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Hearing with Treasury Secretary Geithner: Hearing before the Congressional Oversight Panel

United States: Congress: Congressional Oversight Panel (COP)

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S. Hrg. 111–903

HEARING WITH TREASURY SECRETARY GEITHNER

HEARING

BEFORE THE

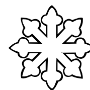
CONGRESSIONAL OVERSIGHT PANEL

ONE HUNDRED ELEVENTH CONGRESS

FIRST SESSION

HEARING HELD IN WASHINGTON, DC, DECEMBER 16, 2010

Printed for the use of the Congressional Oversight Panel



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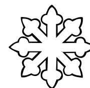

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CONGRESSIONAL OVERSIGHT PANEL

PANEL MEMBERS

THE HONORABLE TED KAUFMAN, *Chair*

KENNETH TROSKE

J. MARK MCWATTERS

RICHARD H. NEIMAN

DAMON SILVERS

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HEARING WITH TREASURY SECRETARY GEITHNER

THURSDAY, DECEMBER 16, 2010

U.S. CONGRESS,
CONGRESSIONAL OVERSIGHT PANEL,
Washington, DC.

The Panel met, pursuant to notice, at 10:05 a.m. in Room SD–538, Dirksen Senate Office Building, Senator Ted Kaufman, Chairman of the Panel, presiding.

Present: Senator Ted Kaufman [presiding], Richard H. Neiman, Damon Silvers, J. Mark McWatters, and Kenneth R. Troske.

Index: Senator Ted Kaufman [presiding], Richard H. Neiman, Damon Silvers, J. Mark McWatters, and Kenneth R. Troske.

OPENING STATEMENT OF HON. TED KAUFMAN, U.S. SENATOR FROM DELAWARE

The CHAIRMAN. Good morning, Mr. Secretary. We appreciate your willingness to come down here and help us.

It's easy today to forget the sense of panic that overwhelmed our economy in late 2008. Stock market was plummeting, employment was plummeting, home values were plummeting. I can remember turning on the television and flipping between news channels and seeing anchor after anchor looking scared and frightened and confused. The American financial system, the envy of the world, was never supposed to collapse in that way.

Today, we know that the panic ended, and you played a key role in that turnaround. As the Panel has stated in the past, the Troubled Asset Relief Program provided critical support to the financial markets at a time when market confidence was in freefall. Combined with the Recovery Act, this restored a degree of stability to our markets and to our economy. The Congressional Budget Office recently estimated that, at the end of the day, the TARP will cost about $25 billion. And I notice you use the same thing in your opening statement. And it's an astronomical sum, to be sure, but far less than anyone expected even 6 months ago.

As Treasury has conducted its work to repair the banking system, governments and business and private citizens across the country have done their part to help build the road to recovery. Thanks to their shared efforts, the economy is in a tremendously better place today than it was when the TARP was enacted. But—and it's a big "but"—we must not forget the pain that continues to plague so many Americans.

Fifteen million Americans still cannot find a job. As many as 13 million families will lose their homes in foreclosure in the next few years. The panic of 2008 has subsided, but it has been replaced by the gnawing pain of countless men and women who can't find work, who can't keep their homes, and who don't know whether their economic story will ever end in recovery.

The TARP was never intended to be a complete solution to these problems. But, even now, your authority to make major changes to the TARP, even though your authority has changed, you still can make steps to help strengthen the broader economy.

For example, the Panel's report this week on foreclosure prevention laid out a series of steps the Treasury can take to help more Americans keep their homes. You could make it easier for homeowners to receive a loan modification by allowing borrowers to apply online; you could focus on helping each and every homeowner who received a loan modification to avoid sliding backward into foreclosure.

These steps will only make a modest difference in Treasury's efforts to prevent foreclosures, but they illustrate a larger point, that although TARP's broad legacy may already have been determined, the details remain to be decided, and these are important details. In fact, Mr. Secretary, you will decide them. You continue to manage $54 billion in the auto industry, $50 billion at a variety of banks, $48 billion at AIG, and $30 billion in authority to prevent foreclosures. That is a weighty obligation, and I look forward to hearing you describe how you will handle it.

I really do hope we can use today's hearings to focus on the remaining opportunities to reshape the TARP to strengthen the economy for all Americans.

Before we proceed, I'm looking forward to other panelists' comment. And we'll start with Mr. McWatters.

SEN. TED KAUFMAN, CHAIRMAN
RICHARD H. NEIMAN
DAMON SILVERS
J. MARK McWATTERS
KENNETH R. TROSKE

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Congress of the United States

CONGRESSIONAL OVERSIGHT PANEL

Opening Statement of Ted Kaufman

Congressional Oversight Panel Hearing
with Treasury Secretary Timothy Geithner

December 16, 2010

Good morning, Mr. Secretary. We appreciate your willingness to join us this morning.

It is easy to forget today the sense of panic that overwhelmed our economy in late 2008. The stock market was plummeting. Employment was plummeting. Home values were plummeting. I can remember turning on the television, flipping between news channels, and seeing anchor after anchor looking frightened and confused. The American financial system, the envy of the world, was never supposed to collapse in this way.

