challenges ahead.
Let me just highlight three areas for continued focus on the policy front.

First, very important that financial institutions continue to improve the quality of disclosure, and even the strongest institutions face compelling incentives to raise new equity capital so that they can take advantage of the opportunities ahead.

Second, alongside the broad policy actions, both monetary policy and fiscal policy, that are already in place to contain the downside risks to the economy, it is very important to strengthen the capacity of major -- the major government-sponsored enterprises, the Federal Home Loan Bank system, the Federal Housing Administration, so that they can provide finance to the mortgage market and help reduce the risk of avoidable foreclosures.

Third, the Federal Reserve, working closely with other major central banks, will continue to provide liquidity to markets to help facilitate the process of financial repair.

Looking forward -- important to look forward -- even as we work to contain the risks in this financial crisis, we need to begin to design a comprehensive set of reforms to the financial system. In addition to the very important objective of putting in place a stronger set of protections for consumers, the overwhelming imperative of reform must be to put in place a stronger framework for financial stability, both in the United States and, I think, globally.

GEITHNER: And our objective should be to create a system that preserves the unique strength of our markets in providing individuals and companies with innovative ways to access capital and credit, but with a greater capacity to withstand stress.

And this is going to require significant changes to regulatory policy and to the regulatory framework.

And I think the focus has to be on changing the incentives all financial market participants face in managing risk and exposure to adverse outcomes.

In my view -- and this is my personal view -- there are a set of important objectives and principles that should guide this effort. And I'm just going to list five, quickly, before I conclude.

First, we need to ensure there's a stronger set of shock absorbers, in terms of capital and liquidity in those institutions, both banks and a limited number of largest investment banks, institutions that are critical to market functioning. And they need to be under a stronger form of consolidated supervision than exists today.

Second, we need to streamline and simplify our excessively complex and segmented regulatory framework to reduce the opportunity it creates for regulatory arbitrage, not just in the mortgage market but more broadly.

Third, we need to make the financial infrastructure more robust, particularly in the derivatives and repo markets, so that the system can better withstand the effects of default by a major participant.

Fourth, we need to redesign the set of liquidity facilities that we maintain in normal times -- we, the Federal Reserve, maintain in normal times and in extremis, both in the United States and across the other major central banks.

And these changes, as many of you have recognized, need to come with a stronger set of requirements for the management of liquidity risk by financial institutions that have access to central bank liquidity.

And fifth, we need to make sure that the Federal Reserve has the mix of authority and responsibility that is necessary to enable it to respond with adequate speed and force to systemic risk to financial stability. Our system has many strengths. But to be direct about it, I think we've suffered a very damaging blow to confidence in the credibility of our financial system.

One of the great strengths of our system, though, is the speed at which we adapt to change. And my colleagues at the Federal Reserve and I look forward to working with this committee, with the Congress and with the executive branch, to try to think through the very important task of how to put in place a stronger system for the future.

I just want to express, in closing, my admiration and appreciation to the officers and staff of the Federal Reserve Bank of New York and the Federal Reserve system. They've performed with great skill and care under extreme pressure.

And I also want to thank Chairman Bernanke, Secretary Paulson, Chairman Cox, and Bob Steele and my
many other colleagues in the Fed and the supervisory committee for really exceptional leadership in a
difficult time.

Thanks again for giving me the chance to appear today.

DODD: Thank you very much, President Geithner.

And let me -- just a couple of quick points, if I can.

First of all, I just want to express, once again, to the witnesses. I realize this is an extraordinary case in
calling this hearing. But with the exception of one witness, we got statements very late last evening.

And again, I want to make this appeal to people. You've got to let us know -- my colleagues here want to be
able to read these statements. They'll develop questions.

DODD: We need to get these statements in a more timely fashion under the rules of the committee, and I'd
be remiss if I didn't bring it up again.

I don't want to keep it repeating at every hearing we go -- so, again, I understand the timing of this
committee may have put some additional pressures, and I know others had to testify at other hearings prior
to this. But I want to make that case.

Secondly, what I'd like to do here -- I think -- why don't I try seven minutes? That's not a lot of time, but there
are a lot of members here and I want to make sure everybody gets a chance to raise questions. So I'm not
going to bang down the gavel at seven, but try and keep that in mind as you develop your questions on the
committee.

And I'll begin, if I can, with a question for the federal regulators here. I guess going back -- I was thinking this
morning, there was the question raised by Howard Baker years ago -- "What did you know and when did you
know it?" -- kind of a question that comes to mind when you look at this situation, talking about the 96 hours
and what did our regulators know and when did you know it in terms of our response to the situation with
Bear Stearns?

And, specifically, there have been some reports in the press about the details of this negotiation. The Wall
Street Journal reported, and I quote them. It says, "This was no normal negotiation. Instead of two parties,
there were three, the third being the federal government." It's unclear what the explicit requests were made
by the Fed or the Treasury.

And, specifically, there have been some reports in the press about the details of this negotiation. The Wall
Street Journal reported, and I quote them. It says, "This was no normal negotiation. Instead of two parties,
there were three, the third being the federal government." It's unclear what the explicit requests were made
by the Fed or the Treasury.

And so, I'll begin with you, Chairman Bernanke, and also ask Secretary Steel, what if any -- what if any
interjections were there over stock price of Bear Stearns?

Specifically, again, there's just reports, I want to share them with you, that they would make an offer -- that
JPMorgan Chase would make an offer of $4 a share. Subsequently it was conveyed to JPMorgan Chase by
someone in the federal government that the offer sounded too high in terms of rewarding Bear Stearns
stockholders, given the taxpayer funding that was involved.

Therefore, were any of you or any or your agencies aware at any point that there was an offer of $4 a share
made from JPMorgan Chase? And, second, did you or anyone in your agency provide feedback to
JPMorgan or Bear Stearns on the value of that offer, in particular?

DODD: And then, lastly, given the specifics of this situation, depending upon your answer, do you think it
would be improper or is it improper for any high-ranking government official to have given advice to the
CEOs of companies regarding what the appropriate stock price should be in circumstances like this?

BERNANKE: Chairman, the Federal Reserve's interest in this negotiation was that Bear Stearns be
assumed by a strong firm so that its obligations would be met. I would emphasize, in fact, that we were very
careful to make sure that there were multiple opportunities for different firms to talk to Bear Stearns over
that short period of time.

We had no interest or no concern about the stock price that was valued. That was a secondary issue as
far as we were concerned. We wanted to see Bear Stearns' liabilities assumed in some way.

DODD: So there was no interjection on the part of the Fed at all in this area?

BERNANKE: Not to my knowledge.
DODD: Secretary Steel?

STEEL: Well, sir, the secretary of the treasury and other members of treasury were active participants during this 96 hours, as you describe. There were lots of discussions back and forth.

Also, in any combination of this type, there are multiple terms and conditions.

I think the perspective of Treasury was really twofold. One was the idea that Chairman Bernanke suggested: that a combination into safe hands would be constructive for the overall marketplace; and, number two, since there were federal funds or the government's money involved, that that be taken into account. And Secretary Paulson offered perspective on that.

There was a view that the price should not be very high or should be toward the low end and that it should be -- given the government's involvement, that that was the perspective.

But with regard to the specifics, the actual deal was negotiated -- transaction was negotiated between the Federal Reserve Bank of New York and the two parties. DODD: President Geithner, do you share any light on this at all on these rumors that are going around about federal agencies recommending a lower price rather than the one that was being offered?

GEITHNER: Let me just echo what the chairman and Bob Steel said. Two objectives very important for us. One was there be an agreement reached that would avert the risk of default because of the consequences for the economy as a whole. And the second was that the outcome, to the extent possible, not add to the inherent moral hazard risk in this kind of intervention.

And I just -- from my perspective, the outcome reached that evening and the subsequent agreement reached a week later are fully consistent with those two objectives.

Would there have been some outcomes that would have been not consistent with those objectives? Possible. But we weren't presented with those outcomes.

DODD: What I want to get at here is whether or not our federal agencies at all -- particularly Treasury in this case here, Secretary Steel -- where one offer was made and the Treasury recommended a lower -- that a lower price be offered. Was there any such intervention directly by the Treasury?

STEEL: I can't confirm that, sir.

Secretary Paulson and Treasury were active participants, but in the end the actual offer made and accepted was between the Federal Reserve Bank of New York and the participants.

As I said, there was a perspective, as President Geithner suggested, that the outcome, with all the different terms and conditions, would be consistent with communicating and making clear moral hazard to the least degree possible. And I think that's consistent with what -- how President Geithner and I describe it.

DODD: Well, no, I understand the motivation behind it. The question is whether -- I guess I maybe should ask the first question: What would be your reaction to the question, generally speaking, as to the propriety, in this sort of circumstance, of the Treasury intervening with a specific request that a certain price be offered where this kind of a transaction is going forward?

STEEL: Well, I think that the Treasury was actively involved and provided a perspective. The final terms and conditions were settled by the Federal Reserve Bank of New York.

It was our perspective, as I said, that moral hazard wanted to be protected as much as possible, and so, therefore, a lower price was more appropriate. And there were lots of terms and conditions.

The appropriateness, from my perspective, is that when there's federal money being involved, as originally $30 billion and then $29 billion, then there is a point of view that should be offered to the principals, which, in this case, the Federal Reserve Bank of New York, as to our perspective.

DODD: All right. Well, let me move on. I don't want to dwell on it, but that's a question I'm sure others may pursue as well, because it's a matter of concern.

I want to go back to the issue of the discount window, if I could, Mr. Chairman, with you.
As I mentioned in my opening statement, in a hearing before this committee a week or two earlier than the events of March 13th and 14th, we had, in fact, a panel of regulators before us.

And I raised the issue as to whether or not opening up the discount window to broker-dealers would be -- would be -- how wise that would be. It wasn't just the vice chairman of the Fed, but, in fact, every regulator at the panel that day rejected the idea.

Obviously, people changed their minds, apparently, over the next 10 days or 12 days.

The question I have for you is, one, what happened in that 10 days that caused the Fed to change its mind?

Secondly, if you had changed your mind, why didn't you change your mind on Thursday night instead of Sunday night? And if you had changed your mind on Thursday night instead of Sunday night, could Bear Stearns have been saved, since Bear Stearns was not insolvent, it was a liquidity issue? And if opening up that discount window would have provided additional liquidity, could all of this have been avoided?

BERNANKE: Mr. Chairman, it was a very substantial step to do what we did, to open up the discount window. And we didn't take it lightly, as Vice Chairman Kohn indicated.

We had, in fact, earlier that week -- on the Tuesday, we had instituted the Terms Security Lending Facility, which was, in fact, open to primary dealers and was a source of liquidity and did provide reassurance. The market responded very well to that, but it was not available during that week.

It was precisely the set of conditions that we saw during the week and that led to the Bear Stearns' situation that caused us to reconsider our previously held position that it would take a very high bar to open up the discount window.

BERNANKE: We made the decision to do so on Sunday. At the time we did it, we didn't know whether the Bear Stearns deal would be consummated or not, and we wanted to be prepared in case it wasn't consummated, that we would need to have this facility in order to protect what we imagined would be pressure on the other dealers subsequently to that.

Whether opening up earlier would have helped or not is very difficult to say. Perhaps President Geithner can add to this.

But Bear Stearns was losing customers and counterparties very quickly. They were downgraded on Friday. And we did lend them money, of course, to keep them into the weekend, but it's not at all obvious to me that it would have been sufficient to prevent their bankruptcy.

DODD: Before I turn to President Geithner on this question, I want to ask as well, as you pointed out and others have, we're in the midst of considering legislation now on the floor dealing with the housing issue, and I've raised this issue. Obviously, there's some serious regulatory questions being raised now as a result of opening up the discount window and expanding that opportunity.

Do you feel you have enough statutory authority to impose regulations on broker-dealers or do you need additional authority that we ought to be providing you?

And since we're on the floor dealing with a related matter, it seems to me that's an important question to get to Senator Shelby and I and others, who'd be interested in knowing whether or not we ought to respond, rather than leaving this door open, potentially with exposure that could cost us dearly.

BERNANKE: Mr. Chairman, for now, we are working very effectively with the SEC and with the firms. We have the information we need. We believe that the lending we are doing to the primary dealers is being done safely and soundly. And so there's not an immediate emergency there.

However, since our lending authority is only for emergencies, we will have to take this window back, we'll have to close it when conditions normalize.

So questions that Congress will want to consider over time, should we make this a regular facility in the future?

If so, presumably we'll want to think through the prudential regulation of the investment banks to make sure that they are, indeed, safe and sound -- adequately safe and sound to receive this particular privilege.

And we would also need to think, I believe, about -- the question was raised about FDICIA: Do we need additional thinking on the appropriate set of circumstances, the appropriate sequencing under which an
investment bank in trouble would be reorganized, assisted and so on.

So I think there are some very weighty issues. But let me just emphasize for the time being that we are effectively lending to investment banks. We are working very closely and carefully with the SEC and with the firms. And we do not feel that we are in any way lending improperly or unsafely at this point.

DODD: Let me ask the rest of you the earlier question I asked about whether or not had this Sunday night decision been made on Thursday or earlier -- and others had raised it earlier; this was not some new idea. People have been talking about it, and had been pretty widely rejected by the regulatory community at large.

But, President Geithner, what's your reaction to that? What do you think might have happened on Thursday night had the decision been made to open that up? Would Bear Stearns have been in a different position?

GEITHNER: Very hard to know. Let me just make two points.

In some sense, we had -- you can think about that question by thinking about what actually happened on Friday.

So Friday morning we took the exceptional step, with extreme reluctance, with support of the Board of Governors and the Treasury, to structure a way to get them to the weekend, so that we could buy some time to explore whether there was a possible solution that would have them acquired and guaranteed.

DODD: Let me ask you something quickly on that point.

DODD: I read in -- reading the statement of Alan Schwartz, I'm under the impression he thought that he got 28 days, not a day -- or two days.

GEITHNER: Well, if you look carefully at the statement that was made and the context of that, the language said "up to 28 days."

But I think I can answer your question. Let me just continue this one thing.

So we took that extraordinary step to buy time to get to the weekend. And as you can hear from Alan later on, you can see -- if you ask about the details of what happened over the course of that day, you can see, a little bit, about the scale of the loss of confidence.

Because the dynamics that Chairman Cox described accelerated, over the course of the day. And the number of customers and counterparties that sought to withdraw funds, the actions by rating agencies on some Bear paper accelerated that dynamic, despite the access to liquidity and despite the hope that that might buy some time.

So I think that does raise a lot of questions about whether this very exceptional, temporary, carefully designed access to liquidity we provided would have been sufficient.

One other point: The way the Federal Reserve act is designed, and the way we think about the discount window for banks is we only allow sound institutions to borrow against collateral in that context.

And I can only speak personally for this, but I would think -- I would have been very uncomfortable lending to Bear, given what we knew at that time, if you could walk back the clock and think about what would happen if that facility had been in place before.

But again, as everybody has emphasized, both these facilities -- the one the chairman described that was announced that Tuesday and the subsequent -- the facility announced Sunday night -- these were exceptionally consequential acts, taken with extreme reluctance and care, because of the substantial consequences it would have for moral hazard in the financial system going forward.

And I do not believe it would have been appropriate for us to take that act Sunday night, if we had not been faced with the dynamics that were precipitated by, accelerated by the looming prospect of a Bear default.

DODD: My time -- I've gone over my time and I apologize to my colleagues.

Senator Shelby?

SHELBY: Thank you, Chairman Dodd.
Chairman Cox, the Securities and Exchange Commission is the primary regulator of Bear Stearns. Under the commission’s Consolidated Supervised Entities Program, which you've mentioned, the SEC oversees certain investment banks, including Bear Stearns, at the holding company level, focusing on the financial condition of the entire company.

SHELBY: Some people think that the SEC missed the boat here, was asleep.

You mentioned earlier the difference between capital and liquidity, which is a big thing.

When did the SEC first discover that Bear Stearns was experiencing severe liquidity problems? And after learning of Bear Stearns' problems, what steps did the Securities and Exchange Commission take to address the situation? And did you work with the Federal Reserve or anybody else in doing this? And what impact did those actions or inactions by the SEC have on protecting investors?

We all know that -- we had some warnings about Bear Stearns earlier as far as capital. There are some other firms that have got some capital problems and are out seeking capital to shore themselves up.

But let's go back to the SEC. Where was the SEC on this? And were they on your kind of a watch list, if you want to call it that? And if not, why not?

COX: They were, going back to the summer of 2007, because of the troubles of their two hedge funds.

And while some thought back in the summer of 2007 that because they did not -- those hedge funds posed direct risk to the holding company -- they were separate -- that shouldn't be of material importance to analysis of Bear Stearns' holding company, the fact that for practical or commercial reasons Bear decided to support one of those funds caused us to take a view that we had to look at even outside the holding company at Bear.

The SEC at that time began to monitor both capital and liquidity at Bear on a daily basis.

Fast forward to January of this year. As of January 31st, the capital and liquidity at Bear were still above regulatory thresholds and adequate for those purposes. The liquidity pool was $8.4 billion.

SHELBY: Was that the last time you examined them?

COX: No, this is now...

SHELBY: January 31st?

(CROSSTALK)

COX: ... January 31st, $8.4 billion on that date. And the liquidity pool grew from January 31st to the first week in March to $21 billion. So substantial additional liquidity was being added in part because of the pressure that the SEC, as their supervisor, was placing on them.

In one day -- take us now to this week of March 10th. In one day, Thursday, March 13th, liquidity at Bear Stearns fell from $12.4 billion to $2 billion. And that is because of what we've heard discussed here this morning, the complete evaporation of confidence, the refusal of counterparties to deal...

(CROSSTALK)

SHELBY: Was there kind of a run on the place or a refusal to do business or what?

COX: Even though we're not accustomed to using that term in the investment banking sphere, that's a well-known notion with depository institutions. The analogy is nearly complete.

COX: Now, to go to the rest of your question, our coordination with the New York Federal Reserve -- that was regular and increasing since August of 2007, in the form of visits to their offices in New York, regular conference calls, many e-mails and so on.

During that time, we also worked together on a major project led by the New York Fed: the paper produced under the auspices of the senior supervisors group addressed to these issues.

The week of Monday, March 10th, the SEC and the New York Fed spoke by phone numerous times.
Beginning on Monday, the Fed provided us with extremely helpful information regarding market rumors that they were hearing from a variety of market sources. We shared with them what we were hearing and provided information on Bear Stearns’ operations and their finances.

We met in their offices in New York on Wednesday and discussed Bear Stearns, as well as the situation of other banks and securities firms. That, of course, takes us to the 96-hour period that everyone has already focused on.

SHELBY: Is there a gap in the regulation process here between, say, the Federal Reserve’s interest here, the SEC’s mandate and so forth? Is there a gap there that something fell through the cracks or is it just something that just accelerated so fast that, like, the liquidity was gone?

COX: Well, I think the speed with which this happened is truly the distinguishing feature. But there are significant differences between the charter and the mission of the SEC on the one hand, and the Fed on the other.

SHELBY: Absolutely.

COX: It is very important -- and the Treasury, I should add, because the Fed is focused on safety and soundness and the financial system.

Treasury is concerned, even beyond that, with systemic risk as it might pass over into the real economy, infect things beyond the financial system.

The SEC is focused very particularly first, under statute, as it applies to these broker-dealers, the investment banks, on their regulated activities and on their customers and the protection of their cash and their securities. We are also focused on orderliness of markets and so on, but within the context of the securities markets themselves.

So there’s overlap between the SEC and the Fed’s systemic concerns. And certainly, where we leave off, they pick up. And where the Fed leaves off, the Treasury picks up.

SHELBY: Chairman Bernanke, are there some comparisons between what happened at Bear Stearns and what happened with the British bank Northern Rock?

BERNANKE: There was a similarity. I agree with Chairman Cox that there was a remarkable falling off of liquidity, essentially a run on Bear Stearns.

SHELBY: A run on Bear Stearns.

BERNANKE: That was analogous in some ways to what happened to Northern Rock, although, of course, all the details are quite different.

SHELBY: Secretary Steel, who first proposed using taxpayer funds to help finance JPMorgan Chase – its acquisition of Bear Stearns? Secretary Paulson? Yourself? The Fed? Mr. Dimon? Or who?

STEEL: I’ll provide my perspective, Senator. And I can be confirmed by others.

But I believe that as the negotiations proceeded through the weekend with the Federal Reserve Bank of New York, with the direct principals, that, as we wore into the weekend and people took time -- and there are various terms to every transactions -- that late Saturday evening or early Sunday morning it was proposed by one of the principals, JPMorgan, to President Geithner, that, so as to move forward, that this would be a condition that they seemed to be appropriate -- seemed to be appropriate to them.

STEEL: And they -- so to answer your question specifically -- proposed by JPMorgan Chase to President Geithner.

SHELBY: And what kind of security, if any, did the Fed get for this $29 billion?

STEEL: Yes, sir.

SHELBY: Could you explain that? And what are the chances of loss there?
STEEL: Well, it's, as I said...

SHELBY: Or gain?

STEEL: Excuse me.

SHELBY: Go ahead.

STEEL: As I said earlier, I think that from the Treasury's perspective there were two concerns through all of this process. Number one was the effect on the markets and the marketplace and stability of markets. And number two was the stewardship that we share -- that we were sharing with others with regard to U.S. taxpayers' funds.

And the transaction that's developed was $30 billion, approximately, of collateral, all investment-grade securities, all of them current in interest and principle. And those securities were transferred as the collateral for the $30 billion loan.

SHELBY: What are the chances that this could happen again, either with an investment bank or one of our large banks?

I know you're watching them. We see them -- a lot of the banks trying to secure more capital. And of course they're going to have, as Chairman Cox (inaudible), they need liquidity with capital. What are the chances there, and where are we today?

STEEL: Well, I think that -- let me start at the highest altitude, and you can take me where you wish.

I think that our perspective is that this whole situation took a very long time to build up, and it will take a good while to work through. Having said that, we think we're making progress. We can cite increases in liquidities, as President Geithner said, and things seem to be doing better. And there are signs of improvement. And where I think the actions of the Federal Reserve Board have been constructive to that end, we're doing our best to be vigilant and to monitor the situation.

