Geithner says financial system healing

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Tim Geithner, US Treasury secretary, said on Wednesday that "the financial system is starting to heal" as he pledged to recycle returned bank bail-out funds into small community banks.

Citing improving lending conditions, easing concerns about systemic risk and lower leverage at banks, Mr Geithner said "a substantial part of the adjustment process" for the financial sector was now over.

As some larger banks become confident enough to repay funds from the government's Troubled Asset Relief Programme, the Treasury will recycle that money into smaller banks with under $500m in assets, Mr Geithner said. They will have six more months to apply for funds, and the Treasury will also increase the amount of money they can access from 3 per cent of risk-weighted assets to 5 per cent.

"As in any financial crisis, the damage has been unfair and indiscriminate," said Mr Geithner in a speech to community bankers. "Ordinary Americans, small business owners, and community banks who did the right thing and played by the rules are suffering from the actions of those who took on too much risk."

More than 90 per cent of America's 8,300 banks are small or mid-sized. The US government has already invested capital in the form of preferred stock in 300 small banks, although the vast majority of Tarp money has gone to the country's largest financial institutions.

A number of those large banks have said they intend to pay back Tarp funds, including Goldman Sachs, JP Morgan and Capital One Financial.

Mr Geithner pointed to a drop in spreads for corporate bonds, lower risk premiums in inter-bank markets and cheaper default insurance on the biggest banks as evidence that fear in the financial system was abating. "These are all welcome signs, but the process of financial recovery and repair is going to take time," he said.

Mr Geithner also said he would soon propose legislation to create a systemic risk fund to support financial institutions in times of crisis, backed by large financial institutions. It would be an "extraordinary mechanism for extraordinary situations," he said, and would be kept separate from the Federal Deposit Insurance Corporation, which insures bank deposits.

"With this authority, the financial costs of intervention would no longer fall to those institutions that played by the rules and made conservative and prudent choices," he said.

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