Today, we know that the panic ended, and you played a key role in that turnaround. As the Panel has stated in the past, the Troubled Asset Relief Program (TARP) provided critical support to the financial markets at a time when market confidence was in freefall. Combined with the Recovery Act, it has restored a degree of stability to our markets and to our economy. The Congressional Budget Office recently estimated that, at the end of the day, the TARP will cost about $25 billion – an astronomical sum, to be sure, but far less than anyone expected even six months ago.

As Treasury has conducted its work to repair the banking system, governments and businesses and private citizens across the country have done their part to help build the road to recovery. Thanks to their shared efforts, the economy is in a tremendously better place today than it was when the TARP was enacted. But we must not forget the pain that continues to plague so many Americans.

Fifteen million Americans still cannot find a job. As many as thirteen million families will lose their homes to foreclosure in the next few years. The panic of 2008 has subsided, but it has been replaced by the gnawing pain of countless men and women who can't find work, who can't keep their homes, and who don't know whether their own economic story will ever end in recovery.

The TARP was never intended to be a complete solution to these problems. But even now that your authority to make major changes to the TARP has expired, you still can take steps to help strengthen the broader economy.

For example, the Panel's report this week on foreclosure prevention laid out a series of steps that Treasury can take to help more Americans keep their homes. You could make it easier for homeowners to receive a loan modification by allowing borrowers to apply online, and you could focus on helping each and every homeowner who has received a loan modification to avoid sliding backward into foreclosure.

These steps will make only a modest difference in Treasury's efforts to prevent foreclosure. But they illustrate a larger point: that although TARP's broad legacy may already have been determined, the details remain to be decided. In fact, Mr. Secretary, you will decide them. You continue to manage $54 billion in the auto industry, $50 billion at a variety of banks, $48 billion at AIG, and $30 billion in authority to prevent foreclosures. That is a weighty obligation, and I look forward to hearing you describe how you will handle it.

I hope we can use today's hearing to focus on the remaining opportunities to reshape the TARP to strengthen the economy for all Americans.

Before we proceed, I look forward to my fellow panelists' opening statements. Let me turn now to Mr. McWatters.

STATEMENT OF J. MARK MCWATTERS, ATTORNEY AND CERTIFIED PUBLIC ACCOUNTANT

Mr. MCWATTERS. Thank you, Senator.

And welcome, Mr. Secretary.

Although the Congressional Budget Office has recently revised its estimated subsidy cost of the TARP downward to "only" $25 billion, such metrics should not serve as the sole determinant of the success or failure of the program. We should remain mindful that the TARP's overall contribution to the rescue of the U.S. economy was relatively modest when compared along with a multi-hundred-billion-dollar bailout of Fannie Mae and Freddie Mac, the multi-trillion-dollar interventions of the Federal Reserve and FDIC, as well as the incalculable efforts of private-sector capital-market participants.

It is particularly difficult to label the TARP, or any other government-sponsored program aimed at securing financial security, an unqualified success when the unemployment rate nears 10 percent, the combined unemployment and underemployment rate equals 17 percent, and millions of American families are struggling to modify their mortgage loans so as to avoid foreclosure. It is cold comfort to these individuals and families that the "too big to fail" financial institutions, aided by the TARP and other government-sponsored programs, are recording near-record earnings.

In order to better assess the TARP, I offer the following recap of certain issues raised by the Panel and its individual members over the past year:

Professor Troske and I noted, in our Additional Views to the Panel's September 2010 Oversight Report, that the repayment by TARP recipients of advances received under the program is a misleading measure of the effectiveness of the TARP and therefore should not serve as the standard by which the TARP is judged. The unlimited bailout of Fannie Mae and Freddie Mac by Treasury, and the purchase of $1.25 trillion of GSE-guaranteed mortgage-backed securities in the secondary market by the Federal Reserve under its first quantitative easing program, no doubt materially benefited TARP recipients and other financial institutions. These institutions were not—were not, however, required to share any of the costs incurred in the bailout of the GSEs.

In effect, the bailout of Fannie Mae and Freddie Mac permitted TARP recipients to monetize their GSE-guaranteed MBSs at prices above what they would have received without the GSE guarantees and use the proceeds to repay their obligations outstanding under the TARP, thereby arguably shifting a greater portion of the cost of the TARP from the TARP recipients themselves to the taxpayers. Costs such as this should be thoughtfully considered when evaluating the TARP.

With respect to the bailout of AIG, the Panel offered the following observations in its June 2010 report, and I quote, "The government's actions in rescuing AIG continue to have a poisonous effect on the marketplace. By providing a complete rescue that called for no shared sacrifice among AIG's creditors, the Federal Reserve and Treasury fundamentally changed the relationship between the government and the country's most sophisticated financial players. The AIG rescue demonstrated that Treasury and the Federal Re-

serve would commit taxpayers to pay any price and bear any burden to prevent the collapse of America's largest financial institutions and to assure repayment to the creditors doing business with them. So long as this remains the case, the worst effects of AIG's rescue in the marketplace will linger."