And a cry that Secretary Paulson has made all along has been for financial institutions who believe they will be needing capital to be on their front foot with regard to raising capital.

From our perspective, this is really about transparency, liquidity and capital are the trifecta of issues that will bring confidence back to the market. People understand the assets, people begin to price them and transactions occur, and institutions have the strong capital position they need to work through the specific situations.

SHELBY: But the Treasury and the Fed and the FDIC, all the regulators, they've got to have some deep concern about some of our big banks, commercial banks, and some of the investment banks. You're not telling us that you have supreme confidence that there's not going to be another problem?

STEEL: Well...

SHELBY: You can't say that.

STEEL: No, sir, I can't.

And so I think our goal is to, as I said, I think this is about -- and about two and a half weeks ago my colleagues at this table, as members of the President's Working Group, issued a report to focus on what we've learned to date and what we can begin to do straight away to make things better. And I really think that the three aspects are as I described.

SHELBY: Well, we can't send the signal out to the marketplace that, if you take the risk and you're too big to fail, the Fed's going to come running and the Treasury's going to back it and taxpayer's going to be on the hook, can we?

STEEL: No, sir.

Basically, my testimony made clear that this was not a specific situation about an organization. This was a decision made with regard to the markets itself. And people shouldn't draw a conclusion from this that there's a message about a specific institution.
This was an unusual time, as all my colleagues have said, and a specific decision was made with regard to market protection and to the effect on the potential real economy. That was the nature of the decision.

SHELBY: If this isn't a wake-up call to the Fed and to Treasury and everybody else, as far as some of our banks and the risk they take, I don't know what it would take, do you?

STEEL: No, sir.

SHELBY: Thank you.

DODD: Senator Johnson?

JOHNSON: Chairman Bernanke, on March 18, the Federal Reserve decreased the interest rate by another 0.75 percent. This is the sixth scheduled emergency cut in as many months.

Are these cuts helping the economy? Will there be any need for further cuts?

BERNANKE: Well, Senator, we do believe that these cuts are justified by the slowdown in the economy. We believe they are helping. The cuts in the federal funds rate both lower safe interest rates, treasury rates, and they contribute to a reduction in spreads, which helps to offset -- and it's true that many -- some rates, at least, have not dropped very much since we've began cutting the federal funds rate, but I think we have offset what might otherwise have been increases in the cost of capital.

So I believe we have helped to offset the credit crunch, to some extent. And therefore I think this is constructive. I would also point out that -- first, that we have been using our liquidity measures, which have also helped to reduce spreads, to some extent, and I think have been positive; and secondly that the effects of monetary policy are felt over a period of time, and we expect to see, you know, further positive effects of these policies, going forward.

Obviously, further actions will have to depend on how the economy evolves. And we're looking, of course, at both sides of our mandate, growth and inflation.

JOHNSON: Are you concerned about inflation?

BERNANKE: Of course we're concerned about inflation. Inflation has been too high. Over the last year, it's been about 3.5 percent, instead of about a little over 2 percent in the previous year.

The primary reason for the high inflation is rapid increases in the prices of globally traded commodities, including crude oil and food, among others.

It's our expectation -- which is consistent with the prices seen in futures markets -- that these prices will moderate during the coming year, and that therefore overall inflation will tend to slow.

However, we are aware of the uncertainties involved with that, and we are obviously going to be watching the situation very carefully.

JOHNSON: Did the Federal Reserve place any conditions on JPMorgan Chase and Bear Stearns when it extended the $29 billion line of credit?

BERNANKE: We did that as part of an overall negotiation, the point of which was to try to facilitate the acquisition of Bear Stearns and the guarantee of its liabilities by JPMorgan Chase.

As President Geithner has discussed, we have substantial protections. They include $30 billion of collateral, as marked to market on March 14th, a $1 billion first-loss position by JPMorgan, professional investment advice from a advisory company, and the luxury of being able to dispose of these assets over a period of time, and not, therefore, have to sell them quickly into an illiquid market.

JOHNSON: Chairman Cox, is the SEC adequately equipped to determine a holding company's liquidity risk? Did the crisis at Bear Stearns bring to light any weaknesses in the Consolidated Supervised Entity Program?

COX: Senator, there's absolutely no question we've learned much more than any of us would like in the cauldron of this experience. The liquidity measures that were thought to be adequate were designed for a scenario in which all of the firm's unsecured funding evaporates, and evaporates for a period of a full year.
The capital floor and the liquidity floor, more to the point, that is required of firms to meet that standard was more than met by Bear Stearns, and yet, as we described here earlier this morning, they ran through over $10 billion in liquidity in a day.

So it is absolutely important for us no longer to believe that that works.

We have already, with all of the firms that we supervise, gone back to work with them to make sure that there is the kind of liquidity that's needed to function in this stress scenario.

COX: And I have communicated directly with the Basel Committee of Banking Supervisors, who are preparing to take up this subject, to encourage them, because of course these standards for capital that are used here in the United States in the commercial banking sector and the investment banking sector are also used around the world. They are considering addressing directly this liquidity issue, and I think it would be very wise of them to do so.

JOHNSON: Chairman Bernanke, do you expect the Fed to facilitate more arrangements, like the JPMorgan Chase purchase of Bear Stearns, for other financial institutions? Does this create a moral hazard for taxpayers?

BERNANKE: We do not expect to have to do this, but we're obviously going to be watching and monitoring the markets very carefully and institutions.

I think this was a very unusual situation. In particular, things happen very quickly in that very little time window. In most cases, when firms, banks have problems, they have a considerable amount of time to take pre-emptive actions in terms of raising capital, finding a partner and taking other measures to avoid these problems.

I'd like to make a comment on the idea that we bailed out Bear Stearns.

As President Geithner pointed out, Bear Stearns didn't fare very well in this operation. The shareholders took very severe losses. The company lost its independence. Many employees, obviously, are concerned about their jobs. I don't think it's a situation that any firm would willingly choose to endure.

What we had in mind here was the protection of the financial system and the protection of the American economy. And I believe that if the American people understand that we were trying to protect the economy and not to protect anybody on Wall Street, they would better appreciate why we took the actions we did.

JOHNSON: Thank you, Mr. Bernanke.

And I have no further questions.

DODD: Thank you, Senator Johnson.

Let me just say, as well -- I know there are a lot of questions you would like to ask. We're going to leave the record open, as well. If you don't feel as though you had all your questions asked, we'd submit some to the committee members in writing and ask you to respond as quickly as you could to some of them.

Senator Bennett?

BENNETT: Thank you very much, Mr. Chairman.

And thanks to the panel. This has been very illuminating.

You used a phrase in the Federal Reserve Act, Chairman Bernanke and President Geithner, that says you can do this in "unusual and exigent circumstances." And I think this qualifies very clearly as unusual and exigent circumstances.

But that's clearly not what the framers of the Federal Reserve Act had in mind in 1913. We live in a very, very different world than we did in 1913 when the Fed was created.

And one of the questions that I have as I look at this is whether or not the members of the legal profession, who are paying very close attention to all of this -- because they have great potential for a great deal of income sorting all of this out -- are going to look at this event and say, "Well, this becomes the new standard for an unusual and exigent circumstance," and start to demand on behalf of their clients that, "Well, you did it
in that circumstance, here is a similar circumstance, and you have a requirement, therefore, to do it again."

BENNETT: And the circumstance that is very different now than it was in 1913, of course, is the existence of derivatives, the creation of hedge funds, people who use computers to slice and dice various financial instruments and discover things that the normal human being can't discover without the ability of computers to help them.

Looking ahead to all of this, what do we see in the possibility of future circumstances, not just here, but worldwide?

You made the, I think appropriate, point, Chairman Bernanke, this was not a bailout of Bear Stearns, and you didn't have the Bear Stearns shareholders in mind. Indeed, the Bear Stearns shareholders are very upset, I think, about what has happened.

But I like the phrase that comes from a specialist who looked at this. He said, "20 years ago the Fed would have let Bear Stearns go bust; today, it is too interlinked to fail." Not too big to fail, too interlinked to fail. And that, again, is the world of derivatives, the world of hedge funds, the world that we all come together.

I don't care who specifically responds, because you're all very knowledgeable in this area, but give me a response to this future possibilities, looking back on what I think we all agree is a truly seminal, historic and maybe pivotal event in the way this international market is going to be dealt with from now on.

Anybody want to look into his crystal ball and help me out on this?

BERNANKE: Senator, if I just might reply quickly, we have a very high bar for unusual and exigent, so this is twice in 75 years that we've used this -- that we've applied this power.

BERNANKE: In thinking about it, we thought not only about the interconnectedness of Bear Stearns and the issues we've raised, but also about the situation in the financial markets more generally.

If the financial markets had been in a robust and healthy condition, we might have taken a very different view of the situation. But given the weakness and the fragility of many markets, we thought the combination was, indeed, unusual and exigent.

We will certainly very diligent in resisting calls to use this power in other, less exigent, situations.

As I indicated earlier, I do think this does raise important questions of regulatory design. The world has changed a lot since the 1930s when many of our regulations were put in place.

And it will be a challenge for all of us and the Congress to think through how we might, you know, adapt to the way the world has changed, the way the institutions have changed, the way the instruments have changed, the way the markets have changed, over 75 years.

BENNETT: Anyone else want to comment on this?

Yes, sir?

COX: Just to echo your formulation, what was unique about this is not just Bear Stearns' role in this interconnected, intricate, complex financial system where we have such a large stock of outstanding derivatives with repo markets as large, but was the circumstances prevailing in markets at the time.

It's the combination of those two things that made it so exceptionally risky for the U.S. economy.

But just to echo something many of you said, I think, which is that the most important thing for us to do is try to figure out how to make the system in the future less vulnerable to these circumstances and make it strong enough to be able to withstand the failure of a major institution, even in fragile conditions like these.

That is a very hard thing to do. It requires a very careful set of judgments about regulation and market discipline. But I think that's the dominant policy challenge we face.

BENNETT: And we have the proposal from Secretary Paulson before us, as a Congress. We'll look at it very carefully.

Mr. Steel, you summarized, I think, the best, when you talked about the need for transparency, capital and liquidity, all of which are leading to the one thing that is essential here, and that's confidence.
If we do not have confidence in our ability to get our checks cashed, we produce a run on the bank in the old model. Here, the international system did not have confidence that there was anybody on the other side of the deal if they were to cash in some of their derivatives. And Bear Stearns stood in the middle of the deal, as the bank that would provide that confidence.

So if Bear Stearns goes down, that is, if the middle broker goes down and neither side has confidence that the paper they hold can be redeemed, then the whole worldwide thing melts down.

BENNETT: And I think we need to keep that foremost in our minds in all of our discussions. All of the details are fine, all of the details are more than fine, they're absolutely necessary, but the ultimate goal to which we must constantly pay appropriate homage is confidence that the system is going to work.

And if I understand what you've said here today, you were afraid that that confidence was going to go out the window and the whole world losing confidence could ultimately come crashing down.

So for all of us, Mr. Chairman, this is, I think, the ultimate goal is to see whatever we do, either you in your regulatory actions or we in our policy actions, keep focus on maintaining international confidence in the system of worldwide credit.

Thank you.

DODD: Thank you, Senator Bennett.

I'd underscore the point, we've been using it over and over again.

Let me just say, I should have responded quickly to President Geithner's comments earlier, this committee's intention is at the appropriate time to take a long look at these various proposals regarding the reform measures to reflect the 21st century (inaudible) very different than when a lot of these institutions were created and been amended to over the years.

And so I welcome Secretary Paulson's ideas in all of this. I just want to quickly say, however, that the timing of all of this, I mean, clearly we need to get to that, but I want to make sure we're concentrating our attention on the crisis at hand.

And the crisis at hand is at its center a foreclosure crisis that is the contamination effect here. We need to concentrate on that.

But I don't want by that statement to reflect any lack of interest in the broader subject matter, which is an appropriate one. But I don't want to digress or divert attention from the issue at hand.

And so we will get to that question, and this committee will. And conduct a series of hearings -- I've talked to Senator Shelby about this already; we'll plan on that -- to outline all of these ideas and consider it thoughtfully and carefully. Obviously, nothing will happen this year. We all know that. It's going to take a new administration coming in. But certainly we can set the table on these issues, and my intention is in this committee to try and do exactly that.

Senator Reed?

REED: Well, thank you very much, Mr. Chairman.

And thank you, gentlemen, not only for your testimony today, but for steering through a crisis which could have had catastrophic consequences. That's an achievement in itself.

And as we go forward, though, I think, as I said initially, we have got to look carefully at what was done. And let me raise a question that was also raised by Chairman Dodd. That is the discount window facility.

Listening to Chairman Cox' analysis of the Bear Stearns situation, it seemed to be the biggest failing was a lack of access to secured funding. And yet the discount window facility would have given that secured funding.

REED: But, President Geithner, as the point on this effort, you indicated that you would not have extended that facility to Bear Stearns because it was -- in your words, "Is not a sound institution." That was a criteria you were applying -- criterion.
Can you tell us why it was not a sound institution? And should the SEC been aware of those shortcomings?

GEITHNER: Let me just say this carefully as I can.

I was expressing my personal view. It's very hard to look back and know.

But all these facilities -- in all these facilities, as you think -- as you would expect, I think, we need to be very confident that we're lending to sound, prudent institutions that are designed to respond to liquidity problems.

And it's very hard to know, looking back, whether, given the way they're designed, they would have been powerful enough to help Bear navigate these challenges.

And I just want to say that it's not obvious to me -- and that's just my personal view -- that lending freely in the context of the accelerating pressures on Bear wouldn't have been -- would have been a prudent act by the Fed.

REED: Was that your conclusion? I know it's a difficult one to make, and I know it's inherently subjective because you have to weigh many (inaudible) factors.

Was that a function of management or a function of the balance sheet, a function of market conditions beyond their responsibility?

And, again, should the regulator, primary regulator -- SEC -- been aware of these faults, that you at least recognized were potential faults?

GEITHNER: Again, very exceptional conditions we're facing in markets. And everybody is rediscovering and rethinking through what they think is adequate liquidity. And any institution these markets is discovering that if you lose your unsecured you might lose your secured.

And independent of the concerns that have been -- we've been seeing throughout the last nine months about strength of individual institutions, we've seen a substantial withdrawal in the willingness of markets to finance -- arrange different types of collateral.

So one thing that's unique about this is the extent to which secured financing markets also became vulnerable.

And a very important point Chairman Cox made several times is -- and Chairman Bernanke -- which is that in these markets these can happen incredibly quickly -- just incredibly quickly.

What you see in this context was a combination of two things. One is these very powerful forces across all markets impairing liquidity for everybody. And you have a set of institutions that were -- some relatively more exposed to those risks, some relatively less exposed.

And with great respect to the people and management employees of that institution, they were in a position where they were more exposed to those risks.

REED: Let me follow up on another line of questioning the chairman raised, and that's the price -- the initial stock price.

REED: And you indicated that -- and Mr. Steel and others -- that there was no deliberate message from any federal official about the price. But did you -- since I recall when I was a young lawyer, went to closings, and there was the -- lots of rules, but the one rule was the golden rule: The person with the gold made the rules.

You had all that, Mr. Geithner.

Did you suggest a certain range that you would not allow or any indication that your agreement to the financing, taking the collateral and given JPMorgan the $30 billion was a function of a price that was, in your view, appropriate?

GEITHNER: We did not set or negotiate the price.

REED: Did you suggest if a price was raised that it was excessive or it couldn't -- the deal would not close? Did you -- or did you in general indicate to them that -- and as I think you indicated in your comments -- the real issue of moral hazard, that you could have said without stating a specific price that the price has to reflect a steep discount from book value otherwise moral hazard?
Is that something you communicated?

GEITHNER: Well, just to repeat again, those two objectives -- finding a solution that would avert default in ways that would make the system stronger, not weaker; not create adverse incentives for future risk-taking that would be a problem for the system -- were at the center of the judgments we made.

But I just want to underscore, both the agreement reached between Bear and JPMorgan that initial Sunday night, which I think was the 16th, and the agreement reached a week later, were in -- just to speak for myself, in my judgment, fully consistent with those objectives.

REED: Chairman Cox, one of the points you raised was this unusual and very rapid runoff of liquidity. Does that suggest to you market activity which is more than unusual, that might be manipulative?

COX: Senator, we don't know the answer to that. But of course the Securities and Exchange Commission investigates market manipulation and we have...

REED: Are you conducting an investigation now? GEITHNER: I'm constrained, as you know, by the general rules of discussion about civil law enforcement matters that have not yet been filed in any court. So I can't confirm or deny the existence of any particular matter under investigation.

But suffice to say that the Securities and Exchange Commission takes very seriously its responsibility to investigate allegations of these kinds, and there have been ample allegations made in this context.

REED: Thank you, Mr. Chairman.

Chairman Bernanke, you indicated that this was not a bailout of Bear Stearns. And at $2 raised to roughly $10, there's some persuasive force in your argument.

But wasn't it a bailout of the surviving investment banks?

Because with, I think, the context of your discussions, your real fear was that Bear could fail, but that had to be the line of defense: that the others, if they fail, would be catastrophic, and that, in fact, your action was very calculated and conscious to prop up remaining investment banks.

BERNANKE: We were concerned about other institutions. We were concerned about a variety of markets in which Bear Stearns participated. We were concerned about the thousands of counterparties whose positions would have become uncertain.

So we were -- if you want to say we bailed out the market in general, I guess that's true. But we felt that was necessary, in the interest of the American economy.

REED: I don't dispute you. I think that's the role you had to assume.

But I think -- and many people, homeowners that are looking at action that helps the markets, helps them indirectly, but I think to say this was a routine action that wasn't designed to save some institution or prevent them from going into distress is not the most accurate characterization. That's my point.

Just a final point, Chairman Bernanke.

You've got about $30 billion of collateral. And some comments have been made that you feel comfortable because it's highly rated. But a lot of highly rated collateral these days is being subject to questions about that.

REED: Your comments on the quality of this collateral. Is -- will eventually the taxpayers be on the hook for a significant amount of that collateral?

BERNANKE: Senator, as was mentioned, it is all investment-grade or current performing assets.

The prices at which we are booking them in terms of collateral are not the face value but rather the prices to which Bear Stearns marked those assets on March 14th.

Therefore, they reflected current market conditions and they reflected in addition the difficult liquidity situation that exists.
We do not know for sure what will transpire. But we have engaged an independent investment advisory firm who gives us reasonable comfort that if we can sell these assets over a period of time that we will recover principal and interest for the American taxpayer.

And certainly under no circumstances are the risks to the taxpayer remotely close to $30 billion. There may be some risk, but it's nothing close to the full amount. We do have collateral, and I would say a good bit of it is very highly rated.

REED: Thank you.

Thank you, Mr, Chairman.

DODD: Thank you, Senator.

And may come back to a couple of questions that Senator Reed has properly raised here, I think, as well. Let me turn to Senator Allard.

ALLARD: Thank you, Mr. Chairman.

We have had downturns in the economy and periods when it's been rather prosperous. And at times they have involved the banking institutions because of the amount of lending that goes on in our economy to keep it going.

And the thing that comes up to me, when you take a lot of these instruments like what we have here and you securitize them, you've got a big volume of assets that are going in there. How can you go about keeping track of those investments? And how do you reach a point where you know that that becomes a very risky security?

ALLARD: And do we have the -- do we have the tools in place to make those evaluations from a regulatory standpoint? Or do we just rely on the common approach that, you know, if you get a greater return there's greater risk and you ought to be smart enough to balance your portfolio so you don't have that?

So I'd like to have some discussion on how you arrive at the credit worthiness of those assets that make up a total security value. And I open it up to anybody on the panel that may want to address that question or that issue.

BERNANKE: Are you referring to the collateral...

ALLARD: Yes.

BERNANKE: I'd perhaps turn to President Geithner.

The investment firm, again, is doing its own evaluation, has done an evaluation.

The Bear Stearns' marks, I expect, were based, to the extent available, on market prices, as available. To the extent where market prices are not available, then the marks are developed by a combination of market information and various models that try to anticipate what the cash flows would be for these various securities.

I don't know the specifics of the individual securities and how they were marked.

ALLARD: Mr. Geithner?

GEITHNER: Senator, I think you're raising a question that is at the center of this financial crisis, in the sense that we've been through a period where extraordinarily rapid innovation, at a time where the world was growing, the faults were very low, and a lot of leverage built up. And therefore it was hard for anybody to know with confidence what the risk was in a lot of those positions, how they would fare in a more averse world.

GEITHNER: And in a sense, you could say that is the dominant lesson of financial crises. And people are learning that lesson again.
And Chairman Cox referred to this comprehensive review of risk management practices, weaknesses and strengths across the major institutions.

And I would say that the central lesson from that review was the difficulty in thinking through how much risk you might face in the extreme event, and how best to manage that risk, how much capital to hold against that risk, how to make sure that your risk management structure, your compensation incentives protected you from that risk adequately.

And because the future’s inherently uncertain, it takes experience with crises to learn more about how those positions are going to respond.

And I think that the -- also -- I mean, it's just another example of why this has been so powerful and difficult to manage, even for a set of very smart, competent people.

ALLARD: Any other comments?

COX: Yes, Senator, I would confer with President Geithner that I think your question leads us, in a way, back into all the root causes of the situation we face. And I'm sure that's where you were taking us.

I would confer -- agree with the observations by Chairman Bernanke and President Geithner. And I think that, when the President's Working Group began their first efforts to try to see what we've learned, that focus on transparency, better risk management, and that all aspects -- all of the actors in this have to do a better job.

And it's not -- but it includes credit rating agency, issuers, investors, securitizers. Everyone has to be focused more on these issues.

And greater transparency is really key. And people need to understand that what they're buying and selling is at the root of the issue.

And hopefully, we have some ideas that can focus us in on that, so that things can be improved and lessons learned from the stress that we've been through.

DODD: Can I just interrupt, Senator, for one second?

I would like to, maybe, ask Chairman Bernanke, maybe it would be helpful for this if the Fed could provide to the committee in writing the current value of these assets.

DODD: If we could have that available to the committee, it would be helpful as well for us.

That's to you, President Geithner or the chairman, whoever could help us out on that. It would helpful to the committee.