With respect to the robo-signing and other mortgage loan irregularities, the Panel offered the following observations in its November 2010 report, again quoting, "Treasury has claimed that, based upon evidence to date, mortgage-related problems currently pose no danger to the financial system, but in light of the extensive uncertainties in the market today, Treasury's assertions appear premature. Treasury should explain why it sees no danger."

With respect to the HAMP and Treasury's other foreclosure mitigation programs, the Panel offered the following observations in the December 2010 report, which was released 2 days ago, again quoting, "While HAMP most—while HAMP's most dramatic shortcoming has been its poor results in preventing foreclosures, the program has other significant flaws. For example, despite repeated urgings from the Panel, Treasury has failed to collect and analyze data that would explain HAMP's shortcomings, and it does not even have a way to collect data for many of HAMP's add-on programs. Further, Treasury has refused to specify meaningful goals by which the—to measure HAMP's progress, while the program's sole initial goal, to prevent 3 to 4 million foreclosures, has been repeatedly redefined and watered down. Treasury has also failed to hold loan servicers accountable when they have repeatedly lost borrower paperwork or refused to perform loan modifications.

In concluding, it is critical to note that, although the TARP has played a meaningful role in the rescue of the United States economy during the closing days of 2008, its enduring legacy may be to have all but codified the implicit guarantee of the "too big to fail" financial institutions, notwithstanding the profound moral hazard risk arising from such action.

Thank you and I look forward to our discussion.

[The prepared statement of Mr. McWatters follows:]

SEN. TED KAUFMAN, CHAIRMAN
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DAMON SILVERS
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Congress of the United States

CONGRESSIONAL OVERSIGHT PANEL

Opening Statement of J. Mark McWatters

Congressional Oversight Panel Hearing with Treasury Secretary Timothy Geithner

December 16, 2010

Thank you Senator Kaufman and welcome Mr. Secretary.

Although the Congressional Budget Office (CBO) has recently revised its estimated subsidy cost of the TARP downward to "only" $25 billion,[1] such metric should not serve as the sole determinate of the success or failure of the program. We should remain mindful that the TARP's overall contribution to the rescue of the U.S. economy was relatively modest when considered along with the multi-hundred billion dollar bailout of Fannie Mae and Freddie Mac, the multi-trillion dollar interventions of the Federal Reserve[2] and FDIC as well as the incalculable efforts of private sector capital market participants. It is particularly difficult to label the TARP or any other government-sponsored program aimed at securing financial stability an unqualified success when the unemployment rate nears 10-percent, the combined unemployment and underemployment rate equals 17-percent,[3] and millions of American families are struggling to modify their mortgage loans so as to avoid foreclosure. It is of cold comfort to these individuals and families that the too-big-to-fail financial institutions aided by the TARP and other government-sponsored programs are recording near-record earnings.[4]

[1] See Congressional Budget Office, *Report on the Troubled Asset Relief Program—November 2010* (online at http://www.cbo.gov/doc.cfm?index=11980).
[2] Pursuant to the requirements of Dodd-Frank, on December 1, 2010, the Federal Reserve released data on the amount and frequency of use of the Primary Dealers Credit Facility, an emergency short-term lending facility which was created in March 2008 and expired in February 2010. For the first time since the Great Depression, the central bank's credit was extended to firms other than banks. The facility provided, cumulatively, $8.95 trillion to primary dealers. It was utilized aggressively by every major investment bank. Among the data disclosed was that Goldman Sachs borrowed money from the facility 84 times between March 18, 2008 and November 26, 2008, with the largest transaction, amounting to $18 billion. Merrill Lynch used the facility 226 times with its largest transaction being $35 billion. The largest single loan was a $47.9 billion loan to Barclays, a foreign bank.

See *Fed aid in financial crisis went beyond U.S. banks to industry, foreign firms*, The Washington Post (Dec. 2, 2010) (online at http://www.washingtonpost.com/wp-dyn/content/article/2010/12/01/AR2010120106870.html).
[3] See Bureau of Labor Statistics, *Economic News Release* (Dec. 3, 2010) (online at http://www.bls.gov/news.release/empsit.t15.htm and http://www.bls.gov/news.release/empsit.nr0.htm).
[4] See *Wall Street Sees Record Revenue in Recovery from Bailout,* Bloomberg (Dec. 12, 2010) (online at http://www.bloomberg.com/news/2010-12-13/wall-street-sees-record-revenue-in-09-10-recovery-from-government-bailout.html).

Until small and large businesses regain the confidence to hire new employees and expand their business operations it is doubtful that the broader aspirations of the TARP will be realized. As long as businesspersons are faced with the multiple challenges of rising taxes, increasing regulatory burdens, enhanced political risk associated with

In assessing the overall effectiveness of the TARP, it is particularly important to consider the non-TARP funded bailouts of Fannie Mae and Freddie Mac, the TARP funded bailouts of GMAC and AIG, the robo-signing and other foreclosure irregularities that have recently surfaced, Treasury's foreclosure mitigation efforts under the HAMP as well as Treasury's contracting authority under TARP.[5] I offer the following abbreviated analysis of these financial stabilization efforts.

Quantitative Easing One and the Bailout of Fannie Mae and Freddie Mac

Professor Troske and I noted in our Additional Views to the Panel's September 2010 Oversight Report[6] that the repayment by TARP recipients of advances received under the program is a misleading measure of the effectiveness of the TARP and therefore should not serve as *the* standard by which the TARP is judged. The unlimited bailout of Fannie Mae and Freddie Mac by Treasury and the purchase of $1.25 trillion of GSE-guaranteed mortgage-backed securities (MBS) in the secondary market by the Federal Reserve under its first quantitative easing program no doubt materially benefitted TARP recipients and other financial institutions.[7] These institutions were not required, however, to share any of the costs incurred in the bailout of the GSEs.[8] In effect, the bailout of Fannie Mae and Freddie Mac permitted TARP recipients to

---

unpredictable governmental interventions in the private sector as well as uncertain health care, energy, and regulatory compliance costs, it is unlikely that they will enthusiastically assume the entrepreneurial risk necessary for protracted economic expansion and a recovery of the labor markets. See the Opening Statement of J. Mark McWatters at the field hearing of the Congressional Oversight Panel on Commercial Real Estate held January 27, 2010 in Atlanta (online at http://cop.senate.gov/documents/statement-012710-mcwatters.pdf).

[5] HAMP is an acronym for "Home Affordable Modification Program."

[6] See the Additional Views of J. Mark McWatters and Professor Kenneth R. Troske that accompany the September 2010 Oversight Report of the Congressional Oversight Panel, *Assessing the TARP on the Eve of Its Expiration* (online at http://cop.senate.gov/documents/cop-091610-report-mcwatterstroske.pdf). Former Panelist Paul S. Atkins and I concluded in our Additional Views to the Panel's January 2010 Oversight Report as follows:

> In order to expedite the swift metamorphosis of many TARP recipients from insolvent to investment grade, the institutions were arguably subsidized through government sponsored purchases of mortgage-backed securities and by the all but unlimited investment of (and commitment to invest) public funds in Fannie Mae, Freddie Mac and AIG. One may argue that the government has created without meaningful public debate or analysis a series of "bad banks" within the Federal Reserve, Treasury, Fannie Mae, Freddie Mac, and AIG to accomplish what TARP alone failed to achieve. These "bad banks" or, perhaps, "debt consolidation entities" operate by *actually* and *virtually* removing toxic assets from the books of TARP recipients and other holders and issuers. The Federal Reserve and Treasury have *actually* removed [over] $1 trillion of troubled assets from the books of TARP recipients and other holders and issuers through outright purchases. The Federal Reserve and Treasury have also *virtually* removed additional troubled assets from the books of TARP recipients and other holders and issuers by propping up the market values of such assets and maintaining historically low mortgage rates.

See the Additional Views of J. Mark McWatters and Paul S. Atkins that accompany the January 2010 Oversight Report of the Congressional Oversight Panel, *Exiting TARP and Unwinding Its Impact on the Financial Markets*, at 145 (online at http://cop.senate.gov/documents/cop-011410-report-atkinsmcwatters.pdf).

[7] According to the Congressional Budget Office, the bailout of Fannie Mae and Freddie Mac is projected to cost more than ten times the projected cost of the TARP, including the Capital Purchase Program employed by Treasury to bail out over 700 financial institutions.

[8] By contrast, TARP recipients (other than under the HAMP program) are required to repay all of their advances, together with interest or dividends thereon, and grant warrants to Treasury.

monetize their GSE-guaranteed MBS at prices above what they would have received without the GSE guarantees and use the proceeds to repay their obligations outstanding under the TARP, thereby arguably shifting a greater portion of the cost of the TARP from the TARP recipients themselves to the taxpayers.[9] Costs such as this should be thoughtfully considered when evaluating the TARP.[10]

Bailout of GMAC

With respect to the bailout of GMAC, the Panel offered the following observations in its March 2010 report:

> Although the Panel takes no position on whether Treasury should have rescued GMAC, it finds that Treasury missed opportunities to increase accountability and better protect taxpayers' money. Treasury did not, for example, condition access to TARP money on the same sweeping changes that it required from GM and Chrysler: it did not wipe out GMAC's equity holders; nor did it require GMAC to create a viable plan for returning to profitability; nor did it require a detailed, public explanation of how the company would use taxpayer funds to increase consumer lending.
>
> Moreover, the Panel remains unconvinced that bankruptcy was not a viable option in 2008. In connection with the Chrysler and GM bankruptcies, Treasury might have been able to orchestrate a strategic bankruptcy for GMAC. This bankruptcy could have preserved GMAC's automotive lending functions while winding down its other, less significant operations, dealing with the ongoing liabilities of the mortgage lending operations, and putting the company on sounder economic footing. The Panel is also concerned that Treasury has not given due consideration to the possibility of merging GMAC back into GM, a step which would restore GM's financing operations to the model generally shared by other automotive manufacturers, thus strengthening GM and eliminating other money-losing operations.[11]