ALLARD: Yes, and that was my question, where I'm getting into, is do you have any concern about the reliability of these ratings, as it pertains to credit ratings? You know, that's a big part of this, it looks to me like.

And credit ratings can change pretty quickly. Sometimes they're under -- and they're a whole compilation. And do we have the capability to say that what we have is pretty reliable?

BERNANKE: I just want to reiterate that we're relying on a well-known investment advisory company which specializes in exactly these sorts of valuations. And we're relying on their opinion.

ALLARD: OK. Thank you.

Now, under the Bear Stearns agreement that was reached, one thought that came to me is the managing -- who's going to be the manager of the remaining assets? And you had determined that the Blackstone Group would be that.

And so, that's a key decision, I think, in managing what's left. And how was that decision arrived at? And how do you determine what their fee or whatever would be determined to manage those assets?

GEITHNER: Thank you, Senator.

That afternoon of Sunday, March 16th, where we were exploring, again, whether there was a way to make
this work, we did a range of things to try to get ourselves as comfortable as we could with the mix of assets that we were willing to consider financing.

You know, the financial system holds, typically, several hundred billion of dollars of collateral at the New York Fed against the possible need to borrow.

GEITHNER: And we have a team of people that spend their lives thinking about how to value collateral and look at that. And we had those people alongside us as we looked at this portfolio.

We established a set of very important conditions, described by the chairman, for what would we accept in the portfolio. And we structured it, again, very carefully -- very, very carefully to minimize the risk of future loss.

But as part of that, we made the judgment -- I made the judgment that we should have a world class adviser sitting there with us. And in that period of time -- very little time -- we made the best judgment we could about what firm would have the mix of expertise, knowledge, experience and independence that could best provide that judgment.

I think they met that test.

I don't think there were any better options available at that moment. And I think we're in a much better position now, certainly we were that afternoon, in going forward to have them at our side as we thought through those judgments.

And as the chairman said and emphasized, part of the agreement we worked out to limit risk to the taxpayer was to have them be in a position to help manage these assets over time.

STEEL (?): If I could just make a correction, sir, your question, the correct name is BlackRock for the institution.

ALLARD: Was it BlackRock?

STEEL (?): BlackRock, not Blackstone.

ALLARD: Well, whoever. Yes, appreciate that. Thank you.

That was an error that we had on my notes, and I apologize for that.

But just the same, I think the question applies, yes.

Mr. Chairman, I see that my time's expired. Thank you.

DODD: Thank you very much.

Senator Schumer? SCHUMER: Well, thank you, Mr. Chairman.

SCHUMER: I hope next time you don't need to bring in Black Boulder instead of BlackRock or Blackstone.

When Chairman Bernanke came before us yesterday at the Joint Economic Committee, I asked him when did he know that Bear Stearns was in such serious trouble that they might go under if nothing happened, and he said 24 hours before.

Is that true of you, Secretary -- Commissioner Cox -- Chairman Cox? Did you just know? Did you just have any idea that they'd go under only 24 hours or so before?

COX: Well, as I described earlier, the liquidity pool which had been $8.4 billion on the 31st of January actually grew in the first week of March to $21 billion, but in one day, on Thursday, March...

(CROSSTALK)

SCHUMER: So is the answer yes?

COX: ... it dropped by $10 billion.
SCHUMER: Is the answer yes? You didn't know till 24 hours before?

COX: We knew of the drop in the liquidity pool. On the other hand, we had been focused, as had the New York Fed working with us, on these issues for some time.

But this precipitous drop...

(CROSSTALK)

SCHUMER: Limited time. I got a simple yes or no from Chairman Bernanke. Did you have an idea that they could go under almost immediately more than 24 hours before it happened?

COX: The drop occurred on the 13th of March.

SCHUMER: How about you...

STEEL: No, sir.

SCHUMER: No.

How about you, Mr. Geithner? GEITHNER: No.

SCHUMER: OK, thank you.

Now, the question I have is, should you have known? And it relates to the future, not the past. Was it simply a regulatory mish-mash, if you will? That in other words safety and soundness is lodged with Chairman Bernanke, oversight of the SEC with Chairman Cox.

We did have signs that Bear had some trouble, obviously, with its hedge funds, et cetera. And as I said, similar places -- not similar places, but places that had a lot of mortgage exposure that had higher capital -- even though this was a liquidity crisis, higher capital seemed to be a cushion against the liquidity run starting.

So the question, I guess I'll ask you, Mr. Geithner: Could a reasonable regulator have known and been ahead of the curve here?

Could some have called Bear in and said, "You need more capital. You need to reduce your exposure to mortgages"?

GEITHNER: Very hard to know.

I want to underscore -- I'll say it very quickly -- these things can happen incredibly quickly in markets like this. What the world is going through and has gone through in the last nine months are truly extraordinary, described by many as the worst in 50 years, worst in a generation.

So it's very important to underscore that. Because it's easy to look back and say, "But doesn't it look obvious?" And I think that's slightly somewhat unfair to the people...

(CROSSTALK)

SCHUMER: Mr. Deputy Secretary (sic), you agree with that?

STEEL: Yes, sir.

SCHUMER: OK.

And how about you, Chairman Bernanke?

BERNANKE: Yes, I do.

SCHUMER: OK. So clearly, then, something is wrong with our regulatory structure, unless we just think we should do these things on an ad hoc basis.
And so I'd like to just talk about going forward to prevent the next Bear Stearns, because our credit markets are still not the confidence -- confidence equals credit. Confidence is not all there. For all we know, in some other -- no one would have thought mortgages would be the place where we'd start doubting credit. It should be a simple cut-and-dry thing.

And it happened in -- if it happened in mortgages it could happen in some of these far more complicated instruments, perhaps.

So my question is: What have we done to avoid this from happening in the future that the next warning signal if, God forbid, it happens in any of these places, would go off sooner and we would not have to rush in at the last minute but could make corrections before that?

Do you have any tools to do that other than the emergency power lodged in the Fed? And what new tools do we need?

Could you again -- Mr. Geithner, tell us what's being done now that's after Bear Stearns that's different than before that might avoid this from happening again if there were another liquidity run on a company?

GEITHNER: First, we have, at the SEC's invitation, a team of people in these institutions, the major investment banks, looking carefully at their funding and how they're managing their funding, how they're going to position themselves to be stronger, to withstand these kind of pressures.

Second, the Federal Reserve has put in place a very powerful set of liquidity facilities to help mitigate the risk that these things intensify going forward.

Third, we've been working very actively to try to -- alongside the Treasury and others -- to try to make sure that institutions take steps to strengthen their capital positions so they're better positioned to manage through this crisis.

Those are very important steps.

I think you need to look ahead, though, because those will not be enough, and we have to think about -- I mean they will not be enough for the future...

SCHUMER: So there you need a change in regulatory structure, which we have talked about...

GEITHNER: I believe you do. I think that you need to look comprehensively at a broad range of aspects of regulatory policy and structure.

SCHUMER: Right.

Because if we don't, it's my judgment -- tell me what you think -- if we don't change the regulatory structure, given the interparty risk you've talked about, the quick moving of huge amounts of money, we're going to be subject to these problems, sooner or later, somewhere or other, that we haven't -- that we might have been able to prevent if we had a better regulatory structure.

Is that fair to say?

Do you agree with that, Secretary Steel?

You, too, Chairman?

BERNANKE: It's partly structure and it's partly practice. I mean, obviously, we have to, you know, understand better how to deal with these risks and how to evaluate those risks, as well as, you know, changing the organization chart.

SCHUMER: Right now, in an advisory way, Mr. Geithner, you are looking at firms and seeing their capital and seeing their exposure and giving them more early warning -- more advice, I guess is how I'd put it, as to being careful. And are they following you? I don't want to ask any specific names; that would be very bad, but...

GEITHNER: We're doing everything sensible.

SCHUMER: And are they following your advice?
Your pause worries me.

GEITHNER: No, I'm just trying to be careful.

I would say that we're doing everything we can, sensibly, to encourage them to take steps that would put them in a stronger position. And I think that there is a lot of focus and attention across those institutions in doing just that.

No one is more worried about it than they are in some sense. And, as I said, you can't look at what happened over that weekend and look at the outcome for that institution and take any comfort from it.

SCHUMER: Correct.

And, you know, right now they may be careful, but all of these steps mean they reduce their profits.

SCHUMER: And the pressure on immediate profit and immediate increase in share value will be back very soon, if it isn't already.

What do you have to say about this, Secretary?

STEEL: I think that you're on the right point.

And earlier, I said I think there are three aspects to this: transparency, liquidity and capital. The secretary and all of us at Treasury have tried to be very strong on the idea of capital increase so that firms have the right balance sheet.

You know, there are two ways this happens. One is that firms can delever to improve their financial position or their capital cushion, or the other is -- and that has an unattractive effect vis-a-vis contracting credit.

SCHUMER: Right.

STEEL: And our preference is that institutions raise more capital, so as to avoid the pro-cyclical effect of contraction. And we've been adamant and will continue to be so.

Unfortunately, I can't tell you that there's a red-light, green-light issue done.

SCHUMER: Of course.

STEEL: I think it's a progression. And we will continue to be vigilant on this point.

SCHUMER: Just one final -- yes, capital and liquidity are related, in some degree?

STEEL: Absolutely.

SCHUMER: And Geithner said yes, too.

Thank you, Mr. Chairman.

DODD: Thank you, Senator, very much.

Senator Bunning?

BUNNING: Thank you, Mr. Chairman.

It's not unusual that Chairman Bernanke and I disagree on certain things. But I would like for him to answer me this question.

Would Bear Stearns' stockholders have fared better in bankruptcy than they did at $2 or $10 a share, in what you call "not a bailout"?

BERNANKE: It's hard to know.

And besides the bankruptcy, they would have been facing, probably, a much worse financial market
condition, as well.

So I'm -- you know, the shareholders certainly lost a huge amount relative to what they had thought they earned -- owned earlier that week. Whether they would have come out with zero or $2 or $4, I don't know.

BUNNING: But the fact is that they're trading on the New York Stock Exchange for over $10 a share, today. Is that accurate?

BERNANKE: I believe so, yes.

BUNNING: OK.

If anybody can answer this question, I would like it. How did we get to the point that the failure of one firm can bring us to the edge of collapse, our whole financial markets?

We know the Fed and others did not do their job in regulating lending practices and supervising the risks banks were taking on, but how do you let the entire financial system become so fragile that it could not tolerate one failure?

BERNANKE: Well, one response, Senator, is that this has been a long time in the making. There was a substantial credit boom that peaked last summer. That credit boom, which was driven by international factors, which I could go into if you like, involved a substantial increase in risk taking, a lot of financial innovation, some of which turned out not to work so well, deterioration in underwriting standards, and essentially a letting-down of the guard.

Supervisors made many efforts to address these problems, who were not successfully, obviously, in preventing the excesses. Starting in August, triggered by, but not, I would say, fundamentally caused by the subprime crisis, there was a sudden rethinking of the amount of risk that people were willing to take. There was a major retrenchment in the markets.

Now, in contrast to last year, when investors were willing to lend against quite risky assets, now even the safest assets find difficulty in getting financed.

And so financial conditions have become much more fragile, much more uncertain. There's a great deal of distrust of counterparties, of the valuation of assets, and a very strong aversion to taking risk, of even liquidity risk, as opposed to credit risk.

As I mentioned earlier, under more robust conditions, under more normal conditions, we might have come to a very different decision with respect to Bear Stearns. We felt that given the context, given the fact that financial conditions are already creating a slowdown in our economy, that the risk was too great.

BUNNING: Anybody else have a different opinion?

GEITHNER: I don't have a different opinion, Senator, but let me just underscore, in a market-oriented financial system where people are free to fail, make mistakes, lose money...

BUNNING: I thought so.

GEITHNER: ... making prudent choices, any system designed that way is inherently vulnerable to the risk that a sharp loss of confidence in economic activity induces a dynamic like we're experiencing now.

This happens rarely, but it does happen. It happens across all different types of financial institutions over time. But you're exactly right, and I think it is the critical objective for policy. The challenge for policy is to try to make the system strong enough so that it can withstand the failure at even large institutions. But no system in a situation this fragile economically is going to be able to withstand that easily; meaning, withstand the risk of default by a major that easily in conditions this fragile.

GEITHNER: What produced this is a very complicated mix of factors. I don't think anybody understands it yet. But we have to spend a lot of time and effort trying to figure out how to get a better handle on this sort of stuff. And there's a lot of people who are going to be part of that, because it's very important that we try to figure out a way to make this system less vulnerable to this in the future.

BUNNING: There were an awful lot of red flags, not just in the last six weeks, not just in the last month, but a year or two before, that we were having some problems in our mortgage markets, that we were having mortgages made that shouldn't be made. That the mortgage brokers were soliciting people into mortgages that they couldn't afford and, finally, they knew, were doomed to failure.
Nobody was watching the store. So it was eventually going to happen.

It just happened to be Bear Stearns who got ahold of all these things in one -- well, in one week. And the crisis occurred when everybody said, "Watch out for Bear Stearns, because they're not going to wind up this week anywhere but in bankruptcy."

I mean, that's what they came and told the Fed. Is that -- am I wrong? Didn't they come and tell you that they were going to go belly up, and ask for help?

GEITHNER: Senator, let me just step back for one second. The people at this table and a bunch of other supervisors and regulators took a lot of actions over the last several years to try to make this system less vulnerable to this kind of event.

BUNNING: I'm sorry...

GEITHNER: I want to -- just let...

BUNNING: I'm sorry. I've been here too long to try to convince me of that.

GEITHNER: Well, I don't -- I'm not trying to convince you; I just want to...

BUNNING: You're not going to be able to convince me, because the red flags have been waving long before you showed up at that table.

GEITHNER: Should I try -- do you want -- can I just go through the, just a few important things, though, for the record?

BUNNING: Certainly. Go ahead.

GEITHNER: We did, working the SEC, the other major supervisors of the major institutions around the world, a series of very important things, beginning in 2004, in particular, focused on exactly the set of risks that are so pronounced today.

GEITHNER: These things focused on strengthening...


GEITHNER: I'm not claiming that people were wise and all-knowing or that we did everything that could have been done, but I just want to underscore the fact that we took a series of actions to try to make the system more resilient to these kind of stress, and those things had made a lot of difference.

The system would have been more fragile without those things. As the chairman said, they did not achieve enough traction in areas where we would have liked them to achieve more.

And we are going to be very focused on -- try to figure out how to deal with those things in the future. But it's going to require a very comprehensive effort, because we don't have the incentives in the system aligned...

BUNNING: You've talked me out of time -- but the biggest problem with that is that I get the last say.

And what's going to happen if a Merrill or a Lehman or someone like that is next?

Thank you, Mr. Chairman.

DODD: Did you want to respond to that, Senator, or...

BUNNING: No.

DODD: All right.

Senator Carper's not here. Let me turn to -- who was next? Senator Menendez not here either.

Senator Tester?
TESTER: Thank you, Mr. Chairman.

Thank God for absences.

(LAUGHTER)

I wanted to ask a couple questions here. Chairman Cox, you'd mentioned some dates to earlier questions about the hedge fund in July of 2007 and adequately (inaudible) as of end of January and then it bounced up as of March 1st -- I'm talking about Bear Stearns and liquidity.

And I guess more specific, the question is when did you know? And Senator Bernanke, you're next -- when did you know that we were in a situation where one of the world's largest investment banks is tethering on insolvency? Was that on the 14th or did you know before that?

COX: Bear Stearns approached the New York Fed on Wednesday night to discuss, as I understand it, possible accelerated access to something like a term lending facility.

The following day, on Thursday, there was a precipitous decline, a drop in over $10 billion in the liquidity pool of Bear Stearns. And by Friday we were in the midst (ph) of these discussions, and in particular the Fed...

TESTER: Sounds good.

COX: ... and the Treasury discussing with JPMorgan and Bear Stearns.

Thank you.

Mr. Bernanke?

BERNANKE: Senator, just to be clear, we are not the supervisor of Bear Stearns.

TESTER: Just your perspective. When did you know?

BERNANKE: We were simply -- we are monitoring the markets. We received, as was indicated, I think about 24 hours in advance a call that they were anticipating bankruptcy.

TESTER: Chairman Cox, I want to come back to you on that issue. Has anyone brought to your attention or do you know of the possibility of short-selling that helped bring down Bear Stearns?

COX: I want to be careful in the way that I respond to your question.

COX: It is a perfectly appropriate question. It deserves a straight-up and factual answer.

I'm a little bit constrained because the SEC is in the law enforcement business, and I tried delicately to answer that question before.

The SEC very aggressively pursues insider trading, market manipulation, and the kinds of illegal naked short-selling that have been very publicly alleged in this case.

TESTER: OK. Thanks. I'll interpret that answer the way I think everybody else in the room interprets it.

The question I had goes also back to Mr. Bernanke. It deals with the $30 billion that's been talked about a lot here today. And I think initially you said it was $30 billion market value, and then, with another question, I think it was Senator Allard, you said it was a model, it was market-to-model value on it.

Who set the value?

BERNANKE: Bear Stearns.

TESTER: Bear Stearns set the value.

You had also mentioned, I think, and if it wasn't you, you can forward this question to Chairman Cox, that for
the most part these were pretty good collateral.

BERNANKE: Yes, they're all investment grade...

TESTER: Why didn't JP Chase take them?

BERNANKE: I can ask President Geithner to elaborate. But they were swallowing a pretty big chunk. They were concerned about the implications of their capital, for their risk profile, and particularly for the liquidity.

One advantage that we have over market participants -- the Federal Reserve, that is -- is that we don't have any problem in financing the assets and we could afford to hold them for a period and dispose of them in a more orderly way.

TESTER: OK. It was a liquidity issue.

And you're nodding your head, so you must agree.

The reason JP didn't take them is because it's a liquidity issue for their firm? That's what I heard Mr. Bernanke just say.

You can say no, you can disagree. Doesn't matter.

GEITHNER: Well, I'd just echo what he said, which is that -- you'll have a chance to ask JPMorgan this, but Bear is a very large, complicated institution, a lot of risk. JPMorgan was not prepared to assume the full risk in that and for reasons that I think were very carefully thought through.

GEITHNER: So, to help make it happen, we agreed to assume some of that risk.

TESTER: Would it be fair to say that the $30 billion in collateral we got was probably the least secure?

GEITHNER: No.

TESTER: So it was just an arbitrary one, just to arbitrarily cut off the -- you arbitrarily took -- all the investments from A to D went to the Federal Reserve and the rest -- how was it determined?

GEITHNER: Very carefully. There was a negotiation. We set a set of parameters for things we would accept or we would not accept. And that's how we got to the outcome we got to.

TESTER: You don't have to do it now, but could I get a list of those parameters?

GEITHNER: Absolutely.

TESTER: OK. Chairman Cox, or whoever's most applicable to answer this question, how much is Black Rock (ph) charging for managing the $29 billion?

COX: Senator, we have not yet completed our negotiations on the fee. It will be a commercially reasonable fee. We will be very careful in setting it, so that we're getting something, or we think, something that matches the complexity of the responsibilities and the importance to us, that it get managed in a way to minimize the risk.

TESTER: I'll ask this to the next panel up, but is that typically how things are done? You enter into an agreement and set the fees later?

COX: Almost nothing is typical about the arrangement that we reached in this context.

And as I said, we tried to be very careful to make sure we designed this in a way to minimize any risk to the taxpayer. And part of that was having them there with us.

TESTER: OK. Senator Bunning brought up some good points in his opening statement that talked about how big is too big? Senator Bennett talked about it being intertwined.

I am curious -- and I think, the bigger you are, the more intertwined you are. So I think both points apply.

The question is, would the Federal Reserve have agreed to this situation if it would have cost $50 billion or
$100 billion?

And I know you said it was based on markets. And it was said earlier here today that $29 billion -- I believe this is a quote, not from you guys, but from somebody on this panel: "$29 billion, the whole world could have come crashing down if we didn't do this."

TESTER: Is that adequate -- is that accurate? And at what point do you say no?

BERNANKE: Well, Senator, it was a negotiation. We think we got a good deal. We didn't spend $29 billion. We lent it against collateral. We believe we will recover most or all of it, probably all of it.

It was, again, a very important consideration to try to make sure that this failure didn't occur. And I would reiterate that, you know, the moral hazard questions that Senator Bunning appropriately pointed to, I think the moral hazard was minimized by the cost borne by Bear Stearns.

And in the future, I think we should -- however, we should take actions to make sure that, you know, that these problems don't arise again.

TESTER: If another investment bank, similar size, in the same situation tomorrow, would you duplicate your effort?

BERNANKE: Well, the situation has, I believe, improved now, and we have put in place these liquidity facilities, and we are monitoring, as the SEC is doing, the condition of these banks.

It was a very unusual situation. Don't expect it to happen again.

But if any situation arises which threatens the integrity of the U.S. financial system, we would have to try to address it the best we could.

TESTER: Thank you very much.

Seven minutes goes by way too fast. Thank you.

DODD: Very good questions, Senator. Thank you very much.

Senator Dole?

DOLE: Chairman Cox, in a recent interview with Baron's, Lawrence Fink, the chief executive of asset manager BlackRock, suggested that both hedge funds and the credit rating agencies may have played a role in the downfall of Bear Stearns.

And he further calls on the SEC to investigate. Given BlackRock's own involvement in the JPMorgan-Fed deal, what do you think of Mr. Fink's appraisal?

COX: Well, I saw the remarks that he made with respect to credit rating agencies. The downgrade that occurred was on Friday, when I think it perhaps was too late to have a different outcome, Thursday having been, as I described, the truly cataclysmic day in that week.

I don't know whether it is the responsibility of a credit rating agency which has its own responsibilities, both contractually and legally, to forebear in downgrading in the face of that kind of a situation, in collaboration with regulators, which was the suggestion that was made.

COX: It would be an interesting fact pattern in a different set of circumstances, but as I say, it occurred so late, on Friday of that week, that I don't think it was the proximate cause of what occurred in this case.

DOLE: Let me ask Chairman Bernanke and Secretary Steel, on Tuesday of this week an article in the Wall Street Journal highlighted the market impact of so-called credit default swaps and estimated these swaps were written against $45 trillion of underlying debt in the first half of 2007.