Bailout of AIG

With respect to the bailout of AIG, the Panel offered the following observations in its June 2010 report:

> The government's actions in rescuing AIG continue to have a poisonous effect on the marketplace. By providing a complete rescue that called for no shared sacrifice among AIG's creditors, the Federal Reserve and Treasury fundamentally changed the relationship between the government and the country's most sophisticated financial players. Today, AIG enjoys a five-level improvement in its credit rating based solely on

[9] A portion of this benefit may be offset by the successful exercise of "put-back" rights by RMBS investors and others against mortgage loan originators.
[10] The TARP also created significant moral hazard risks and all but enshrined the concept that some financial institutions and other business enterprises are too big or too interconnected to fail.
[11] See the March 2010 Oversight Report of the Congressional Oversight Panel, *The Unique Treatment of GMAC Under the TARP*, at 4 (online at http://cop.senate.gov/documents/cop-031110-report.pdf). See also the Additional Views of J. Mark McWatters and Paul S. Atkins that accompany the March 2010 report (online at http://cop.senate.gov/documents/cop-031110-report-atkinsmcwatters.pdf).

its access to government funding on generous terms. Even more significantly, markets have interpreted the government's willingness to rescue AIG as a sign of a broader implicit guarantee of "too big to fail" firms. That is, the AIG rescue demonstrated that Treasury and the Federal Reserve would commit taxpayers to pay any price and bear any burden to prevent the collapse of America's largest financial institutions, and to assure repayment to the creditors doing business with them. So long as this remains the case, the worst effects of AIG's rescue on the marketplace will linger.[12]

Robo-signing and other Mortgage Loan Irregularities

With respect to the robo-signing and other mortgage loan irregularities, the Panel offered the following observations in its November 2010 report:

> To put in perspective the potential problem, one investor action alone could seek to force Bank of America to repurchase and absorb partial losses on up to $47 billion in troubled loans due to alleged misrepresentations of loan quality. Bank of America currently has $230 billion in shareholders" equity, so if several similar-sized actions – whether motivated by concerns about underwriting or loan ownership – were to succeed, the company could suffer disabling damage to its regulatory capital. It is possible that widespread challenges along these lines could pose risks to the very financial stability that the Troubled Asset Relief Program was designed to protect. Treasury has claimed that based on evidence to date, mortgage-related problems currently pose no danger to the financial system, but in light of the extensive uncertainties in the market today, Treasury's assertions appear premature. Treasury should explain why it sees no danger. Bank regulators should also conduct new stress tests on Wall Street banks to measure their ability to deal with a potential crisis.[13]

Foreclosure Mitigation under the HAMP

With respect to the HAMP and Treasury's other foreclosure mitigation programs, the Panel offered the following observations in its December 2010 report which was released two days ago:

> While HAMP's most dramatic shortcoming has been its poor results in preventing foreclosures, the program has other significant flaws. For example, despite repeated urgings from the Panel, Treasury has failed to collect and analyze data that would explain HAMP's shortcomings, and it does not even have a way to collect data for many of HAMP's add-on programs. Further, Treasury has refused to specify meaningful goals by

[12] See the June 2010 Oversight Report of the Congressional Oversight Panel, *Congressional Oversight Panel Examines AIG Rescue and Its Impact on Markets*, at 10 (online at http://cop.senate.gov/documents/cop-061010-report.pdf). See also the Additional Views of J. Mark McWatters that accompany the June 2010 report (online at http://cop.senate.gov/documents/cop-061010-report-mcwatters.pdf).

[13] See the November 2010 Oversight Report of the Congressional Oversight Panel, *Examining the Consequences of Mortgage Irregularities for Financial Stability and Foreclosure Mitigation*, at 6 (online at http://cop.senate.gov/documents/cop-111610-report.pdf).

See also the Opening Statement of J. Mark McWatters at the hearing of the Congressional Oversight Panel on Foreclosure Mitigation held October 27, 2010 in Washington, DC (online at http://cop.senate.gov/documents/statement-102710-mcwatters.pdf).

which to measure HAMP's progress, while the program's sole initial goal – to prevent 3 to 4 million foreclosures – has been repeatedly redefined and watered down. Treasury has also failed to hold loan servicers accountable when they have repeatedly lost borrower paperwork or refused to perform loan modifications. Treasury has essentially outsourced the responsibility for overseeing servicers to Fannie Mae and Freddie Mac, but both companies have critical business relationships with the very same servicers, calling into question their willingness to conduct stringent oversight. Freddie Mac in particular has hesitated to enforce some of its contractual rights related to the foreclosure process, arguing that doing so "may negatively impact our relationships with these seller/servicers, some of which are among our largest sources of mortgage loans." Treasury bears the ultimate responsibility for preventing such conflicts of interest, and it should ensure that loan servicers are penalized when they fail to complete loan modifications appropriately.[14]

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[14] See the December 2010 Oversight Report of the Congressional Oversight Panel, *A Review of Treasury's Foreclosure Prevention Programs*, at 5 (online at http://cop.senate.gov/documents/cop-121410-report.pdf).

See also the Additional Views of J. Mark McWatters and Professor Kenneth R. Troske that accompany the December 2010 report, at 126-127 (online at http://cop.senate.gov/documents/cop-121410-report-mcwatterstroske.pdf), which provide:

> It is regrettable that the HAMP creates disincentives for investors and servicers as well as homeowners by rewarding their dilatory and inefficient behavior with the expectation of enhanced taxpayer-funded subsidies. Since any intermediate to long-term resolution of the housing crisis must reside substantially with the private sector lenders and investors who hold the mortgage notes and liens, instead of spending an additional $30 billion on a government sponsored foreclosure mitigation effort, we believe Treasury would be best served by strongly encouraging these participants to engage in good faith, market-based negotiations with their distressed borrowers. In our opinion, this is the best way to bring stability to the housing market so that the economy can start growing again.

See also the Opening Statement of J. Mark McWatters at the hearing of the Congressional Oversight Panel on Foreclosure Mitigation held October 27, 2010 in Washington, DC (online at http://cop.senate.gov/documents/statement-102710-mcwatters.pdf), which provides:

> I also wish to note that in my view, the Administration's foreclosure mitigation programs – including the HAMP and the HARP – have failed to provide meaningful relief to distressed homeowners and, disappointingly, the Administration has inadvertently created a sense of false expectations among millions of homeowners who reasonably anticipated that they would have the opportunity to modify or refinance their troubled mortgage loans under the HAMP and HARP programs. In fairness, however, to the efforts of the Administration, I remain unconvinced that government sponsored foreclosure mitigation programs are necessarily capable of lifting millions of American families out of their underwater home mortgage loans. From my perspective, the best foreclosure mitigation tool is a steady job at a fair wage and not a hodgepodge of government-subsidized programs that create and perpetuate moral hazard risks and all but establish the government as the implicit guarantor of distressed homeowners. I question why the taxpayers should subsidize mortgage lenders and RMBS participants when it is most often in the best interest of such parties to forgive principal and modify or refinance troubled mortgage loans without government assistance. Why should the taxpayers provide incentives when they appear to be neither needed nor merited?
>
> I remain troubled that HAMP itself may have exacerbated the mortgage loan delinquency and foreclosure problem by encouraging homeowners to refrain from remitting their monthly mortgage installments based upon the expectation that they would ultimately receive a favorable restructure or principal reduction

As I have stated before, it is critical to note that my assessment of the TARP and the HAMP is in no way intended to diminish the financial hardship that many Americans are suffering as they attempt to modify or refinance their underwater home mortgage loans, and I fully acknowledge and empathize with the stress and economic uncertainty created from the bursting of the housing bubble. As such, I *strongly encourage* each mortgage loan holder and RMBS investor and servicer to work with each of their borrowers in a *professional, good faith, transparent and accountable manner* to reach an economically reasonable resolution prior to pursuing a foreclosure remedy. In my view, foreclosure should serve as the exception to the rule that only follows from the transparent and objective failure of the parties to modify or refinance a troubled mortgage loan pursuant to market-based terms.

Contracting Authority under the TARP

With respect to Treasury's contracting authority under the TARP, The Panel offered the following observations in it October 2010 Report:

> The largest TARP financial agency agreements were those with Fannie Mae and Freddie Mac to provide administration and compliance services for Treasury's foreclosure mitigation programs. As described in detail in the case study accompanying this report, these agreements raise significant concerns. Both Fannie Mae and Freddie Mac have a history of profound corporate mismanagement, and both companies would have collapsed in 2008 were it not for government intervention. Further, both companies have fallen short in aspects of their performance, as Fannie Mae recently made a significant data error in reporting on mortgage redefaults and Freddie Mac has had difficulty meeting its assigned deadlines.[15]

After reflecting upon the analysis conducted by the Panel and its individual members over the past several months it is clear that the success or failure of the TARP program remains an open question and that neither a favorable adjustment to the CBO subsidy rate nor the repayment of TARP funds by some recipients tells the entire story. Although the TARP played a meaningful role in the rescue of the United States economy during the closing days of 2008, its enduring legacy may be to have all but codified the implicit guarantee of the "too-big-to-fail" financial institutions notwithstanding the profound moral hazard risks arising from such action.[16]

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subsidized by the taxpayers. The curious incentives offered by the HAMP arguably convert the concept of home ownership into the economic equivalent of a "put option" – as long as a homeowner's residence continues to appreciate in value the homeowner will not exercise the put option, but as soon as the residence falls in value the homeowner will elect to exercise the put option and walk away – or threaten to walk away – if a favorable bailout is not offered.

[15] See the October 2010 Oversight Report of the Congressional Oversight Panel, *Examining Treasury's Use of Financial Crisis Contracting Authority*, at 6 (online at http://cop.senate.gov/documents/cop-101410-report.pdf).