Given these credit default swaps were a contributing factor regarding the recent troubles at Bear Stearns, as well as the concern about whether or not federal securities laws actually apply, what are the Fed and Treasury doing to make sure that these financial instruments are better understood and accounted for?

BERNANKE: Senator, first, to the extent that the credit default swaps were involved in any market manipulation, to which I have no knowledge that's the case, that would obviously be an issue for the
Securities and Exchange Commission to be looking at in the course of their duties. So that would not be our particular province.

We are interested in credit default swaps in a number of contexts. First of all, through our regulation of supervised institutions. We want to make sure that they understand and they properly manage the risks associated with their credit default swaps, the counterparty risk, the credit risk and so on.

And, secondly, President Geithner at the Federal Reserve Bank of New York has led a very substantial effort, working with private participants, private market participants, to improve the clearing and settlement process for credit default swaps to eliminate or reduce the risk that uncertainties about who owns (ph) who to what that might arise in a period of rapid changes in prices or changes in conditions would be an issue.

I just want to commend President Geithner for his work on that front. We have not seen clearing and settlement issues play a very important role at all in any of these recent financial problems that we've had.

STEEL: Senator, I think that Chairman Bernanke has pointed to the right issue, and the whole area of the over-the-counter derivatives market is quite complex, it has grown a lot and is very, very large and important. When the President's Working Group recently issued a report of issues to be focused on in the near term, we specifically highlighted the area of over-the-counter derivatives as something where policies and procedures need to be enhanced. And President Geithner's been a lead person on that. And so we think you're on exactly the right track, and we're committed to doing that.

DOLE: Let me ask one somewhat tangential question, Secretary Steel.

I have, along with Secretary Martinez and Hagel and Sununu, been a strong advocate of GSE reform. And our legislation would create, as you know, an independent world-class regulator to oversee the safety and soundness of Fannie and Freddie, which earlier this decade had significant accounting problems.

Last month, OFHEO announced that it was lowering the capital requirements for both Freddie and Fannie, which comes on the heels of the temporary increase of the GSEs conforming loan limits.

DOLE: Secretary Steel, in light of the most recent action, this most recent action, is it not now all the more urgent that comprehensive GSE reforms be enacted to ease the turmoil in our credit markets and to further ensure that GSEs do not pose more of a systemic risk?

STEEL: Senator, I think that several of the other senators, now including you, have raised this issue of what have we learned about regulation and our regulatory regime in general.

And I think the importance of clear responsibilities and the ability to have the tools to deal with challenging times is really the note that everyone is singing to. I believe that comprehensive GSE reform is completely on key with that issue, and the Treasury would be a strong proponent of a comprehensive GSE reform bill.

DOLE: Thank you.

Thank you, Mr. Chairman.

DODD: Thank you very much, Senator.

And at that point, we turn now to Senator Carper.

CARPER: Thank you, Mr. Chairman.

And you all are holding up well. Thank you for your patience and for dealing with this for all this time.

I indicated when I made my brief opening statement earlier that we were going to be asking you to sort of explain what you've done, why you've done it, and what you think the implications are -- the lessons learned from it.

We're about to undertake some actions here in the Senate, under the leadership of Senators Dodd and Shelby, to take up what I call the housing recovery package.

The elements of it include -- and you may have heard some of them, but the elements include FHA modernization, trying to bring FHA into the 21st century and to make it relevant in the lives of a lot of people; providing the ability to use (inaudible) for mortgage revenue bonds, to help out in refinancing some subprime mortgages; some extra money for Community Development Block Grants, to enable state and local
governments to work with distressed housing in some of their communities; some extra money for housing counselors to try to steer people into Project Hope Now, so they can take advantage of that.

CARPER: Those are -- the net operating loss carry back for homebuilders, I think it goes back about four years. And Senator Isakson's proposed a tax credit to go to people who actually move into -- buy a home that's been foreclosed and agree to stay there for an extended period of time.

Those are all ideas that are included in the bill. There's a few others. But those are the ones that are there.

Senator Dole, who's just asked about GSE regulatory reform -- and we've debated that this Congress, last Congress. And Chairman Dodd's indicated a strong desire to move us to that legislation quickly and to get it put in place a strong, independent regulator for our GSEs for Fannie and Freddie and for the home loan bank side. I applaud that and look forward to that.

That's not part of this package. But my hope is that it is something that's going to be honored real soon. And the chairman indicates that's his full intent.

Among the amendments that are going to be offered to the bill, the housing recovery bill on the floor -- if not today, then the next couple of days -- is one that would empower a judge in bankruptcy to not only modify the interest parameters with respect to a primary home mortgage (inaudible) with a second home; but to enable them to not only work down or modify the interest parameters of the first mortgage, the primary mortgage, but to also work on the principal itself.

And there are some who think that is a good idea, some who are concerned about it. I just would ask is this something we're likely to vote on in the next day or two. We'll just ask what you think is good about that proposal, what is not. Is there a better option out there for us?

BERNANKE: Well, Senator, first of all, I think you're absolutely right to be focusing on housing. Housing is very central to the current situation. It's affecting both the broad economy as well as borrowers, lenders and communities. So I complement you on that focus.

I think some of the areas that I have advocated and I think are productive -- one is the FHA modernization, the general idea of letting the FHA, which as seen its market share shrink to a very small amount, ironically displaced to a large extent to subprime lending to increase its ability, its flexibility, its budget in order to both finance more new purchases and also to be able to refinance people out of troubled mortgages.

A second area that I would mention again -- Secretary Steel mentioned government sponsored enterprises. They are supposed to be stabilizing the markets. To do that they need both good oversight and they need to raise more capital so that they can expand their activities and substitute for the weaknesses in the remainder of the housing market.

I'd like to mention counseling, which I believe is a very high bang-for-buck activity. The Federal Reserve at the reserve bank level has worked extensively with Neighbor Works and other community organizations on counseling activities, and I think that's very productive.

On bankruptcy, I think there are arguments on both sides. Some argue that a bankruptcy judge could take a more comprehensive view of a borrowers situation and make a better overall determination. Opponents note the length of time that it might take, the delays that might occur, and argue that they would lead eventually to higher costs of borrowing in the future.

The Federal Reserve did not take a position on the earlier bankruptcy bill, and we're not taking a position on this one. And I think it's a very substantive decision that the Congress will have to face on that one.

CARPER: Thank you very much.

Others, please?

Chairman Cox, you may or may not want to comment on this. It's your call.

COX: I think as chairman of the SEC it's difficult for me to comment on this particular piece of legislation. As a former member of the Congress, it's really easy. But I think I will forebear in the interest of...

(CROSSTALK)

CARPER: ... keep your current hat on rather than put on a new one.
Secretary...

STEEL: Senator Carper, thank you for the question. A couple of things. And I think that Chairman Bernanke did a good job of kind of walking through the issues.

As you went down the list of all the various components and issues, we haven't seen the specifics of this.

STEEL: And some of the things you alluded to are not part of the bill. But I think our position is pretty clear.

FHA modernization is important and can allow the FHA to do more right away. FHA has been a force for good throughout this process. They can do more. Modernization is something we support and look forward to doing what we can to be helpful for that going through.

I think that also the GSEs, as Senator Dole first raised, consistent with prudent operations, it's something -- it's a time where they can be stepping in and be doing more, and we would encourage that.

Counseling, also.

I think on the issue of bankruptcy that, as you said, there are arguments on both sides. I think from our perspective that does not seem to be the right tool for the task, that there's lots of public policy suggests that there was a very purposeful decision when this process was described this way, and that, should you allow bankruptcy to be organized in the same way with regard to single-family residence, it would have a chilling effect. It basically would reduce the amount of capital and raise the price -- the price of capital.

And I think that's been the public policy perspective. And I think that we need to be very careful to consider anything other than that.

I think the idea that -- and, also, too, I think something that Chairman Dodd said, that we're working now in real time and it doesn't seem to me that when we need a fast solution that heading to the courts is our logical first ideal.

So I think that, given those perspectives, that would not be something we would view as a key tool.

CARPER: All right, thank you.

Mr. Geithner?

GEITHNER: I don't have anything to add.

CARPER: All right. Fair enough.

Well, thank you very much.

DODD: Thank you very much, Senator.

CARPER: Mr. Chairman, if I could, I know the chairman's been working with I think his counterpart, Congressman Frank, the chairman of the House Banking Committee, on a different approach that helps to address the situation for folks who have their mortgages underwater, where the amount of money that is owed is significantly worth more than the value of the property.

And got a situation where a lot of people are thinking about -- walking away or thinking about walking away.

Some have suggested that that might be, actually, a better approach than working on the bankruptcy side. And I think that's a question...

DODD: Well, you'd like to avoid -- again, once you're into bankruptcy, you've got another whole set of issues. If you can avoid that situation, obviously.

And the value I've tried to explain in all of this, where there's clearly value, obviously, in trying to keep people in their homes, all the residual effects of that, the large value to me is that you're establishing a floor.

DODD: You're getting to the bottom of this. And unless you get to the bottom of this, you're not going to see capital begin to flow. That to me is the great asset, potentially, of a plan like this.
And we’re spending a lot of time talking about it and getting other people’s advice and opinion on this, and I’m anxious, and Senator Shelby and I have talked about it, I’m not going to make it a part of this particular bill we have on the floor right now, because it’s controversial, and I don’t want to end up having a lot of people vote against something that I think they might be inclined to vote for if we can frame it right.

So we’re going to be having some hearings on it, and I’m going to be soliciting the opinions of many of you here as to how we do this. But in my view, in the absence in doing that or something like that, all we’re doing is dealing with the effects of all of this rather than dealing with the problem. And the problem is to get capital to flow.

And so that’s another -- that’s what we’re trying to drive at in all this.

With that, Senator Martinez?

MARTINEZ: Thank you, Mr. Chairman.

I want to pursue a little more on the inquiries that Senator Dole raised regarding the government-sponsored enterprises, Fannie Mae and Freddie Mac, from two aspect.

Number one, Mr. Chairman, I’d like to know your thoughts on whether a failure of one of these enterprises would pose a systemic risk to the system. And, obviously, I think I know the answer to that, but I’d like to be sure I understand your position on that.

BERNANKE: I think it would. There would be sort of two options. One would be significant systemic risk or government guarantees. So either way would be not a good outcome, obviously.

So for that reason I certainly support both good oversight and that the GSEs should continue to raise capital. The recent evidence is that financial firms can raise capital, they can do so -- and they can do so profitably, given the opportunities they have right now in the housing market. So I would strongly urge them to do that.

MARTINEZ: In order to raise capital, would it be helpful, do you anticipate that the investor would have a higher level of confidence and would bring new money into the market for mortgages if there was a world-class regulator that would give investor confidence at a time like this when there is such fragility and where we’ve seen a huge failure of one of the investment banks?

BERNANKE: I think that’s an excellent point, Senator. It would assure investors that the GSEs were safe and sound, and that they had adequate capital to conduct profitable operations.

MARTINEZ: Secretary Steel, can I get your comments on both of those issues?

STEEL: I think that the two questions, one, would it -- is the size, scale, scope of these GSEs -- is there the potential for systemic risk?

The answer is yes, period.

I think, with regard to the second question, I would concur with Chairman Bernanke that anyone who would consider investing in these entities would have to view the establishment of a clear, strong, appropriately empowered regulator as a positive.

And so, therefore, the answer to the question is yes.

MARTINEZ: So it seems to me that, based on the fact that we’ve seen accounting irregularities in the recent past, that they have worked out of -- and this is good -- with the need for them to play an increasing role with higher conforming limits, with us empowering them to lend more money by reducing their capital requirements and all of us knowing that OFHEO, today, does not represent that kind of world-class regulator that Senator Dole was talking about, that, maybe, the time is now for us to give the investor confidence that is needed, as well as provide the kind of security to our taxpayers.

Because, make no mistake about it, these entities cannot be allowed to fail. And there is an implied guarantee of the federal government.

So, rather than us be here Monday morning quarterbacking, some time down the road, it sure would seem to me to be a good idea for the Congress to get about the business of something I’ve been advocating, even before I was in the Congress, and that is a world-class regulator.
It's, kind of, a long question.

(LAUGHTER)

On the current issue, which is the Bear situation -- and I guess this might be to you, Mr. Geithner, one of the issues that has concerned me, as it relates to the shareholder, is whether there were other suitors, whether there were options available that might have provided a better outcome to the shareholders?

MARTINEZ: Could you comment on that?

GEITHNER: Absolutely. You know, I do say quite a bit about this in my written testimony. And, of course, you'll have a chance to hear from -- hear later today their perspective on this.

Bear Stearns began approaching people right away. Very quickly. And they, of course, had a very strong incentive in trying to get as many people looking at ways to provide financing as possible. And we encouraged that.

It's very important to us, too, that we maximize that chance for being an outcome that was going to be, you know, good for the system as a whole.

Ultimately, though, only one institution was willing -- had the ability, the will -- willing to move that quickly.

Was there a better option available at the time? No. I don't believe so. And I think everything was done to maximize the chance that there would be a range of choices available, but I do not believe there was a better option available.

MARTINEZ: And the governmental entities involved did not presume or select JPMorgan in this instance?

GEITHNER: Absolutely not. It was Bear's decision who they initially approached. And our interest was only -- and it was very important to us that they open and allow a range of institutions to do due diligence, which they did.

MARTINEZ: Thank you.

Chairman Cox, a couple of questions more, related to the shareholders. One has to do with the value of the $2, which, I know there was a financial adviser that provided an opinion of fairness at the $2 level.

I guess when the transaction was upped significantly, it raises in my mind a question of whether, in fact, the financial adviser's advice was appropriate, adequate, or was it just a better deal when it became $10? The $2 value.

Do you have any concerns from the shareholders' standpoint about the appropriateness of the financial adviser's role in this transaction? COX: Well, the commission's concern is that the shareholders get all of the information that they need to evaluate that for themselves. There are many things about this transaction that are unusual and that have broken the mold, but one thing that is not different is that this is ultimately a transaction between JPMorgan Chase and Bear Stearns. There's a merger. There's going to be a proxy. There are going to be shareholder votes and so on.

And all of those decisions have to be understood and approved by shareholders. The SEC has never in its history intervened to determine the price of a transaction, and we would not in this case.

MARTINEZ: Will there be a shareholder vote in this transaction?

COX: Now, if you're getting into the terms of the transaction and the "what ifs," I think I might better yield to the people that are directly involved in it.

MARTINEZ: Fair enough. Maybe we can get...

COX: And I mean other witnesses, as well as the next panel.

MARTINEZ: Mr. Geithner?

GEITHNER: I don't think I'm the one in the best position to talk about the way forward in terms of the legal
issues around consummating this agreement, but I think you'll have the opportunity later today to have them...

MARTINEZ: Maybe I should pursue the question later today.

COX: I will say that, just as a generic matter, and under the terms of the merger agreement, which is not unusual in this respect, there is to be a shareholder vote.

MARTINEZ: But is it not a stock exchange?

COX: It must be approved. It's a stock-for-stock transaction, must be approved by the shareholders.

MARTINEZ: OK. OK. Good enough.

Thank you very much.

Thank you, Mr. Chairman.

DODD: Thank you very much, Senator.

Senator Menendez?

MENENDEZ: Thank you, Mr. Chairman.

Chairman Bernanke, I'm trying to get a sense here of the risks for the taxpayers, and I've heard some of the -- or was informed of some of your answers to Senator Reed before.

You know, as -- a letter from the Treasury indicates that these are largely mortgage-backed securities and related hedge investments.

Now, I've heard this panel testify in your opening statements that in essence what happened here was a lack of confidence. Well, a lack of confidence happens because of underpinnings. I'd hate to believe that simply the rumor mill can bring down one of the largest investment banks in the nation, because then we're really in trouble.

MENENDEZ: So there had been some underpinnings of what created that lack of confidence. And that's what I'm concerned about, is what is the confidence that we have in where the taxpayers are out there on liability?

And I know that you said that you are reasonably comfortable that the risks are not remotely close to the full amount. Well, what are they remotely close to?

Because, you know, we've seen reports that Bear Stearns was leveraged 30-1; in some cases, 100-1.

I mean, what -- we've heard other financial institutions say that they, in fact, can't truly verify the full value of their securities.

So, if we don't have a valuation of these securities, how are we so confident?

I know that the first billion of loss goes to JPMorgan, but they wouldn't get involved with this transaction unless the Fed came forward. That's still $29 billion.

So what is the response to where the risks lie, here, for the taxpayers as a whole?

BERNANKE: Well, Senator, first of all, Bear's overall condition, or its leverage, is irrelevant here. Because we're only looking at a set of assets. These were assets, as President Geithner mentioned, that we negotiated to get.

They are not, in any way, the residual or the worst assets or anything like that. They're representative assets.

MENENDEZ: Are they worth $29 billion?

BERNANKE: They are -- we have several sources of information. We have Bear's own marks. But in
addition to that, we have the evaluation of our own experts.

As President Geithner mentioned, we do value assets for the purpose of lending at the discount window. And we have the advice of a well-respected independent advisory firm that takes the view that if we sell these assets over time -- and we have allowed ourselves up to 10 years, although we can sell them any time we like -- and therefore avoid the need to sell into a distressed market, that we will recover the full amount and that, in addition, if we're fortunate, we may turn a profit beyond that.

BERNANKE: But I think we have a very good chance of recovering the full amount.

MENENDEZ: If that is true, why did JPMorgan say they would never have gotten involved in this but for your guarantee?

BERNANKE: Well, again, it was an issue of how much they could swallow, how much total risk they could take on, how much capital they have, and just the shortness of time from their perspective...

MENENDEZ: You are telling the committee that, as far as you are concerned, the American taxpayer has not liability here.

BERNANKE: I'm not saying that. There is...

MENENDEZ: Oh, well, what is -- I am trying to quantify the liability. Give the committee a sense of what the liability is for the American taxpayer in this regard.

BERNANKE: I don't know the exact number. I think the new...

MENENDEZ: And that's my concern.

BERNANKE: Well, again, our adviser suggests that we have collateral that is worth as much or more as our loan.

And I would like -- Senator, I would just simply like to point out that this cost, if it turns out to be a cost, which is by no means obvious, must be weighed against the effects on the American economy and the American financial system of allowing this firm to collapse and all the consequences that would have had for the markets and for the economy.

MENENDEZ: Well, listen, I realize that. I said that in my opening statement. I also realize that a year ago when I said we were going to have a foreclosure -- a tsunami of foreclosures, you all downplayed it. And we haven't even seen the crest of that tsunami. And I believe that that consequence to the economy is equally consequential.

As a matter of fact, if, in fact, these securities are mortgage-backed residential and commercial securities, I'm not so sure of the value.

What does highly rated -- you've mentioned several times "highly rated securities." MENENDEZ: What does highly rated mean in a time where so many highly rated securities have absolutely plummeted?

BERNANKE: Senator, all I can say is that we're not basing our evaluations on face values, we're basing them on market values from several different sources. I can't give any firmer guarantees than that.

I don't know, President Geithner, if you want to add to this, but we believe, based on independent professional advice and our own evaluation, that we have an excellent chance of recovering the full amounts, as well as interest.

MENENDEZ: Well, I have to be honest with you, haven't you gone beyond a -- it seems to me, as I understand the process that you've set up, the Fed -- what the Fed is getting in exchange is a question. (inaudible) a bit surprising because the deal is far from a standard loan. The money goes to JPMorgan, the firm isn't the borrower, the Fed can't demand repayment from JPMorgan if the Bear assets turn out to be worth less than what has been promised.

And what's odd is that if there is any money left over -- which, hopefully, it will be, but I'm not so sure, I am really concerned that it is not -- the Fed gets to keep the residual value for itself. That seems to be more of an investment than a collateral loan. You've really stretched the limits of what this is all about.

And, Chairman Cox, you know, what are you all doing at the SEC? It seems to me that we always say, "Oh,
we've learned all these things." We can never have the foresight to look ahead and say, "You know, we need to change the regulatory system to ensure that in the dynamics of all of these new instruments that are being used that we have the appropriate regulation and we are looking for the right standards to ensure that this doesn't happen"?

How does, you know, when a JPMorgan analyst says that in fact it's now indisputable that rumor and innuendo can bring down a firm and quickly, you know, that's troubling, particularly at a time when shorting of stocks as a core investment style becomes so widespread.

What are we doing, what are we doing to ensure that that just can't happen? And to put the taxpayers at the risk -- at the risk -- because I haven't heard anything here that gives me a sense that we are whole by any stretch of the imagination.

COX: Senator, the fact that unsecured funding might not be available in terms of stress is baked into all the regulatory models that are used for both commercial banks and investment banks in this country and around the world. The idea that secured funding, even for good collateral, would be unavailable and in such breathtaking fashion as occurred in this case was indeed a revelation. And everyone has inferred that lesson since the time.

As a result, not waiting for new legislation or even new regulation, the SEC, the Fed are in all five of these firms, working with those firms to make sure that they do things such as, first, increase their liquidity pools; second, lengthen the term of their financing; third, redouble their focus on their own risk practices and models.

And beyond that, the act that the Fed has taken in opening the discount window to all of the firms has dramatically changed the risk landscape.

So much has changed since this happened. But you are absolutely right that we are living in very different times.

MENENDEZ: Mr. Chairman, I won't (inaudible). I just want to make one last point.

There are all series of new financial instruments which we have not kept up with in a regulatory context. I urge those of you who have not to read the book "Trillion Dollar Meltdown." Think it does a very good job of describing what we are facing and what we are headed toward.

And I have to be honest with you, I'm looking for our regulators to be protectors, not following the aftermath, the cleanup brigade. And I don't think that what we've had here -- what we have here is a cleanup brigade, not a protector of the very institutions that we need to have protected for the well being of all Americans.

Thank you, Mr. Chairman.

DODD: I thank the senator. And let me, I don't know if you were here in the room of not, Senator, when I mentioned earlier that the issue right now, in fact, is there some additional authority that the regulators need that they don't have since we've now expanded the opportunity to investment banks and broker-deals at a discount window here, where capital requirements and other regulatory sanctions at least exist on the member banks here. Should we be doing something?

The chairmen (inaudible) let me know whether or not we need to be giving them some authority in this window. Granted, it's a limited period of time, but nonetheless that's an important consideration so we don't look aback and say why didn't we do something in the middle of all of this.

And they're very legitimate questions that you and Senator Tester raise as well as to I look back on some of these other arrangements, whether you're looking back on the situation at Chrysler or others, there was, you know, to what extent was there some assets that were coming back to cover the very exposure that potentially we have. So a very good set of questions.

Let me turn to Senator Corker.

CORKER: Mr. Chairman, thank you. I think this has been an outstanding hearing.

And to all of you for your patience. I know I'm one of the few things that separates you from leaving the building and having lunch and doing something maybe more productive.

And I want to generally say that there's going to be all kind of postmortems I know on this deal and that you all had to make decisions in a vortex of a short amount of time and a lot happening and a lot at stake. And
I'm sure there are even decisions that you can think back upon that you might have made a little bit differently.

But, generally speaking, I think that you've acted in the best interest of the financial markets and our country, and I want to thank you for that. I think it's been a good thing.

And I would actually say that, I know a lot of people are asking, you know, what too big to fail is. My guess is any of the institutions today because of where we are liquidity-wise, that are so intertwined, would have been dealt with in this manner -- any of them.

CORKER: And, anyway, again, I think it was probably prudent.

I did -- I have read the testimony of the witnesses coming after you. And I know that Alan Schwartz, who I know has not had a good life over the last several weeks, nor have his stockholders, talked a great deal about the rumors and how, in essence, I mean, it was just laced.

I mean, in essence, if you read his testimony, it was almost solely occurred because of rumors and the ability of those rumors to move quickly with telecommunications, the way they do today.

On the other hand, President Geithner, you were asked the question about, you know, would you have -- would it have made sense to open up the Fed window. And I think I heard you say that you did not think that was prudent, that you would have -- if I heard you correctly -- open the window to other comparatively well-managed firms, but you would not have done so to Bear Stearns, which gives me an indication that it was more than rumors, that you actually felt like the firm was not well managed.

And I just would like for you to square that up, if you will, with Mr. Schwartz's testimony.

GEITHNER: It's a very difficult question. And, again, I can't -- I don't think anybody could say with confidence what would have happened if we'd done this -- what would have been possible.

But, just to go back to what I said to Senator Dodd on this, it's not clear to me, far from clear to me, that the facilities we designed carefully to try to mitigate these market pressures would themselves have been powerful enough, sufficient, to insulate Bear from the position they found themselves in at that time.

I don't think I can say it any differently. It's just not clear to me, very hard to know. I may be wrong, but it seems to me that the combination of the unique pressures on markets and the specific position Bear was in makes it hard to reach the judgment that would have delivered a different outcome.

CORKER: I would just make the observation, based on the testimony today and other written statements recently that it appears to me there's a tremendous difference -- I know one of the other senators talked about the relationship between capital and liquidity. There's a relationship, no question, but there is a vast, vast difference. And I do wonder whether any of the firms, any of the major firms that we all know today, any of them could survive, period, with a run on their particular facility. And I'd love to have -- it seems to me that none of them could, with the liquidity change that Secretary Cox referred to earlier with the run, that we have no firms in our country today that could stand the run on their particular institution.

GEITHNER: I think you're right that financial systems rely on confidence. Confidence can go quickly. Without liquidity, no leveraged financial institutions can survive.

And the system as a whole depends on the ability of institutions, individually, to convince their creditors and people who fund them that they should continue funding them.

And every system relies on that. What's unique about our system is that we put in place, almost a century ago, a set of protections to reduce the risk to the economy that comes from runs on banks.

But the system's changed a lot since then. And those protections do not extend to a set of institutions who are also vulnerable to liquidity pressures, who also play a very important role in the economy.

And we've been trying to adapt our system to compensate for that change. But we're going to have to think through very carefully a set of other changes, in the future, to get ourselves a better balance.

But you're absolutely right that every system depends on confidence. And no leveraged financial institution can withstand the abrupt cliff of unwillingness for people to fund it.

CORKER: It just seems to me that, in the future, as we look at what might happen over the next couple of years -- and I know that's not the focus of our meeting -- that, really, liquidity should be our focus, and not
Capital. I know, is important. But at a time like this, liquidity is certainly much more that way.

And I know one of the things you recommended was shock absorbers. And I think that, in essence, is, maybe, what you're referring to. But I look forward to expanding that discussion, a little bit, later. I know I only have seven minutes here.

Secretary Steel, I know that Secretary Paulson and you both were involved in the negotiations in, it seems to me, a fairly big way. I'm not criticizing that in any way.

And I'm sure that Secretary Paulson was focusing, with the Fed chairman, on the fact that the price needed to be low because of the moral hazard issue, that if there were, in fact, going to be transaction, the share price needed to be very, very low. CORKER: I guess if I'm a Bear Stearns person, or a former Bear Stearns -- I guess a present Bear Stearns stockholder, where are we as a country, as a federal government, as it relates to shareholder suits and those kinds of things?

What kind of -- I know you all thought about that as you were moving through the process, but where does that put the federal government as it relates to shareholder suits?

(UNKNOWN): Well, I'm not an expert in this area, and maybe someone else here will be, but I'll do my best.

I think that this was a transaction that was agreed upon between JPMorgan Chase and Bear Stearns. On behalf of the government, the Federal Reserve Bank of New York was at the table because of...

CORKER: Let me just add something to that.

The fact is, that my sense is Chairman Bernanke wanted buy-in by Treasury. In other words, they didn't want to do a $29 billion guarantee without the Treasury saying good things about what they had done. I'm sure there was -- and I mean that in a positive way, you guys. I think that's healthy that you all were talking with each other.

The fact that Secretary Paulson was saying low price, I'm sure affected the whole transaction. It's kind of like, look, there needs to be a low price or maybe we won't say good things about what happens. And so, my guess -- I'm just putting it in that context.

It seemed to me that that does affect, if you will, the terms of the transaction. I'm just wondering, again, if you could, in that context talk to me.

(UNKNOWN): I'll try.

And I'd invite Secretary Bernanke -- excuse me, Chairman Bernanke to speak.

I think that Secretary Paulson and others at Treasury were active participants. I think that this twin responsibility of wanting to be sensitive to the state of the markets and what the situation could cause balanced with also wanting to not encourage a sense of moral hazard. And consistent with that is a price that seems to be appropriate. And I guess the answer to that is low. And I'm sure that the secretary provided that perspective to Chairman Bernanke and President Geithner.

I just would add, though, sir, that throughout this process that I can report to all of you that there was good collaboration. And I view that as a good thing, that people were helping each other, trying to think about various issues.

And the 96 hours was fairly fraught. And the secretary was in constant communication and trying to be helpful to Chairman Bernanke and President Geithner as they came to this -- worked through this -- and offered his perspective.

CORKER: Let me just -- I'll ask one last question. It seems to me that the amount of taxpayer liability that the Fed was willing to put up actually determines the value of the stock.

In other words, if you had been willing to guarantee $100 billion, the stock price might have been $20 or whatever, maybe $30, who knows.

So I know this is going to be a debate that ensues over the next couple of years, a debate as to whether the Fed, acting alone, can risk taxpayer dollars on its own, or whether the Fed needs to seek the approval of
other people in political positions.

CORKER: And by the way, I don't have a position. I'm looking forward to learning. But I wonder if you might comment on that.

I know this transaction had to happen in a hurry. And it seems to me there was healthy collaboration between all departments when this occurred.

But should, in fact, the Fed need the approval of the Treasury secretary or somebody else in a, quote, "political position," that is looking in a different way at taxpayer funds, when something like this is done?

STEEL: Well, Senator, first of all, there was excellent collaboration. And we very much valued not only the Treasury's support as a department but the market knowledge and insight of Secretary Paulson and Undersecretary Steel. So that was a very useful collaboration, much of it taking place at the wee hours of the morning.

In terms of legal authorities, you should recognize that we loan money against collateral all the time. We don't do it, usually, in quite these unusual circumstances, but we do have the authority to do it.

But, certainly, given the unusual circumstances, it was helpful for us to have -- to consult with the Treasury and to make sure that they were comfortable with what we were doing. And it was very helpful that they were.

You also raise a good point, which is that, as I said earlier, my main concern was that this deal happened, so that there not be the implications to the market of a Bear default.

And I didn't personally have a strong view on the share price. But it is true that, to the extent that the Fed was facilitating the transaction, it would certainly have been -- you would have questioned it, I think, even more, if the price had been very high. You would have asked the question, why didn't the government, you know, strike a better deal?

So that certainly, you know, is a relevant consideration. And indeed, when JPMorgan raised its offer for Bear, based on a number of considerations, over the next week, the government renegotiated and improved our situation as well.

So those two things were linked, in that respect, certainly. CORKER: I know my time is up. I'd love to ask some more questions, but thank you, Mr. Chairman.

DODD: Well, you're going to be able to submit them, if you want. I realize we have such a heavy participation by members that a second round probably is not going to be possible, but we can submit questions. And I'd urge you to do so. They're good questions.

CORKER: Thank you.

DODD: Senator Bayh?

BAYH: Thank you, Mr. Chairman.

And thank you to our panelists. I'm grateful for your dealing with these very complex, very significant challenges that arose in these circumstances.

And I think a fair amount of modesty is in order for those of us who weren't there in the room, trying to deal with this.

And yet, I think you understand we need to try, for the purposes of going forward, to prevent situations like this from reoccurring, as best we can.

Chairman Bernanke, I'd like to begin with you.

How much, as we gathered today, has been lent through the discount window to investment banks?

BERNANKE: Well, the amount differs, day by day. I think -- President Geithner, correct me if I'm wrong -- I think a recent number was on the order of $35 billion to $40 billion.

BAYH: How long do you anticipate this continuing?
BERNANKE: Well, we're going to keep the primary dealer credit facility open so long as conditions remain stressed and these liquidity issues that we've been talking about are still prevalent, we want to make sure that conditions have improved so we're not going to be precipitate in closing that window.

BERNANKE: But our legal authorities requires, you know, exigent circumstances, and so at some point we would have to close it.

BAYH: I thought Mr. Geithner went through a list of several advisory or supervisory activities that you've been trying to counsel people about how to improve their condition.

Is there a requirement on behalf of these investment banks that have used the discount window that they listen to Mr. Geithner and follow up on his recommendations or can they just disregard him at their pleasure?

BERNANKE: Well, first of all, we're cooperating very closely with the primary supervisor, the SEC, and the firms are also providing excellent cooperation, both in information and in conduct.

We have a very strong tool: We don't have to lend to them. We can deny anyone who wants to come to the window if we don't feel that they're safe and sound, and don't present adequate collateral. So...

BAYH: I'm interested, just as a shadow banking system seems to have arisen, perhaps we have the seeds of a shadow supervisory and regulatory structure in nascent form here.

But in any event, I'm glad to know that they're aware of your ability to lend or not lend, and perhaps that does lead to them taking suggestions to heart when we do that.

Mr. Geithner, to you -- thank you, Mr. Chairman -- to you secondly, I think the chairman was right. And as many, including my colleagues Senator Corker pointed out, we did not bail out, at least in substantial regard, the shareholders of Bear Stearns, but we did ride to the rescue of the credit holders. I think that's fair to say. And the counterparties certainly were rescued in this situation.

Do you have any plans to identify who these counterparties were, what kind of risks they had run, so that we can evaluate whether they had engaged in reasonable behavior or not, since we have provided a substantial service to them?

GEITHNER: Well, I guess I would just step back and begin by saying that you can't protect the system against the risks of this type of systemic crisis without...

BAYH: Well, the reason I ask, Mr. Geithner, I suppose the failure of Bear Stearns, while tragic in and of itself, did not really pose a systemic risk, it was the counterparties, it was the ripple effect from that, correct?

GEITHNER: Yes, I would say they're inseparable.

BAYH: And somebody mentioned 1,000 counterparties or thereabouts, I guess. In order to keep this from reoccurring and to really understand what was going on here, we need to understand what was the magnitude of the counterparty risk.

GEITHNER: Well, I agree. I think that the -- I would say anybody in this world today is spending a huge amount of time trying to figure out what their exposure is directly and indirectly, not just the first round, but the second round, third round, fourth round effects of this kind of thing. Very hard to do that.

But in some sense what you're seeing in markets -- the reason markets are so fragile now is party the symptom of people preparing for and buying more insurance against those very difficult to measure effects as these things ripple through the system.

But one, I would say, I would put on the top of the agenda for how you think about risk management improvements and reform, just the point you made, which is how to make sure people can do a better job of figuring out what that exposure is in extreme events better ahead of the boom.

BAYH: If I could get your reaction to a couple of suggestions that have been made for our consideration going forward. Some of these special purpose off-balance-sheet vehicles are pretty exotic. Obviously, they had a tremendous impact here. And yet there are no minimum capital requirements and the holders of these were not really required to report their results. Do you think there should be minimum capital requirements in the off-balance-sheet world? Should the results be required to be reported?
GEITHNER: Bob, I can't -- Secretary Steel, I can't remember which part of the President's Working Group report addresses this question, but there is a lot of issues around accounting treatment, the disclosure, the capital treatment, and how liquidity puts our regulator in that context, which a lot of people thought (inaudible) are going to be working through.

I agree with you it's an important question, got to get it right. I don't think we've got it right at the moment.

STEEL: And it'll be a combination of market discipline, which transparency will make clear. Sometimes people didn't recognize what was going on. So the combination of transparency with better risk management from financial institutions.

BAYH: Really got to look at the accounting standards with regard to some of this off-balance-sheet stuff...

STEEL: Yes, sir.

BAYH: ... and the appropriateness of capital requirements and margin requirements and all that kind of thing. I just have -- I got a whole minute left, how about that? -- two more quick questions.

BAYH: Chairman Bernanke, to you, and back to your point again, we did not -- the equity holders in Bear took a huge hit here. The holders of the bonds -- I don't follow the value of their credit instruments, but I suppose they have performed much better.

Is that a fair guess on my part? Following the government's intervention here.

BERNANKE: That's correct, but you had, you know, many short-term lenders, including...

BAYH: Well, here's my question: It's going forward, the lesson -- and, perhaps, Secretary Steel, this gets to you a little bit, is that the lenders of equity need to be more prudent in the risks they take.

What lesson are we sending to the providers of credit and the kind of risk that they take? And might this not skew the market toward greater risk taking in the credit arena than the equity arena? And what are the consequences of that?

BERNANKE (?): You raise an excellent question, Senator. It's hardly the case, though, that the debt spreads for other companies have shrunken to zero, you know, lenders believe now that they're completely safe.

I mean, there's still quite a bit of concern about counterparty and credit risk. So it's hardly the case that we have persuaded the market that debt instruments are entirely safe.

But you're absolutely right. There is a bit of asymmetry there.

BAYH: My final question, Mr. Chairman, and it's been touched upon by a number of others, and I'd just throw out for any of you: Obviously, the public is following this. And there are a variety of perspectives.

People who have made prudent decisions -- I'm talking about homeowners here -- who have made prudent decisions, who are paying their mortgages, you know, they wonder, well, those who didn't make prudent decisions, they're receiving some assistance. What about me?

And yet, at the same time, if we allow some of those to go down, it does have an impact on them.

And you had to make a decision here about the systemic risk with a large Wall Street bank, and we're providing up to $29 million (sic) in credit. We've made a -- going back to the '30s, opening up the discount window, again, to try and at the top level provide systemic risk.

When constituents of mine ask me about all this, what would you say to them and the appearance of, well, when it comes to large Wall Street institutions, we ride to the rescue and yet for the little guy -- and I think Senator Schumer mentioned this -- in the aggregate, which could be just as important, that was the genesis of all this, there's a greater degree of indifference with regard to them.

What would you say to people who raise that concern?

BERNANKE (?): Well, I think the key point to make -- and I realize it's not an easy sell sometimes, but the truth is that the benefits of our actions were not Bear Stearns and were not even principally Wall Street.

It was Main Street. It was the fact that the financial system has been under a lot of stress and that has
affected our ability to grow. It's affected employment. It's affected credit availability.

And I think people are sophisticated enough to understand that if a financial system crashes or at least is severely hobbled, that the economy can't grow in a healthy way either. And that's why we did what we did.

On the other hand, it's also important to address the problem you're referring to, which is a housing issue. I would say that the Fed is trying to help on that dimension as well. By cutting interest rates, for example, we have reduced the pressure of resets, for example. And by improving liquidity in the market, we have reduced -- we've helped to reduce mortgage rates. So we are doing our part in that respect.

We're also working with communities on the local level, through our Reserve banks.

So we're trying to address both issues. But our ultimate concern is the health of the American economy and of the average person. As I said before, I think one of the key issues here is housing, though.

BERNANKE (?): And I commend the Congress for focusing on that issue, which I believe is crucial, both to the financial situation and to the economic situation.

BAYH: My time has expired. And I don't expect any of you to comment further, unless you want to. But I would just conclude, Mr. Chairman, by saying the reason for my -- and I appreciated your answer very much, Chairman Bernanke -- the reason for my question is it seems to me that, in trying to strike the balance between systemic and moral hazard, in the moment, you made the right decision.

And yet I have been somewhat disappointed, Mr. Chairman. You and Senator Shelby have done a great job. But some of the things that would go to the, sort of, little guy, for lack of a better term, are still out there to be addressed.

And I think it's important we send a message to them that we're going to take their concerns to heart, as well as those that present systemic risk from the top, those that present, in the aggregate, systemic risk at the bottom also need to be addressed in a real way, so that the reality and perception of fairness in our system is maintained for all the participants.

DODD: Well, it couldn't have been said better. And, obviously, the point of today, in fact, is to contribute to that, that sense of confidence that people need to feel.

And the perception is -- and I appreciate the answer of the chairman as well -- the perception is that -- and I think all of us are aware of this -- I hope you are, anyway -- that it seems to be lacking balance, that we're not addressing, as directly as we could, the problem of those individuals who are, at 7,000 or 8,000 a day, running the risk of losing the most important investment in their life.

Most of them will never own a stock or a bond, or anything else, more than likely. They will count on that home, that equity in that home, for their retirement, for health prices, for their kids' education, for all of these things that can happen.

And that's the great asset, the great wealth creator for them. And it's been put at great jeopardy and great risk. And so we need to do a far better job and, I hope, in the coming days, we're going to. You've articulated it very, very well, Senator.

Senator Casey?

CASEY: Mr. Chairman, thank you very, very much.

I may be last. Is that correct?

(LAUGHTER)

I just want the panel to know that -- unless someone else walks in.

(LAUGHTER)

Thank you for your testimony and your presence here.

I want to focus my questions principally, I think, initially, to Chairman Bernanke and to President Geithner, on a couple of areas, one in particular, this question of collateral, the valuation of the collateral.

And I think, for purposes of my questions, we could probably establish a couple of things. First of all, pursuant to a question by Chairman Dodd, I guess we're going to get a report, as part of this record, about
that valuation. Is that correct?

BERNANKE: You'll receive, certainly, a list of the major categories and the valuations.

CASEY: OK. And we can also establish, for the record, that the valuation of the collateral, in this arrangement, was established by Bear Stearns. Is that correct?

BERNANKE: That's correct. But in our accepting it, we had the advice both of our own experts and also the investment advisory firm.

CASEY: And something that Chairman Bernanke, you know, from our Joint Economic Committee hearing from yesterday, I asked you about the question of, if there was a shortfall from the valuation placed upon the collateral, and then what happens to be something less than $30 billion, if that were to occur.

So that differential, that shortfall -- the taxpayers would not be able to go back, then, to JPMorgan to make that up. Is that correct?

BERNANKE: That's correct.

CASEY: And something that Chairman Bernanke, you know, from our Joint Economic Committee hearing from yesterday, I asked you about the question of, if there was a shortfall from the valuation placed upon the collateral, and then what happens to be something less than $30 billion, if that were to occur.

So that differential, that shortfall -- the taxpayers would not be able to go back, then, to JPMorgan to make that up. Is that correct?

BERNANKE: That's correct.

CASEY: So I wanted to ask -- and I turn my attention, I think, to President Geithner and Chairman Bernanke.

Looking at both sets of testimony, you outlined a lot of the detail of what happened here, especially, Mr. Geithner, your fairly exhaustive review of what happened here, day by day, and sometimes hour by hour.

The one thing I thought was missing -- and I want to explore it -- were a couple things. First of all, I didn't get any sense of -- first of all, Black Rock was no mentioned, as far as I could tell by reading it. I'm not saying that they necessarily had to be mentioned. But I think there's a missing piece there, in terms of the role of Black Rock.

You had said that their fee is still being negotiated, the payment terms. But I think what I want to know for -- in the context of what happened here, this was obviously very complicated. The time pressures were excruciating. And I recognize that.

But I want you to fill in some blanks for me and for the committee members in terms of just generically, were there steps taken here -- as it pertains to the particular question of valuation of collateral, concern about taxpayer interest here, all of those basic concerns -- were there steps that you took here because of the exigent circumstances that you would not take if you had more time?

CASEY: But I want you to fill in some blanks for me and for the committee members in terms of just generically, were there steps taken here -- as it pertains to the particular question of valuation of collateral, concern about taxpayer interest here, all of those basic concerns -- were there steps that you took here because of the exigent circumstances that you would not take if you had more time? That's number one.

And, number two, walk us through the process that you undertook or, Chairman Bernanke, you and your team undertook, to do the due diligence to make sure that we were doing everything possible to make sure that the valuation of the collateral that Bear Stearns provided was adequate for you to go forward.

Do you get my sense of what -- in terms of, I'm concerned about the process here, even though you had tremendous time pressures. I just want to walk through that with you.

(UNKNOWN): It's hard to know what would have been possible. But I think it we had had more time, we'd have done exactly the same thing, in the sense that we would have had a mix of our own people looking at the collateral and its value. We would have had -- we'd try to get the best expertise in the world to give us a second opinion on that.

We would have had more time, certainly, to go through the details. But I think the fundamental parameters we established for what we would accept, what we would not accept, and the design of the structure to mitigate the risk of any loss are things that we would have done, I think come to, even if we had a lot more time.

Now, but, as we've been clear, there is risk in this transaction. There's no doubt about it.