[16] The Additional Views issued by J. Mark McWatters and former Panel member Paul S. Atkins with respect to the Panel's January 2010 report on *Exiting TARP and Unwinding Its Impact on the Financial Markets* describes some of the challenges presented by the TARP:

> The January report analyzes the difficulties that may arise when the United States government directly or indirectly undertakes to prevent certain systemically significant institutions from failing. Although the

Thank you and I look forward to our discussion.

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government does not generally guarantee the assets and obligations of private entities, its actions and policies may nevertheless send a clear message to the market that some institutions are simply too big or too interconnected to fail. Once the government adopts such a policy it is difficult to know how and where to draw the line. With little public debate, automobile manufacturers were recently transformed into financial institutions so they could be bailed out with TARP funds and an array of arguably non-systemically significant institutions – such as GMAC – received many billions of dollars of taxpayer funded subsidies. In its haste to restructure favored institutions, the government may assume the role of king maker – as was surely the case in the Chrysler and GM bankruptcies – and dictate a reorganization structure that arguably contravenes years of well-established commercial and corporate law precedent. The unintended consequences of these actions linger in the financial markets and legal community long after the offending transactions have closed and adversely – yet subtly – affect subsequent transactions that carry any inherent risk of future governmental intervention. The uninitiated may question why two seemingly identical business transactions merit disparate risk-adjusted rates of return or why some transactions appear over-collateralized or inexplicably complicated. The costs of mitigating political risk in private sector business transactions are seldom quantified or even discussed outside the cadre of businesspersons and their advisors who structure, negotiate and close such transactions, yet such costs certainly exist and must be satisfied.

See the Additional Views of J. Mark McWatters and Paul S. Atkins that accompany the January 2010 report, at 157-158 (online at http://cop.senate.gov/documents/cop-011410-report-atkinsmcwatters.pdf).

The CHAIRMAN. Thank you.
Mr. Silvers.

STATEMENT OF DAMON SILVERS, DIRECTOR OF POLICY AND SPECIAL COUNSEL, AFL-CIO

Mr. SILVERS. Thank you, Mr. Chairman.

Good morning. I would like to begin by thanking Secretary Geithner for appearing once again before our Panel. And I would like to also note that I, in general, appreciate and concur with my colleague Mr. McWatters' comments and summary of some of the issue that we have been concerned about.

The story of the Troubled Asset Relief Program over the last 2 years is one that has two faces:

On the one hand, looked at purely from the perspective of how much TARP will cost the American public, and the effect of TARP on the acute crisis, and severe crisis, we faced in 2008, the news keeps getting better and better.

Recently, as my fellow panelists have noted, the Congressional Budget Office estimated that the total cost of TARP will be approximately $25 billion, less than a tenth of the original estimates. Certain individual investments, which were entered into on terms that were clearly unfavorable to taxpayers, in light of the risks involved, such as the preferred stock purchases and asset guarantees at Citigroup, have been skillfully managed by Treasury to produce significant profits.

And I would like to commend you, Mr. Secretary, for—and your colleagues, the TARP directors, Herb Allison and Tim Massad—for what you have done to protect and recover the public's money in this regard.

But, there is another and, frankly, more important way of looking at TARP. TARP cannot be held solely accountable for the state of the U.S. or the global economy. But, oversight of TARP requires that we look at two critical areas of our economy that TARP was designed to address: the availability of credit to the real economy, and the state of the foreclosure crisis. Frankly, on both fronts the news is grim. Witnesses have testified before our panel, in recent hearings, that we can expect between 8 and 13 million families to face foreclosure before the crisis is over; millions more than we have experienced already. Under the pressure of hundreds of thousands of foreclosures a month, housing prices have resumed their downward slide.

On the credit to the real economy side of things, mortgage financing is available today, but entirely through the assistance of government-backed vehicles, like, but not limited to, the GSEs; but business lending remains hard to come by, other than for those companies that can access the public credit markets.

Bank holding companies have over $1 trillion on deposit with the Federal Reserve System, while business lending remains stagnant by banks, at crisis levels.

Unemployment levels today are above those projected as the worst-case scenario in the TARP bank stress tests undertaken in the spring of 2009.

Asset deflation, banks that won't take normal banking risk—these are the signs of a financial system that remains unhealthy.

I continue to believe that we made a fundamental mistake in our management of the financial crisis by not restructuring the major banks. By not following our own Nation's approach to similar crises in the past, we started down the path Japan took in the 1990s, and we are reaping the same outcomes: a sluggish and uncertain recovery, banks that can't restructure bad loans and won't lend to business to create jobs. But, because our financial crisis involves home mortgages, the decision to make preserving the banks' capital structure our highest policy goal has meant not just a weak economy, but the unprecedented human tragedy of millions of foreclosures. In the end, at worst, bank stockholders got diluted. Millions upon millions of American families have been dispossessed. And there is a difference.

I hope today we will be able to explore the question of TARP and the mortgage crisis with Secretary Geithner and that—and the—and explore the intersection of the mortgage crisis with issues of systemic risk and the overall health of our economy. I very much look forward to the Secretary's testimony.

And, once again, thank you for appearing before us.