But I think we've been very, exceptionally careful to limit that risk. And we try to provide as much details of how we limited that risk, but there is risk in this. But, of course, the judgment we were making is the comparison between that modest risk and the certainty of very substantial losses across the financial -- including to the comparatively prudent.
CASEY: I just want to know more about the role of Black Rock in this. In other words, what do they contribute in this window of time? If you can summarize the due diligence analysis.

(UNKNOWN): You know, again, more eyes are better than one, one pair. So there is value in that. They've got a set of expertise that is really exceptional. And they were able to help us get as much confidence as we could in that period of time that we had some sense of the overall risk we were taking.

So I don't know how else to say it beyond that.

CASEY: But was part of that -- was BlackRock charged with the responsibility of providing -- well, two questions. One, charged with the responsibility of providing a valuation of the collateral? Were they asked to do that? And I realize the time was short, but were they asked to do that?

(UNKNOWN): Well, let me come back.

CASEY: Or were they asked to do something in substitution of that.

(UNKNOWN): No. Let me come back. We reached a decision to finance in a carefully designed structure a portfolio of securities that would be valued at Bear Stearns marks on March 14th.

A lot of uncertainty in how conservative those marks were. Some may have been more conservative than other institutions, some less conservative. Very hard to know. But there was uncertainty around what those things were actually worth.

That uncertainty exists today, of course, because this is a very complicated markets. It's very unclear, over time, what the value of those things are likely to be.

What BlackRock did is help us make some judgments -- I think good judgments -- about what we should take and what level of risk was that going to be leaving us with.

CASEY: But that didn't include a valuation?

(UNKNOWN): Well, of course, part of what they're going to be doing in sort of thinking about how to manage this portfolio with us will be a bunch of judgments about valuation.

And, as I said in my written testimony, we will disclose quarterly our fair value estimate of this portfolio through the life of this transaction that's outstanding. So that will give people a reasonable picture, a reasonable frequency, about what's happening in terms of best estimate of value over time.

CASEY: Chairman Bernanke, do you want to add anything to that?

BERNANKE: No. I think, given the remarkable time pressure, that President Geithner and his team did a good job of getting a good estimate of the -- and a good level of confidence in the quality of the assets.

Which, again, we had a great deal to do in choosing. They weren't some residual.

CASEY: In terms of the question overall of due diligence, not just as it pertains to valuation of the collateral, but just generally, when you're facing this kind of decision, you're making determinations rather quickly, what is the process you undertake on due diligence?

In other words, I know you said in your testimony that you dispatched a team of examiners to Bear Stearns. You spoke to due diligence later in the testimony. You go on to talk about the lending against the collateral and the authority for that.

But describe for us in summary what that means in terms of...

GEITHNER: I think the...

(CROSSTALK)

CASEY: I mean, is there a check list of due diligence that you undertake?

GEITHNER: I would say, as much as we can, as carefully as we can in the time allotted, with the best
resources available.

But we had not faced, and hope do not face again, quite this level of challenge in terms of complexity in reaching those judgments.

But I’d be happy to walk you or your staff through in more detail all the things we did.

CASEY: If you could provide that for the record we’d appreciate that.

I think the last question. On the question of interest payments, Mr. Geithner, is it correct that your new partner in this received an agreement that they would receive interest payments at a rate of 4 percent -- 4.5 percent greater than what the Fed would receive?

GEITHNER: That's correct. CASEY: And when it comes to the question of arriving at an interest payment, how did you arrive at that determination?

GEITHNER: That's an interest they're taking on a subordinated note, which has a lot of risk in it. Remember, they're going to absorb the first losses, the first billion of any losses on this.

That interest rate, if you look at similar structures in the market, is way, way below what would normally have accompanied that type of position.

But, like anything, it was a negotiation.

CASEY: But that interest rate is higher than what...

GEITHNER: That's right. Higher.

CASEY: Higher than what taxpayer will get.

GEITHNER: But that makes sense given the nature of the risk. And it really should be judged relative to the risk and the funding -- different funding situation of us and them in that context.

And I think in light of that, it's an economically very sensible arrangement for the taxpayer.

CASEY: When you make that determination are you evaluating risk in the transaction itself plus greater risk to the credit markets in the economy or how do you...

GEITHNER: No, I think -- well, of course, overall in reaching these judgments we were trying to find a balance between what was best for the system and what was possible. But in this case it was just, I think, again, the relative economics of the different risk in the structure we designed support a different interest rate, although if this had been done in a different context, if you look at a similar structure in the market, that interest rate, which, as you said correctly, is 450 basis points (inaudible) would have been multiples of multiples higher.

QUESTION: Thank you, Mr. Chairman.

DODD: Thank you very much, Senator Casey.

BERNANKE: Could I...

DODD: Yes, sure.

BERNANKE: I just want to add one point on the interest payments, which is that we, the taxpayers, the Federal Reserve, get paid all our principal and all our interest before JPMorgan gets a penny.

So they don't get paid interest until we are fully made whole.

CASEY: Thank you.

DODD: Thank you, Mr. Chairman.

Let me -- because I made the request and Senator Casey raised it again earlier, and that is the requirement or the request by the committee here to have a, if we can, Chairman Bernanke, the mark-to- mark value at
the close of business yesterday of these assets. The committee would like to -- whether that should be addressed to you, Mr. President or you, Mr. Chairman, but to whomever it would be addressed, it would be helpful to the committee I think to get that.

GEITHNER (?): I apologize, Senator. I was just talking to my chief of staff.

DODD: Well, there was a request I made earlier about the valuation...

GEITHNER (?): About the valuations. Well, we laid out in my written testimony a description of the collateral in broad terms.

DODD: No, I just -- I want to know the value of it.

GEITHNER (?): No, I understand that. And we will -- we'd like to work out some arrangement with your staff so they could come and confidentially review the portfolio. And in that context, as I said, we'll go forward. We'll provide a quarterly valuation on fair value. A quarterly estimate of the fair value over time.

DODD: Well, again, this is a very important point, obviously, considering the potential exposure.

GEITHNER (?): Precisely.

DODD: It's important to this committee that we be able to have access to that is going to be very, very important.

GEITHNER (?): I understand that.

DODD: Let me just take a couple of quick points, if I may, and try to raise them. One -- and it's been raised by some already. And I'll make this quick, if I can.

But I was struck -- I went back and looked at the volume of transactions. I guess, Chairman Cox, I'd like to address this to you, if I can.

I was looking at the volume of transactions. It looks like historic volume -- I'm looking at the amount of transactions that occur, daily, weekly.

On a daily basis, the numbers run at Bear Stearns, running up to this week, 3 million, 5 million, 6 million, 8 million, 7 million, 2 million shares -- roughly those numbers.

DODD: You get into the week of March 10th through the 14th and the volume jumps to 32 million, 54 million, 26 million. On Friday, March 14th, 186 million, a substantial jump in volume.

I'm also intrigued about the 30-day puts -- the $30 puts, excuse me -- over 10 days. There seems to have been a rather significant -- in fact, someone ran the math on it for me, and if you made a $600 investment on Thursday in Bear Stearns, on Monday that was worth about $37,000. Not a bad deal to make.

To what extent is the Fed looking at this? Excuse me, not the Fed, the SEC. And I understand you answered the question earlier you can't comment on investigations.

Let me put it this way to you I guess, Chairman. I mean, I would hope that you're looking at this, and to the extent this kind of spike that occurs here it would seem to me must have triggered some sort of bells and whistles at the SEC here. This goes beyond rumors. There's no violation in law about rumors. There is about collusion. And when I look at a 10-day on 30-day puts, I wonder what's going on here. And when I see this spike, it at least raises bells and whistles in my mind what's going on.

I guess I can ask you this. Did your agency react to this at all? Was there a reaction going on that week to these activities?

COX: Yes, Mr. Chairman, your hopes will be, I think, met and exceeded with respect to the agency's response to these concerns.

There's been some discussion here today about the concept of "too big to fail."

COX: The rumors surrounding the activity you described are too big to miss. And our enforcement division is very active, for a number of reasons, including the fact that a well-policing market is essential to market confidence.
This is all about market confidence.

DODD: Well, I appreciate that.

Let me, if I can jump to one other issue. Again, this has been an issue Senator Menendez, Senator Tester, many people have raised the issue.

Let me frame, if I can this issue. And, again, I want to state what I did at the outset here. I agree with those who've said, look, this is -- we're going back and reviewing this more for future benefit, I sense, at least I am. I obviously want to know what happened.

But there are some precedents we may be setting here that I want to make sure we don't necessarily duplicate or, if we are, to understand why we're going to do it in the context of sound policy and prudent judgment.

And it goes to this -- let me -- if I'm incorrect at all in framing this, in terms of the transaction, you correct me.

I want to focus on the $30 billion worth of assets involved here. As I understand it, Bear Stearns will sell $30 billion worth of its assets to this new LLC, which is funded by a $29 billion loan from the Federal Reserve Bank of New York and a $1 billion loan from JPMorgan Chase.

Bear then receives $30 billion in cash from this LLC. The deal is contingent and contemporaneous with the merger so that the $30 billion in cash then goes to JPMorgan Chase. In effect, JPMorgan Chase will lend $1 billion to buy assets and then get $1 billion back immediately, once it buys Bear Stearns, which now has the $30 billion in cash on its balance sheet.

Is that a correct characterization? Is that what this is? Does that describe it?

GEITHNER (?): JPMorgan is certainly taking a billion dollars of risk on this position. They're not somehow avoiding that risk.

DODD: But then when they acquire Bear Stearns, they get the money back -- get the cash.

GEITHNER (?): Right, but they have the billion dollar note financing the LLC, which they won't get repaid if they -- if the...

DODD: OK. I understand. Let me ask you a couple of questions.

One is, was this -- you mentioned earlier that there were a number of other people who expressed an interest in being involved, that you reached out to a number of other people. Were they aware -- were all the other potential purchasers aware of this particular offer?

DODD: Let me just clarify one thing. Bear reached out to a number of different people. And you talked to -- you encouraged it. You encouraged them to reach out to as many as possible?

(UNKNOWN): Right.

But I think it was pretty clear to me, at least, I think, that, at the time where we contemplating what -- whether there were things we could do to facilitate this, there was no other institution that was going to be in a position to make a binding commitment to acquire them and, critically, guarantee their obligations.

Now, if -- again, it's very hard to know what would have been possible. If, at that moment, there were more than one institution in that position, would we have done the same thing?

Of course, we would have had to have been prepared to do that. And it would have been in our interest, in some sense, because then we could have had a bit more of a sense of what the feasible set (ph) was.

But we made the judgment, which I think is right, which is that -- and I think it was clearly true, late Friday night, that that was necessary, that we had to maximize the chance something was in place before the Asian markets opened, because of the chain of events set in place by the events of late Friday.

DODD: Which was Sunday night?
(UNKNOWN): Yes, that's right, Sunday night. I apologize. Yes.

But, of course, if we'd been in a situation where there were a range of institutions, at that point, who were really committed to doing this and had the ability to do it and could have stood behind, would we have made a similar arrangement with them?

Of course we would have considered that. And it would have been in our interests, if we'd gotten to that. That would have been better for us.

DODD: Right. And again -- I appreciate that, but it's an important point. I also -- and this goes to the issue -- and, again, listen, again, the time constraints in dealing with all of this, I think those are very valid points you're made here.

But, in terms of any precedent-setting nature of this, what it looks like, to many of us up here -- and we're also, listen, hoping and relying that these assets are going to turn out to be worth more, in fact, than the numbers we're talking about.

DODD: We hope that's the case. But, again, the issues that Senator Menendez raised and others raise obvious questions about it.

What it looks like, if I had to try and frame this to people, is that we've socialized risk and we've privatized reward. We're on the hook -- hopefully it doesn't happen -- but we're on the hook.

Why didn't we try to take some of those assets and at least cover to some degree the potential, merely the potential of the liability to the American taxpayer, as we have done in other examples, totally different in many ways than what we're talking about here. But in the past warrants, for instance, were a part of those -- that risk, that we could bring back, at least potentially covering the potential or possible losses to the American taxpayer.

GEITHNER: I think, Senator, we've actually designed it with that in mind and with that objective in reach, in the sense that if these assets were managed over time where -- and it's perfectly possible they will be -- that there's a positive return to them, then that return is captured for the American taxpayer.

DODD: Well, I understand that, again, but -- all right, you've heard -- made my point on this, and I've kept you here a long time.

Let me turn to Senator Shelby any quick...

SHELBY: I'll try to be quick. Just a few observations.

Everybody here knows banking is managing risk or trying to manage risk. We have extraordinary stress, it seems, in the marketplace today, financial markets, a lack of confidence in the market, a lot of exotic products that probably a lot of us certainly don't understand. And I hope you do as regulators, but I'm not sure.

Liquidity, a lack of -- a lot of capital, lack of liquidity.

Too much leverage. But we know banking is leverage, you know, to some extent, and managing risk.

I fear -- and I've feared this for a long time, when I was chairman of the committee -- that the market might be running ahead of the regulators with products and so forth. And if you continue as regulators, whether you're the Fed chairman, the SEC chairman, at Treasury or the New York Fed, which is a very important part of the Fed system, to continue to react to situations after they've happened, where are we going to be? And my last observation would be, is this an unusual era we're going into now or is this an intervention by the Fed and Treasury and others, is this a one-time deal?

I don't believe you know the answer to that. We certainly don't know the answer to that. We hope. But we had better, I believe, from this point up here on the Banking Committee, and you as regulators, had better be concerned.

And I hope -- and Senator Dodd and I have been on this committee a long time together, more than anybody, more on this side or that -- but we've seen stress.

SHELBY: We've been through the thrift bailout. I hope -- this $29 billion is not peanuts. It's not a few dollars. It's a lot of money. And I hope that the Fed manages that risk. And I hope that they get this money back, you know, by managing it.
But if -- but we've got some investment banks that you all know here and some commercial banks that are dying for capital and probably liquidity. So I hope this is one heck of a wake-up call to you as regulators.

Thank you, Mr. Chairman.

DODD: Thank you very much.

By the way, I mentioned earlier, in fact there are a lot of people in this country owning stock. I should have made that point. My point is that in terms of great value, it's the home that is a substantial value for people.

You've been incredibly patient. And there are probably some additional questions from members in writing. I'll ask them to submit them quickly to them. And if you can respond as quickly, I'd appreciate it very, very much.

This has been very helpful to us. I know it's a lot of time to take, but this transaction has obviously provoked serious questions from all of us and constituents across the country. So we're very grateful to all of you for taking the time in being here. And we thank you very, very much.

Oh, I'm sorry. Senator Corker, do you have something?

CORKER: If I could -- I know everybody wants to leave and I know you have people, but if you could just give us, while we have this panel together, which is a unique group, a sense of what inning we're in -- not as it relates to the economy but just the issue of liquidity itself sort of getting back to norms, if you will.

Chairman Bernanke -- and not everybody has to respond if one is sufficient, but I wonder if you'd just give us a sense of that today.

BERNANKE: Well, a lot of losses have been taken.

BERNANKE: And I think a lot of the adjustment in house prices, for example, has taken place.

But, you know, we have to remain agnostic and continue to see how the economy evolves. We remain ready to respond to whatever situation evolves, and that's, I think, part of the value of having the Federal Reserve and the Treasury have this flexibility to respond to different conditions.

CORKER: But any sense of where we are from the standpoint of liquidity and getting back to norms?

BERNANKE: I think we've seen some improvement recently. But, you know, we have to see if it persists. I can't -- I can't guarantee that it will persist.

CORKER: Thank you, sir.

DODD: Thank you all, very, very much. I appreciate you being here. We'll take just a couple minutes of break, while we bring in our second panel. We express our gratitude to them, as well.

(RECESS)

REED: I'd like to, on behalf of Senator Dodd, welcome the second panel. He has taken a momentary break, and I would recognize on this panel Mr. James Dimon, chairman and chief executive officer of JPMorgan Chase; and Mr. Alan Schwartz, president and chief executive officer of the Bear Stearns Companies Inc.

Gentlemen, thank you.

And, Mr. Dimon, if you're ready, we'd be pleased to accept your testimony. If you could just bring that forward and make sure the microphone is one.

DIMON: Can you hear me now?

REED: Yes, sir.

DIMON: Great. Thank you.

Good afternoon, Chairman Dodd, Senator Reed, Ranking Member Shelby and members of the committee.
My name is Jamie Dimon. I am the chairman and chief executive officer of JPMorgan Chase.

I appreciate the invitation to appear before you today.

Mr. Chairman, your letter inviting me to testify asked me to address a number of issues relating to the JPMorgan-Bear Stearns merger. At the outset, I want to underscore a few key points about the transaction.

First, we got involved in this matter because we were asked to help prevent a Bear Stearns collapse that had the potential to cause serious damage to the financial system and the broader economy.

Second, we could not and would not have assumed the substantial risks of acquiring Bear Stearns without the $30 billion facility provided by the Fed. Though we wanted to help, and I believe we were the only firm ultimately in the position to help, we had to protect the interests of our shareholders.

Third, this transaction is not without risk for JPMorgan. We are acquiring some $360 billion of Bear Stearns' assets and liabilities. The notion that Bear Stearns' riskiest assets have been placed in the $30 billion Fed facility is simply not true. And if there's ever a loss in the assets pledged to the Fed, the first $1 billion of that loss will be borne by JPMorgan alone.

Let me turn now to how we became involved in the effort to rescue Bear Stearns and avoid a financial crisis.

On Thursday evening, March 13th, Bear Stearns called to tell us that it might not have enough cash to meet obligations coming due the next day and that it needed emergency help.

We contacted the New York Fed and learned that they were aware of the situation and that they recognized that if Bear Stearns bankruptcy posed a serious risk to the financial system.

DIMON: Working through the night and into Friday morning, the New York Fed agreed to establish a secured lending facility for the company, using JPMorgan as a conduit.

But it became clear by the end of Friday that a comprehensive solution would be needed before the markets reopened in Asia on Sunday evening.

We had teams of people working around the clock that weekend in an effort to determine what we could do to help.

My perspective, from the start, was that we could not do anything that would jeopardize the health of JPMorgan. That would not be good for our shareholders and it would not be good for the financial system.

But I also felt that, to the extent it was consistent with the best interests of shareholders, we'd do everything we reasonably could to try to prevent the systemic damage that the Bear Stearns failure would cause. We and the whole board -- we, the management team, and the whole board of the company viewed that as an obligation of JPMorgan as a responsible corporate citizen.

By Sunday morning, we had concluded the risks were too great for us to buy the company entirely on our own. We informed the New York Fed, Treasury and the Bear Stearns of our conclusion. This wasn't a negotiating posture; it was the plain truth.

The New York Fed encouraged us to consider what kind of assistance would allow us to do a transaction. That is what we did. Finally, on Sunday evening, the private and government parties announced a plan with three core elements.

First, JPMorgan would acquire Bear Stearns in a binding stock deal worth $2 per share to Bear shareholders. Second, the Fed would provide the merged company with a $30 billion nonrecourse loan, collateralized by a pool of Bear Stearns' assets valued on Bear Stearns' books at the same amount.

Third, JPMorgan would provide an unprecedented guarantee on hundreds of billions of dollars of Bear Stearns' trading obligations. This was done to assure the market that it could continue to do business with Bear and prevent a further run on the bank.

We hoped that the initial plan would save Bear Stearns and reassure the market that Bear Stearns would survive, but we also understood that we had to monitor the situation very closely.

It soon became clear that we had not done enough. Customers and counterparties continued to flee for two reasons: The market perceived our guarantee as too narrow and it doubted that a $2 offer price would be
enough to get Bear Stearns' shareholders to approve the transaction.

Discussions with Bear Stearns and the federal government in the week following the initial merger led to a revised rescue plan with a package of five critical new elements designed to address these real concerns.

First, we strengthened our guarantee to cover virtually all of Bear Stearns' products, customer relationships and subsidiaries. Second, in response to a request from the Fed, we gave it a separate guarantee on its existing loans to Bear Stearns.

Third, we agreed to take the first $1 billion of losses that might ultimately flow from the Fed's $30 billion nonrecourse funding. Fourth, Bear agreed to sell 95 million newly issued shares to us, representing 39.5 percent of its voting stock. And, fifth, to help achieve finality we increased our offer to $10 per share.

The amended plan seems to have worked.

In the week following this announcement, the liquidity situation at Bear stabilized, and that day, Standard & Poor's raised Bear Stearns' credit ratings.

Let me say a word also about the $30 billion of collateral for the Fed. We are subject to a confidentiality agreement with the Fed in relation to those assets, so I'm constrained in what I can say, but I can make a few general points.

The assets taken by the Fed consist entirely of loans that are current and rated investment grade. We kept the riskier and more complex securities in the Bear Stearns' portfolio for our own accounts.

We did not cherry-pick the assets in the collateral pool. The process of designating what collateral would be pledged was overseen by the New York Fed's adviser, Black Rock, a recognized expert in the field.

While no one can predict how the portfolio will ultimately perform and, of course, it could actually increase in value, if the portfolio declines in value, the first $1 billion of that loss will be born solely by JPMorgan.

Finally, let me turn to the committee's interest in the implication of this rescue for American taxpayers.

The key point in my view is this: Bear Stearns would have failed without this effort, and the consequences could have been disastrous.

DIMON: The idea that a Bear Stearns fallout would have been limited to a few Wall Street firms just isn't so.

People all over America, union members, retirees, small-business owners, and our parents and children are now invested in the financial system through pensions, 401(k)s, mutual funds, and the like.

A Bear Stearns bankruptcy could well have touched off a chain reaction of defaults at other major financial institutions. That would have shaken confidence in the credit markets that have already been battered. And it could have made it harder for home buyers to get mortgages, harder for municipalities to get the funds they need to build schools and hospitals, and harder for students who need loans to pay tuition.

Moreover, such a cascade of trouble could have further depressed consumer confidence and consumer spending, resulting in widespread job losses, and accelerate the ultimate downturn.

Mr. Chairman, the events of the past three weeks have been extraordinary. I commend you and your colleagues for examining their implications for the future. One thing I can say with confidence, that, if the public and private parties before you today had not acted in remarkable collaboration to prevent the fall of Bear Stearns, we would all be facing a far more dire set of challenges.

Thank you. And I look forward to answering your questions.

DODD: Thank you very, very much.

Mr. Schwartz, we thank you.

By the way, I was out of the room for 30 seconds before you came in, and I apologize that I was not here personally to welcome both of you. Let me extend that welcome and thank you.

You've been here a long time, already, this morning, but having the benefit of hearing a wonderful, distinguished panel of regulators, here, was certainly -- having spent some time with them -- I should have
said, by the way, and I want to note this, while I didn't speak with either of these two gentlemen over that weakened, Chairman Bernanke and Secretary Paulson called periodically, over that weekend, to sort of, at least keep me posted as to what was generally going on.

And so I was very grateful they'd taken time out, at least, to generally keep me informed. I was not aware of any of the details of this, I must say.

I'll also tell you that I spent 72 hours, at the end of that, leaving, in fact, on Sunday evening, to meet with economic ministers of the European Union in Brussels, on Monday morning, having flown all night, leaving without knowing the outcome and fearful that I was going to have to get on a plane and come right back again in the morning.

But the press has already reported this, but the reception of the conclusion was warmly received. That's not to suggest that we're not understanding of the difficulties, Mr. Schwartz, that you and the Bear Stearns and others and shareholders face, but going to the point, earlier, about whether or not this was a better outcome, the reaction was such.

With that, Mr. Schwartz, thank you.

SCHWARTZ: Thank you, Chairman Dodd, Ranking Member Shelby, Senator Reed. My name is Alan Schwartz. I am the president and chief executive officer of the Bear Stearns Companies.

SCHWARTZ: Bear Stearns and its 14,000 employees provide global investment banking services, securities and derivatives trading, clearance and brokerage services, and asset management services worldwide.

I have been part of and have grown with the Bear Stearns family for over 32 years. I am saddened by the fast-moving events of the past several weeks that bring me here today.

During the week of March 10th, even though the firm was adequately capitalized and had a substantial liquidity cushion, unfounded rumors and attendant speculation began circulating in the market that Bear Stearns was in the midst of a liquidity crisis.

The company assured the public that our balance sheet, liquidity and capital were strong, but the rumors and conjecture persisted.

Due to the stressed condition of the credit market as a whole and the unprecedented speed at which rumors and speculation travel and echo through the modern financial media environment, the rumors and speculation ultimately became a self-fulfilling prophecy.

Because of the rumors and conjecture, customers, counterparties and lenders began exercising caution in their dealings with us, and during the latter part of the week outright refused to do business with Bear Stearns.

Even if these counterparties and institutional investors believed, as we did, that we were stable, it appears that these parties were faced with the dilemma that if the rumors proved to be true, they could be in the difficult position of having to explain to their clients and others why they continued to do business with Bear Stearns.

As the week progressed, unfounded rumors grew into fear, and our liquidity cushion dropped precipitously on Thursday, as customers withdrew cash and repo counterparties increasingly refused to lend against even high-quality collateral.

There was, simply put, a run on the bank.

I want to emphasize that the impetus for the run on Bear Stearns was in the first instance the result of a lack of confidence, not a lack of capital or liquidity. Throughout this period, Bear Stearns had a capital cushion well above what was required to meet regulatory standards. However, by Thursday of that week, a tipping point was reached on liquidity. The market rumors became self-fulfilling and Bear Stearns' liquidity pool began to fall sharply.

At that point, we needed to find a source of emergency financing to stabilize the situation and calm our clients and counterparties. On Thursday, we reached out to JPMorgan, among others, in part because JPMorgan served as our clearing agent and was therefore already familiar with our collateral position.

We also informed the SEC and the Federal Reserve as to what was happening.
We worked through the night, and on Friday morning, March 14th, JPMorgan agreed to make a short-term loan available to Bear Stearns supportive by a back-to-back loan from the New York Federal Reserve Bank.

We believed at the time that the loan and the corresponding backstop from the New York Fed would be available for 28 days. We hoped this period would be sufficient to bring order to the chaos and allow us to secure more permanent funding or an orderly disposition of assets to raise cash, if that became necessary.

However, despite the announcement of the JPMorgan facility, market forces continued to drive an accelerate our precipitous liquidity decline.

Also, that Friday afternoon, all three major rating agencies lowered Bear Stearns' long-term and short-term credit ratings.

SCHWARTZ: Finally, on Friday night, we learned that JPMorgan credit facility would not be available beyond Sunday night.

The choices we faced that Friday night were stark: Find a party willing to acquire Bear Stearns by Sunday night, or face what my advisers were telling me could be a bankruptcy filing on Monday morning, which could likely wipe out our shareholders and cause losses for certain of our creditors and all of our employees.

Therefore we set out to find a potential purchaser to acquire Bear Stearns that had the wherewithal to find the backing we needed, an arrangement we hoped would reassure our constituencies and curtail the flight of our clients and counterparties.

And we needed to find and reach agreement with such a party over the weekend.

On Sunday, March 16, after an intense effort to find the best transaction possible, we reached the first agreement with JPMorgan, which has been much discussed in the press.

JPMorgan would acquire Bear Stearns for $236 million, or $2 a share. Significantly, JPMorgan also agreed immediately to guarantee the trading obligations of Bear Stearns and its subsidiaries.

As part of this deal, as has been noted, JPMorgan obtained an agreement from the New York Fed to loan up to $30 billion to JPMorgan, secured by certain of Bear Stearns assets.

While we at Bear Stearns had some understanding that JPMorgan was seeking this commitment, we were not directly involved in the negotiations between JPMorgan and the government.

The following week, due to market uncertainty about the guarantees and the successful completion of the deal, the agreement between Bears Stearns and JPMorgan was renegotiated.

SCHWARTZ: In the end, JPMorgan agreed to pay $10 a share for Bears Stearns in a stock-for-stock merger. Enhancements were made to JPMorgan's guarantee of our operating and certain other obligations, and a number of other changes were made to give greater certainty of closing.

At the same time, we understand that JPMorgan's agreement with the New York Fed was modified to make the terms more favorable to the New York Fed.

In sum, before unfounded rumors began circulating in an already precarious credit market, leading to the run on Bears Stearns, the company had adequate capital and liquidity and a book value of approximately $12 billion.

Facing the dire choice of bankruptcy or a forced sale under exigent circumstances, we salvaged what we could to avoid wiping out our shareholders, bond holders and 14,000 employees.

Federal officials that you talked to today and JPMorgan are in a better position than I to discuss their rationale and motives for participating in this transaction. I can only say that as devastating these events have been for the Bears Stearns family, the failure of Bears Stearns could have had an even more extensive, devastating impact on the stability of the financial markets as a whole, and it may have triggered a run on other investment banks with potentially disastrous effect on the nation's overall economy.

Like many of us, I am certainly glad such a disaster did not occur.

Thank you for your time. I'm prepared to answer any questions that you might have.
DODD: Well, thank you very, very much. And it was well said. And on behalf of all of us here on this dais, our sympathies go out to your employees. I've just read story after story about longstanding employees having spent careers at Bears Stearns who watched assets go from a Friday to a Monday that literally were devastating for them. And there's no adequate way we can express our sorrow to them what happened. Obviously, shareholders same sort of feelings, but obviously the employees particularly. It's a particularly hard blow.

You know, in fact, you and I chatted some months ago, and you raised with me this whole idea of the discount window. I'm going back now, whether it was last spring or something, I forgot exactly when I stopped by and chatted with you at Bears Stearns about various ideas, and you raised this issue.

DODD: And I raised the issue -- and I don't know if you were in the room or not when I raised the issue this morning, but that when I had a hearing a couple of weeks ago and raised with the -- in fact, a panel of regulators, including the vice chairman of the Federal Reserve Bank, about the possibility of opening the discount window.

And it was widely rejected out of hand as something that would just be inadvisable.

Then, of course, you had the events on Thursday night, and then again on Sunday night. And I raised the question, had that decision been reached earlier, whether on Thursday night or even before, whether or not this might have salvaged the situation and avoided this 96 hours that you and Mr. Dimon and others went through.

You heard, earlier, in response, I think, to Jack Reed's question, it may have been, but the question to President Geithner about whether or not, in fact, had this window been open, whether or not Bear Stearns would have qualified for them as a prudent risk.

Would you respond to that as well?

SCHWARTZ: I certainly would, Senator. I think what I conveyed to you, if I remember correctly, when we spoke, was that it was my view -- and, I think, shared by some others in the investment banking community -- that this was the first major credit crisis that we'd experienced since there had been an elimination of some of the Glass-Steagall restrictions against the competition or the participation in investment banking by commercial banks, and that it felt, to me, that, as this environment unfolded, having direct competition, people being in the same exact businesses between commercial banks and investment banks, and the commercial banks having a known access to a liquidity source for all of their high-quality collateral, and the investment banks not having that, that that created a situation that I thought was precarious for the whole financial system.

SCHWARTZ: Now, getting directly to the point about what might have happened if action had been taken more quickly. I'll just parse it in two ways, because I remember there were two questions about it. What happened if they'd have just opened that window on Thursday night? Or what if they had done it sooner?

On Thursday night, I think, as Mr. Geithner pointed out, there was already a run going on. But when he said that the experience on Friday that showed that even the facility they came up with did not stop the run, as we know, on Friday afternoon, I think the problem with that analogy is, when you make an emergency situation available for one particular bank, that does not shore up the confidence in that particular bank. I think that's different than if you make a facility available for all investment banks as a precautionary note. I think the situation could be different.

Having said that, I don't know whether Thursday night would have been too late, since the run on the bank and the crisis of confidence was occurring Thursday afternoon.

It's my strong belief that by every measure that I can think of that our balance sheet, our capital ratios, our risk profile lined up well with all of our leading competitors. So I do believe that if as a policy measure the discount window had been open to investment banks that are high-quality collateral, I think it's highly, highly unlikely, in my personal opinion, that we'd be in the situation we find ourselves in today.

DODD: Let me -- and I'm getting down to the weeds a bit on this, but I had read your testimony, and you just made the point again here this afternoon that you were working on an assumption that that extension was going to be good for 28 days.

President Geithner said, as I recall his language, it was up to 28 days, which is kind of a different reaction here. Take me through that a little bit. That's not -- I presume someone at some point raised the question that this was going to be more than two days.
SCHWARTZ: Well, I want to start by saying that this -- everything happened in a very, very short period of time on Monday morning, when we put this together. So we first got a draft of what we were going to be putting out that referenced an agreement between JPMorgan and the New York Fed and then referenced JPMorgan's facility to us. And I believe the language said that there would be an interim period of up to 28 days. When we, our advisers and others read that, I think we interpreted it, just the language, that the initial period would be 28 days unless we could stabilize the situation in a shorter period of time.

As it turns out, and maybe exacerbated by the situation with the run that continued on Friday, and since this was not stabilizing the situation, we were informed that their view of the language was, no, it could be up to 28 days but could be removed.

SCHWARTZ: And so I think there was just an honest different reading of the same words.

DODD: Let me, if I can -- I raised at, sort of, the end of the appearance by the panel of federal regulators, this -- again, and I -- you both have forgotten more in the next 10 minutes than I'll ever probably understand about all of this.

But this question of what happens -- and I looked at the volume. And this -- I was just getting at Yahoo. In fact, I looked at the volume of trades, of Bear Stearns, historically.

I don't know if that was just that month or so, but the numbers -- I don't know if that's true, throughout the last year or so, but that $3 million, $2 million, $5 million, $6 million, $7 million, and then jumping to that Friday of $156 million, not to mention the $30 puts for 10-day, that truncated period, went on here -- share with the committee, here, your own thoughts and observations.

This sounds like more than just rumors, to me, that were contributing to this.

SCHWARTZ: Well, point number one, I don't have any specific fact -- and I hope some facts will emerge, over time. And given what I've been through in the last few weeks, I don't want to encourage too much rumor or speculation. I'd like the people to find the facts.

But I would say that the nature and the pattern of the rumors -- I mean, one of the things we were trying to do was get facts out that discounted the rumors that were out there.

And the minute we got a fact out, more rumors started that were a different set of rumors. So you could never get facts out as fast as the rumors.

I would just say that, as an observer of the markets, it looked like more than just fear. It looked like there were people that wanted to induce a panic.

And there's lots and lots of reasons why people could have a financial motivation to induce a panic. There's a lot of the trading that would point to that. I can only hope -- there are laws against manipulating the market. There used to be laws, in this country against spreading rumors about banks, because it could cause a run on the bank. There are no such laws on investment banks, but there are laws against manipulating the markets. And if facts can come to light, then, I think, that would be very appropriate to go after.

DODD: Mr. Dimon, welcome, and thank you for being here, as well. I appreciate it very, very much.

In your testimony, you said that the -- and I quote here -- the "New York Fed encouraged us to consider what kind of assistance would allow us to do a transaction," end of quote.

Mr. Steel, the secretary, in his testimony, said that J.P. Morgan first approached the New York Fed asking for government assistance.

Can you help us out as to which of these versions is...

DIMON: Yes, Mr. Chairman, I think it was a very -- lots of things took place in a very brief period.

When we had the conversation that we'd be unable to do loan, we had a quick conversation, what would it take if you got help to do it?

So I don't actually remember who suggested it, or not suggested it, but it was the only way that we could have done it.

DODD: Let me just ask you the question, here, if I can, did you or any of the senior management at
PMorgan ever have a conversation with anyone in the federal government about the price which you were going to offer for Bear?

And if so, who did you talk to and what did they say?

DIMON: Yes, so, with Mr. Geithner -- President Geithner, the answer is, he knew the price, but he always said that it was a decision of JPMorgan Chase.

And at one point, with Secretary of the Treasury Paulson, he also knew the price because we had spoken several times.

He also made it very clear that that was a decision of JPMorgan Chase, but did express the point of view, which was held by a lot of people, including on the JPMorgan Chase side, that the higher the price, the more the so-called moral hazard.

DIMON: So that was simply taken in consideration among all the other factors and what the price would be.

DODD: So the stories that have gone out and circulating about your willingness to pay $4 a share and that was rejected flatly in a very direct way by the Treasury are not true.

DIMON: Right. And I think another fact you can add to that, Mr. Chairman, is that sooner after we were willing to go pay more. And we felt completely free to make such a suggestion.

DODD: No, I understand that (inaudible) I'm looking at that 96- hour period.

Now, Mr. Schwartz, let me ask you, were you ever offered $4 a share?

SCHWARTZ: No. At different times during the negotiation different prices were discussed as potential prices, but the only actual offer we ever received as $2 a share.

DODD: OK.

Senator Shelby?

SHELBY: Mr. Dimon, you're the CEO of one of our largest banks. Do you believe that most of our bigger banks are well capitalized and have enough liquidity today or do you not know?

Speak of your own bank first. I know you know where you are.

DIMON: Yes, we've always believed in being extremely well capitalized, conservative accounting, strong loss reserves, and being prepared for what we call bad weather, which happens when you don't really expect it.

And I really can't speak about all the other financial institutions in the country.

SHELBY: Do you believe that the -- do you have an inkling that the Fed might have to go to intervene again -- we keep bringing this up -- if another house failed?

DIMON: Senator, I don't know the answer to that, but I think they've done an awful lot of powerful financing that hopefully will eliminate or greatly reduce the chance of that having to happen again. SHELBY: Mr. Schwartz, do you believe that your management team at Bear Stearns has any responsibility for the company's collapse?

SCHWARTZ: Well, Senator, I don't say -- I don't think a management team can ever say it bears no responsibility for anything that happens.

SHELBY: Because the buck stops with you, basically.

SCHWARTZ: Yes, the buck stops here. And we and our shareholders paid a price.

I can just tell you that -- I can guarantee you it's a subject I've thought about a lot, looking backwards and with hindsight, saying if I'd have known exactly the forces that were coming, what actions could we have taken beforehand to have avoided this situation. And I just simply have not been able to come up with anything, even with the benefit of hindsight, that would have made a difference to the situation that we faced.
SHELBY: Did you believe that at Bear Stearns earlier, when the week began, that you had adequate capital and liquidity to carry on business? I think Thursday you had problems. On Monday, how were you on Monday?

SCHWARTZ: Well, I certainly believed on Monday that we had adequate capital and liquidity. They were in our normal ranges. And by most measures, I believe, our capital was measured as being above standard.

I always had a concern, I never dreamed it would be as rapid as things happened here, but I always had a concern that the lack of a known liquidity facility for your collateral is something that can cause a problem with the lenders against that collateral.

SCHWARTZ: All of us, as investment banks, lend against high-quality collateral, and we turn around and use that collateral. We never worried -- we never believed we could rely on unsecured financing. We always felt like we needed a collateral pool.

And I did worry that there was an environment that could happen that, if we didn't have -- if the market couldn't see that we had some place to go, and borrow against that collateral, then the fears could start. I just never, frankly, understood or dreamed that it could happen as rapidly as it did.

QUESTION: Do you believe that a lot of the value of the collateral just collapsed?

SCHWARTZ (?): No, I don't think...

QUESTION: Followed by rumors and other things?

SCHWARTZ (?): I don't think the value of the collateral collapsed. The willingness of people to lend against it...

QUESTION: Dissipated?

SCHWARTZ (?): ... on our behalf, just dissipated because of fear.

QUESTION: Mr. Dimon, for some time, JPMorgan Chase has acted as the clearinghouse for Bear Stearns. I believe that JPMorgan Chase also has extensive OTC derivative contracts with Bear Stearns. What was the extent, sir, of JPMorgan Chase's interconnectedness to Bear Stearns, prior to Bear's announcement of their intention to file for bankruptcy?

And what would have been the impact on your company's balance sheet if Bear Stearns had been liquidated?

Were these considerations that went through your mind?

Because you were connected. You were the banker, basically, the commercial banker, for an investment bank.

DIMON: Senator, yes. We were one of their bankers, and one of their main clearinghouses. So we had, obviously, extensive relationships and exposures. But the answer to the question, our direct exposure, on that day, was approximately zero. So, if you said -- and where we did have exposure, it was fully and totally collateralized.

Our real exposure would have been if Bear Stearns went bankrupt, the impacts it would have on the financial system, we probably would have lost money, but we still would have been in fine shape.

DIMON: So it really did not -- was not one of the reasons we went ahead and did this transaction.

SHELBY: Mr. Dimon, in your testimony, you also point out that the assets securing the Fed's loan, quote -- and I quote your words -- "consisted entirely of loans that are current and domestic securities rated investment grade," end quote, and that JPMorgan Chase is retaining, quote, "the riskier and more complex securities in the Bear Stearns portfolio."

Since your company -- and you gave us an amount earlier of 300 and something billion dollars...
DIMON: $300 billion was the amount of assets we're buying from Bear Stearns, right.

SHELBY: Since your company will be purchasing, according to your testimony, the riskiest assets of Bear, why did you opt not to purchase Bear without federal assistance? And if the Fed is truly getting good assets, and we hope and pray they are and they work out, why does JPMorgan Chase not want to purchase those assets or why didn't you?

DIMON: So, Senator, one of the...

(CROSSTALK)

DIMON: Right. One of the concerns we had was how much exposure can we take on top of other exposures. So we already had plenty of mortgage exposures and risky security exposures. And we could do nothing that would leave JPMorgan in the precarious position, like you've seen has happened to lots of other institutions.

SHELBY: You couldn't jeopardize your bank (inaudible).

DIMON: Well, that $30 billion, you have to look at how many straws can you put in the camel's back, and we are fairly conservative. And we went as absolutely far as we can go, both in terms of taking risky assets, taking more mortgage assets, and having to borrow another $30 billion.

SHELBY: Thank you, Mr. Chairman.

DODD: Senator Reed?

REED: Thanks very much, Mr. Chairman. Thank you, gentlemen.

I just want to clarify, Mr. Dimon, the guarantee that you have. You made mention in your testimony. The loan is for $30 billion which was extended by the Fed. You're guaranteeing the first $1 billion of that?

DIMON: Yes. So the $30 billion special facility, Mr. Senator, we are going to take the first $1 billion of loss.

DIMON: The Fed has also lent $25 billion to Bear Stearns under the primary facility, another $25 billion, which exists today, and we've also guaranteed that.

REED: So you're guaranteeing the $25 billion total facility, the first facility...

DIMON: Yes.

REED: ... and $1 billion in the second facility?

DIMON: That's correct.

REED: Thank you very much.

Mr. Schwartz, you've said, and I think Chairman Cox also said that your capital ratios were adequate as far as supervisors were concerned, that many things seemed to be in order just several days before this transaction was entered into.

But others have raised the issue of your leverage, the fact that you might have been more highly leveraged than other competitive institutions. Can you comment on that leverage issue?

SCHWARTZ: Yes, I can. I think that, when people examined our balance sheet, a lot of people examined it very carefully and got very comfortable with it.

There's one measure of leverage which is total assets to equity, which I don't think that any sophisticated analysis of a balance sheet says that one measure is a sign of leverage. It depends on what kinds of assets with what kinds of risk.

The way capital cushions are monitored, as you look at all of the liabilities you have, or all the assets that you have, and you take a haircut, based on the risk of those assets.
And those are basically across the board, you know, across the industry, are the same.

And so, when you looked at our capital versus the perception of risk by those measures, compared to our people, our capital looked very adequate for the risk that we had on our balance sheet.

QUESTION: The other issue that's raised is that a lot of your funding was very short-term funding, and that you left yourself exposed to a sudden seize-up of the market, as happened. Can you comment on that?

SCHWARTZ: I could. And it's a good question. Because I think some of the testimony you've heard today said that this credit problem has been intensifying for many, many, many months.

Coming into it, we had made a decision to reduce our reliance on unsecured financing, at all, and get all of our high-quality collateral out, and, as much as we could, get it out on longer-term lines.

We also borrowed in the long-term markets when we could.

As this credit environment has frozen, it became very, very hard to continue borrow in the long-term market. And the facilities that one had against secured collateral that were term, as they termed out, people didn't want to lend for a longer period of time, and they started shortening.

Having said that, we worked as hard as we could against that. And we actually had, you know, a bigger liquidity cushion than we'd had in a long, long time, you know, from the actions that we took.

QUESTION: Let me ask you another question.

You had two funds that failed, basically. Mortgage securities were the principal item in the funds. And it caused concern, not only here but on Wall Street. And your response to the fate of those funds -- did that dramatically alter your behavior?

Or can you comment on how you reacted to those fund failures?

SCHWARTZ: I'm not sure I understand the question.

QUESTION: Well, some would suggest that that was a strong wake-up call about the overall condition. Also, it alerted, to many people in the market, the potential disruption at your firm, and raised, I think, in my mind, the obvious question, is how do you not only compensate but perhaps even overcompensate for that, not only the economic effect but the psychological effect?

I mean, you're a major firm, one of the premier firms. You've had two funds that you backed your reputation with, and they've totally failed.

SCHWARTZ: Correct. Well, there's no question that those funds that had our reputation -- they were not our economic exposure, but they were our reputation, and we took a significant reputational hit because of that.

SCHWARTZ: We were extremely aware of that. We did an awful lot of things, and the thing that we could do the most was just put our heads down and perform as we went forward, because we couldn't set the clock back.

We also -- we did step in. We had no obligation to make a loan to those funds, but we decided to make a loan to one of those funds in an attempt to try and save investors' money if we could liquidate the collateral in an orderly basis.

The market continued to go down. We weren't able to accomplish that. And then we did take some losses on that loan.

But we ended up, you know, we ended up with a loss for the quarter. I think if somebody puts in context the losses that -- context the losses that we took relative to many, many financial institutions, they actually were not particularly large.

And once again if you took a look at our balance sheet, as many people did, we had recovered, our capital ratios were strong, our liquidity was strong, we were back to earning money, and our business was actually moving along at a nice pace.

REED: After your experience with these funds, and I think also with the growing economic situation that all your competitors were facing, there was a need to raise additional capital, even though you might technically
be well capitalized.

I think you attempted to enter into a transaction with China's CTIC Securities in October, and that transaction
did not close. Was there any particular significant to the failure to close that transaction or to raise capital by
other ways?

SCHWARTZ: No. There's two parts to that question, if I could.

First, in terms of raising capital, it's my understanding that if you looked at the capital raised, and it went on
at other financial institutions, it was often -- it was always accompanied by a very significant loss that was
reported, and that that loss had brought their capital down. And it's my understanding that the capital they
raised brought their capital ratios back up to acceptable levels. So that's a different situation than
anticipatory.

The transaction with CTIC Securities, the largest securities firm in China, was a transaction that we thought
had tremendous strategic value to the firm, and as part of the transaction we were raising $1 billion in
capital. They did extensive due diligence on us. They agreed to go forward with the transaction. We needed
to get approvals from the various regulatory authorities in the United States. We had just gotten those
approvals, they were about to go and get the same approvals from the CSRC when all of the events of the
week we described happened.

REED: Thank you very much, Mr. Chairman.

Thank you, gentlemen.

DODD: Thank you, Senator, very much.

Senator Corker?

CORKER: Mr. Chairman, thank you.

And thank both of you for being here today. I know that this is kind of a bittersweet situation with
stockholders of one company being -- feeling good and the others not. But I thank you both for being here. I
know you've had both distinguished careers.

From the standpoint of JPMorgan, I know there's been comments. Our chairman mentioned the large
amount of options trading that took place, and they grew toward the end of the week.

On the downside, I know that Mr. Schwartz has talked about things stronger than rumors, if you will, driving
that.

You obviously had this relationship and were obviously paying attention to what was happening. I wonder if
you have any editorial comments regarding what was actually happening, whether it was actually driven by
people who had nefarious kind of thoughts and actions or whether or was just, in fact, rumors from your
standpoint.

(UNKNOWN): I don't -- Senator, I don't know what the real facts are here. But I think there's enough smoke
around the issue that it is a proper thing for the regulators to look at what actually happened.

And I personally think that if people knowingly created or passed on false rumors, they should be punished
under the law.

CORKER: The negotiation that took place at the end of the day, I mean, it was either not be in business or
sell. So it really wasn't much of a negotiation, it sounds to me, which I understand under the circumstances.

It seems to me that actually the pricing of the stock was based more upon making sure there was not, in
essence, some kind of moral hazard. I wonder if you could speak to that, just for a moment?

DIMON: Yes, I think, Senator, the price of the stock was not really based on the value of the company. It
was really based on protecting the downside of JPMorgan.

You know, I told people buying a house is not the same as buying a house on fire. Well, some people look at
the upside. And we hope there's upside for our shareholders. We were far more focused on the downside.

Other people were there and couldn't do it, at all, probably at any price. And then, obviously, during the next
week, we did recognize there was more value. And I think it ended up for a fair place for the Bear Stearns shareholder, too.

CORKER: And from your side, Mr. Schwartz, I mean, in essence, it was just whatever the price was, it was, right?

I mean, at that point, it really -- there was no negotiation. It was, in essence, what was JP willing to do? It doesn't seem like there was much leverage from your standpoint.

SCHWARTZ: Well, I think all the leverage went out the window when a deal had to happen over the weekend.

I think that -- we had another party who had started doing due diligence on Friday, sophisticated party who was, after doing diligence, said was prepared to write a multi-billion-dollar check to invest into equity at Bear Stearns.

SCHWARTZ: But he was going to require some significant financial institutions that he had relationships with to provide a funding facility. That is one example of the type of party that we could have talked to.

I think there could have been other large financial institutions that would have like to, including JPMorgan might have wanted to pay a higher price if they had a chance to do the kind of due diligence that normally goes with a large acquisition.

But I think to go to a board of directors on a weekend and say that we're stepping into the shoes in this credit environment of another financial institution and say we're going to do that in a basis where we have to commit firmly to the transaction, we understood in those circumstances there were very, very few entities, and we thought maybe if any. So we understood that JPMorgan was stepping up to doing that, and the price we had no leverage at all.

CORKER: Mr. Dimon, what you obviously are highly heralded, and should be, and I'm sincerely happy for you and the stockholders of your company.

What is it that you and your colleagues now in this environment are doing, if you will? I mean, people are looking at liquidity issue of having short-term debt against longer-term obligations. What is it that just as a group your colleagues are doing to make sure that you stay strong and that these other -- these types of issues don't occur with other institutions?

DIMON: Senator, first, I appreciate the nice comment about JPMorgan. I should point out, we've made plenty of mistakes ourselves, so we don't stand in front of you as if we've made none.

And we are always looking at capital measures, risk measures, accounting, loss reserves, how bad can it get, how bad can the storm be, stress testing. And there are multiple other measures we look at, including just plain old common sense. What happens if you're wrong? Because very often you're wrong.

So we try to maintain as firm a balance sheet and finance the company way ahead of time so that we don't ever get in the position where we can find ourselves in financing difficulty.

CORKER: But are you and your colleagues even changing the way you're doing business right now based on the circumstances of the last 30 days? Are more proactive steps being taken by other colleagues?

DIMON: I believe the answer is yes, a little bit, but not in a material way. But we, like everybody else, when events like the past few weeks happen, hopefully we learn from them. So we analyze them to death, and then we go through all the facts, and we look about what could we do better. And we're doing, in the process of doing that today. But we feel we're completely properly (inaudible) and funded.

CORKER: And just the last question. I know when people began accessing the Fed window, they realized that, right behind that, regulatory issues were going to come.

CORKER: I wonder if you might -- some editorial comments about some notions in that regard, knowing that that has to be coming, with access to Fed funds.

DIMON: Right. So, Senator, many people commented, this morning, about the need for change in the regulatory system, and that some of the things we all live under were -- those laws were passed, and they're closer to the Civil War than they are to today, and that we all acknowledge we need streamlining, modernization.

And, I think, opening up the primary window to investment banks does have positive ramifications. And I
hope, you know, the regulators and the Congress spends a good amount of time to come up with good policies and rules that prevent, at least, this kind of accident from happening again.

CORKER: Thank you, Mr. Chairman.

DODD: Thank you very much.

Senator Carper?

CARPER: Thanks, Mr. Chairman.

And gentlemen, thank you for being here. Thank you for your extraordinary patience, and for standing up during a really difficult period of time, for not just your shareholders and your institutions but, I think, for our country.

I was treasurer Delaware, a number of years ago, when folks at Chrysler just about went belly-up. And there was a bail-out that was fashioned here -- an assistance plan fashioned here in Congress to help save Chrysler.

We participated in our state, along with a number of other states who had Chrysler facilities.

There was a bit of a (inaudible) cry about the taxpayer bail-out to -- at the time -- and it turned out the U.S. Treasury made money off the deal, and we in Delaware did, too.

And Chrysler has had some ups and downs since. We're hopeful that they're going to survive. But, knock on wood, they'll be around for a lot longer.

But there have been concerns raised in this instance, that potentially some taxpayer exposure, Treasury exposure.

And I don't know that the taxpayers are going to walk away, as we did with Chrysler, actually being better off and being able to show a profit for our intervention. But in terms of whether or not it was worth it for the taxpayers and worth it for our country, what comments would you have there for us?

DIMON: Well, Senator Carper...

CARPER: What would be the upside for...

DIMON: I think the first comment is, this would have been far more, in my opinion, expensive for taxpayers had Bear Stearns gone bankrupt, and had added to the financial crisis we have today. And it wouldn't even have been close.

I think the Fed has protected itself with the expect-a-loss note and the collateral, the long-term funding, the professional management. And we'll hopefully get back all this money, and possibly more.

And we did have a conversation, at one point, with the Fed, that we could have done it differently, you know, share upside and downside. But I'm not really -- wasn't aware of all the regulatory, statutory issues they have in doing something like that.

DIMON: I think they have certain constraints they live under by law.

Plus, we didn't have a lot of time. We had literally 48 hours to do what normally takes a month.

CARPER: Mr. Schwartz, Senator Corker over there asked you a question I was planning to ask myself, and the question is, if you go back in time, I don't think that Congress had to pass a law to say to the Federal Reserve, "You can open a discount window to investment banks." I believe they did that, they took that step under a law that may have been passed in the Great Depression, if I'm not mistaken.

I don't know that it was ever exercised until now. And it may have been exercised prior to now, but it hasn't been exercised often.

And the question that Senator Corker has asked is: What are the ramifications in terms of regulation, presumably regulation from the Fed? And I just want to go back to that and say, if this is the kind of thing that's going to happen with more frequency, again, what are the ramifications for regulations from the Fed?
P|Morgan Chase already has to deal with that. But Bear Stearns and other investment banks don't.

SCHWARTZ: Right. So I do think that -- look, it's a well established precedent under regulation that financial institutions that rely on confidence, that knowing that there is liquidity for their assets actually inspires that confidence. And so it's much harder to start rumors that they have no place to go with their collateral if there's an identifiable place at the government where they could take that collateral.

So the rumors and the fear become deflated by the fact that people know that they have a liquidity source, and therefore you have to find some other thing.

So I believe that going forward, I think when everything, you know, everybody had to move here in a very, very, very rapid basis, I think when people sit down, all of the people in government, and look at this, I think they're going to say, "We need a new system."

And I think that one of the elements of that system I am convinced of will be that the major investment banks -- I was very glad to see Sunday night that the window was open to those investment banks. I was very, very glad to see that. And I think that some sort of facility will be made available to keep a run on the bank from starting or happening. I think that it's very appropriate to ask, if that's going to be part of a new regime of some kind, then what are the other oversights and regulatory reviews that have to occur to make sure it's done on a sound basis. And I think that process will begin, and I hope it moves in a positive direction.

CARPER: Thank you.

The last question I have deals with -- really with us and our action. We've been sort of observers to some extent watching the Federal Reserve be involved in a variety of ways, in extraordinary ways in the last couple of months, and to watch Treasury being involved in setting up project Hope Now and doing a number of other things to try to help the situation.

It's our turn now, and it's our turn now in the leadership of Senators Dodd and Shelby bringing to the floor today, literally today for debate and vote legislation that is designed to deal with the situation, again, restore some additional liquidity, deal with the homes that are foreclosed on.

What advice would you have for us as to one or two elements that, if we do nothing else, in the context of legislative action, this week, next week, what would be some of the must-do -- some of the things on a must-do list?

DIMON: Senator, I think there's a pretty long to-do list, and I think that most people that you speak to, it's kind of nonpartisan, we want to get it done, we know we need to make changes. There will be a lot of debates about those changes.

DIMON: I think they -- I would say we should do it in due haste, just get all the help you can get. And, obviously, JPMorgan in any way, shape or form that it can help, we'd be happy to do so.

And then have a regulatory system which adjusts very quickly after that, because I do think that the regulatory authorities need to move very quickly in this new world, and they don't have the luxury to do some of the things you might have wanted them to do.

For example, the Fed might have acted very differently that weekend, had they other statutory authorities.

CARPER: All right. Thank you.

Mr. Schwartz, any advice for us as we turn to our legislative responsibilities?

SCHWARTZ: Not a lot. I do think that raising the limits on conforming mortgages could be helpful to supply some liquidity to housing. I think expanding the authority of FHA to step back into a market that it was created for would make sense.

I think those are short-term. And I think helping homeowners stay in their homes is not only the right thing to do, but it's good economic policy.

I think, longer term, we'd have to look at the whole way that mortgages get underwritten. Because there has to be some liability to the people who underwrite the mortgages, to make sure that they are applying standards appropriately.

CARPER: Thank you very much. Thank you.
DODD: Thank you, Senator.

We’ve been joined by Senator Menendez, who I believe has some questions, as well.

MENENDEZ: Thank you, Mr. Chairman.

Thank you, gentleman. Let me ask you, Mr. Dimon, with reference to the securities that are backing this transaction that the Fed has done, my understanding is that they are largely mortgage-based securities and related hedge investments.

Is that a fair statement? DIMON: Yes, Senator.

MENENDEZ: Do you know what the valuation of those assets are?

DIMON: The valuation at which the Fed has taken them into their books is at the same valuation that Bear Stearns had it marked on March 14th, and it’s the same valuation that JPMorgan has taken the other $300 billion at as of March 14th.

MENENDEZ: And what is that?

DIMON: That’s the Bear Stearns that -- whatever is on their books for.

MENENDEZ: But in reality, that’s not the valuation of them, are they? Is that the real value of it in the marketplace at this moment?

DIMON: Well, I think, Senator, I think you can have a big debate on what the value is, but I think that they -- that Bear Stearns, I believe Black Rock’s also looked at it, you know, believe those values are approximately appropriate.

MENENDEZ: Why do you think that there was this first panel testified -- I assume you agree with them that there was a crisis of confidence and a set of rumors -- why do you think an institution like yours with such reputation, such standing, could simply fall on a series of rumors, if it isn’t a question of valuation at the end of the day?

SCHWARTZ: I think that, as I said in the earlier testimony, or opening statement rather, I think that it’s well established in financial history that institutions that lend money against assets, if people are concerned that there is a liquidity crisis or if there are rumors that there money is not going to be there after everybody else withdraws their money, there’s a rush to the exit. It’s my mind that that’s what happened this week.

MENENDEZ: Well, let me ask you, do you really know what the value is of the securities that you have?

SCHWARTZ: I think that when you ask do we know the value of the securities, I think that when you get into, I think, Chairman Bernanke testified that if you look at securities that become highly, highly illiquid, if you have to sell them overnight, then you will have a much, much lower value than if you look at what is a required return and how you value that return over a reasonable period of time.

So do I think there are some assets on our balance sheet that may turn out to be worth less than what we’re carrying them for? Yes.

We have some significant hedges against a number of those assets that would tend to move in the other direction where we’re short.

I also think there’s a number of assets on our balance sheet that could be worth a lot more than what they’re carried at. One example of that was highlighted in the transaction with JPMorgan where they asked for an agreement to be able to buy our headquarters building for $1 billion. It’s not carried on our books at anywhere near that.

MENENDEZ: Well, the problem is, is that Chairman Bernanke also testified in response to my questions that he can’t tell us what the liability of the American taxpayer is here. So if your valuations are equal to or greater then we have not problem. If your valuations are less than, we have a problem, even over the long term.

And I think that I’ve seen some statements and some reports that going back in time say that when we had analysts during this home mortgage crisis situation, there were analysts -- and I think -- I don’t know, Mr.
Dimon, if your institution was one of them -- who said we can't really tell you the totality of the challenge that we might have. So I don't particularly think that you all know what the value of the instruments that you have really is. And that's part of our challenge here.

Mr. Dimon, is it wrong to have said that you would not have, on behalf of our institution, entered into this agreement without the Fed's position?

DIMON: Senator, that's correct.

MENENDEZ: Yes. And, as such, the reason you took that position is why?

DIMON: Because, remember, JPMorgan was buying another $300 billion of assets, some of which were far riskier than the $30 billion. And we analyzed this from our downside, that we're going to put on so much debt, so much risk asset, so much risky asset we already had.

And we could not leave JPMorgan, for any reason, under any circumstances, in a predicament where we could jeopardize our financial health. And that's a judgment call we made. How many straws can you put on that camel back?

And that's all we could do. And we would have and could have done no more.

MENENDEZ: And so you looked at the transaction and you looked at the assets that would be acquired and you said, well, there are more straws there that might break the camel's back than we can afford.

DIMON: I thank we -- the way we analyze it is, what is the chance that things can go wrong or get worse?

I mean, we don't live in a static world. So, when we know that things can get better, the question I had to answer for my board is, what if things get worse? Are we in a good enough position?

And it was plain and simple. And we needed the capital and the funding ability so that JPMorgan remained a strong, healthy institution after the transaction.

MENENDEZ: And hopefully, the federal exchange on behalf of the American taxpayer asked the same question. Thank you, Mr. Chairman.

DODD: Yes. It's a great question. And I tried to frame it, Bob, after you had left -- and I don't want to oversimplify it, but it's, sort of, the concerns, I think, on this aspect -- and again, all the time constraints and everything else, we're very conscious of, but what I called the socialization of risk and the privatization of reward.

And although we're all hoping that the case will be that this will turn out well, there is that question mark, there, we have. And if that's a precedent-setting decision, it has incredible implications.

And so I think it's important to identify it for what it is and recognize that we all hope this one works out, but as others have suggested, in the absence of some real changes, we could be looking at other situations to come down the pike here, maybe at far greater risk than the ones we're talking about here.

And to the extent we want to socialize risk, in a sense, the socialization of it, it's going to raise some very serious questions, here, as well.

But it's an excellent set of questions. And I appreciate it.

MENENDEZ: And, Mr. Chairman, I just may note, if we want to socialize risk, then we should look at socializing the risks of mortgage foreclosers in this country.

DODD: Well, that's just a wonderful lead into my next question.

In the sense that -- to digress for a minute, because I don't want to miss the opportunity of having two very talented people here. And let me say, Mr. Schwartz, as well, when you and I had that conversation, however many months ago, about the discount window, I want to just say, in this hearing room, I regret that others didn't listen to you, at the time. I think it might have made a big difference.

You had to have commensurate quality assets... and collateral and regulatory framework for all of it. But I think it was -- unfortunately, at the time, there was a failure to understand the gravity of the problem.
We kept on hearing the language "the problem's contained," that things are rosy, things are getting better. And they couldn't have been more wrong in their analysis of the situation.

And had there been people listening and willing to utilize some of these vehicles, earlier on, at a time when, I think, we might have had a better response, we might be avoiding the kind of hearing we're having today.

I want to ask you about this issue that -- utilizing your talents, here, and background. Obviously, this is -- the point you've made, that, in the absence of this decision, this merger -- and I agree with this. I think most of us do here, that we'd be looking at a very different situation, had it come Monday morning.

That's in no way to minimize the impact to employees and shareholders and the like. But I think you framed it, both, well, in terms of what was involved here.

There are those -- and Senator Menendez just raised the issue, here. And I've been trying to come up with some ideas, again, not new ideas. In fact, in the previous years, the idea of trying to figure out a way to keep people in their homes but also find that bottom, here, that will unleash capital and begin to move us out of this problem.

And I raised this issue before, and Senator Shelby's been gracious enough to say, let's hold some hearings and take a good, hard look at it. There's a lot of potential exposure, but there's some tremendous benefit as well.

And I don't know if you have a chance to take a look at this idea. And I'm not asking you to endorse a specific idea, but just to comment, generally, on this question of whether or not we can do something.

In the past, actually, the federal government bought these mortgages at highly discounted value and kept people in their homes for a period of time and actually made money -- I think some $14 million -- decades ago.

What we're talking about here is insuring, through FHA -- obviously, they're getting a write-down of the overall value of it, but keeping people in a voluntary program over an extended period of time, and then have enough transactions occur so that you could help identify that floor.

And if that is the case, then I'm told, by those who believe this could work, you then begin to see capital begin to move.

Could you comment on that idea, generally, as to the value of it, or what your...

SCHWARTZ: Well, I think there's a lot of pieces to the puzzle. I do think that, in our mortgage servicing, over the years, we think that it is economically appropriate, getting away from the social side of it for a second, that there are times when it is better to modify a loan, even cut the principal that somebody owes so they have an incentive to continue making their payments. And those payments become easier to make because large numbers of people being taken out of their homes -- as difficult as it is for those homeowners -- also creates additional supply on the market which keeps affecting supply and demand for housing.

So it's a very complicated set of facts and I think but an intersection of seeing where there are appropriate modifications to give people a real chance to stay in their homes, you know, would help on the supply and demand side to stabilize the housing market which is -- underneath all of this -- a point I think you are making, which is: Until we can stabilize the housing market, it's really hard to say what is going to happen to a lot of securities that relate to the value of the home in the United States.

DIMON: I agree. Personally I think the legislation has moved rather quickly on Fannie Mae and Freddie Mac and changing things to make it easier to get capital to the borrower, the person who actually wants to buy the home.

I think when you are in a crisis like this, you shouldn't stand in ceremony; you should fight the crisis. Those things will all have ramifications in future policy.

Using FHA to have people take haircuts in their mortgages, which would be the banks -- I want to make sure that people understand we are not looking for any sympathy in this. We are obviously -- JPMorgan Chase had among the best underwriting standards, but we also made mistakes and would like to be very helpful.

I think a program and a policy like that could actually work quite well. We love to get engaged and see if we can help come up with something that makes sense for the homeowner and for the American public.

DODD: Thanks very, very much. I appreciate that.
Senator Shelby, any closing comments?

SHELBY: No.

DODD: Well, I thank both of you. You've been very gracious.

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