[The prepared statement of Mr. Silvers follows:]

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Congress of the United States
CONGRESSIONAL OVERSIGHT PANEL

Opening Statement of Damon Silvers

Congressional Oversight Panel Hearing with Treasury Secretary Timothy Geithner

December 16, 2010

Good morning. I would like to begin by thanking Secretary Geithner for appearing once again before our Panel.

The story of the Troubled Asset Relief Program over the last two years is one that has two faces.

On the one hand, looked at purely from the perspective of how much TARP will cost the American public, the news keeps getting better and better. Recently the Congressional Budget Office estimated the total cost of TARP will be approximately $25 billion, less than a tenth of the original estimates. Certain individual investments which were entered into on terms that were clearly unfavorable to taxpayers in light of the risks involved, such as the preferred stock purchases and asset guarantees at Citigroup, have been skillfully managed by Treasury to produce significant profits. I would like to commend you, Mr. Secretary, and TARP directors Herb Allison and Tim Massad for what you have done to protect and recover the public's money.

But there is another and frankly more important way of looking at TARP. TARP cannot be held solely accountable for the state of the U.S. or the global economy. But oversight of TARP requires that we look at two critical areas of our economy that TARP was designed to address: the availability of credit to the real economy and the state of the foreclosure crisis. Frankly, on both fronts the news is grim. Witnesses have testified before our panel that between 8 and 13 million families and homes are facing foreclosures, millions more than we have experienced already. Under the pressure of hundreds of thousands of foreclosures a month, housing prices have resumed their downward slide.

On the credit to the real economy side of things, mortgage financing is available today, but entirely through the assistance of government backed vehicles -- like the GSEs. But business lending remains hard to come by. Bank holding companies have over $1 trillion on deposit with the Federal Reserve System, while business lending remains stagnant at crisis levels. Unemployment levels today are above those projected as the worst case scenario in the TARP bank stress tests.

Asset deflation, banks that won't take normal banking risk -- these are the signs of a financial system that remains unhealthy. I continue to believe that we made a fundamental mistake in our management of the financial crisis by not restructuring the major banks. By not following our own nation's approach to similar crises in the past, we started down the path Japan took in the 1990s, and we have reaped the same outcomes: a sluggish and uncertain recovery, banks that can't restructure bad loans and won't lend to business to create jobs. But because our financial crisis involves home mortgages, the decision to make preserving the banks' capital structure our highest policy goal has meant not just a weak economy, but the unprecedented human tragedy of millions of foreclosures. In the end, at worst stockholders got diluted. Millions upon millions of families have been dispossessed. There's a difference.

I hope today we will be able to explore the question of TARP and the mortgage crisis with Secretary Geithner, and the intersection of the mortgage crisis with issues of systemic risk and the overall health of our economy. I look forward to the Secretary's testimony and once again thank him for appearing before us.

The CHAIRMAN. Thank you, Mr. Silvers.

Dr. Troske.

STATEMENT OF KENNETH TROSKE, WILLIAM B. STURGILL PROFESSOR OF ECONOMICS, UNIVERSITY OF KENTUCKY

Dr. TROSKE. Thank you, Senator Kaufman.

Mr. Secretary, I would like to thank you for agreeing to appear again before this Panel. I know your previous testimony has been quite helpful to us as we carry out our oversight responsibilities, and I am confident that this trend will continue.

During my time on the Panel, I have become more and more concerned about the public's perception of TARP and the impact this perception has on the government's ability to adopt similar measures during any future financial crisis.

As we indicated in our September report, the consensus among the academic economists and other experts that we consulted was that TARP played an important role in helping to end the financial crisis, a view I largely share. Yet, despite this consensus among the experts, I think it's fair to say that, to the general public, TARP remains one of the most vilified pieces of legislation ever enacted, viewed largely as an effort on the part of former Wall Street executives to bail out current Wall Street executives.

I would argue that a large part of the public's disdain for TARP can be traced back to the original way it was proposed, a 3-page bill submitted to Congress asking for the authority to spend $700 billion with almost no oversight, as well as how it was implemented, changing the focus of the program from one designed to purchase toxic assets to one where Treasury began to purchase equity in private-sector for-profit firms. I would argue also—I would also argue that previous—that the previous administration's decision to classify General Motors and Chrysler as financial firms in order to use TARP money to bail out these firms increased public skepticism even further.

Let me be clear: I am not questioning the wisdom of these decisions; instead, I am focusing on the public's perception of these actions.

I recognize—in short, I recognize that, in trying to overcome the public's hatred of TARP, you are forced to deal with these past actions. However, I think that there are a number of actions that Treasury could and should be taking right now to try and help turn public perception.

One important way that any government can show its programs are effective is to periodically have independent researchers conduct thorough and rigorous evaluations of its programs. This is true whether the program is designed to retrain displaced workers, to rescue banks in financial crisis, or to assist struggling homeowners. When performing this type of analysis, a government needs to collect comprehensive data on both program participants and nonparticipants in order to have a meaningful comparison group. Yet, despite the Panel's repeated urging in various reports for Treasury to expand—significantly expand its data collection efforts, it does not appear that Treasury has made comprehensive data collection for TARP programs a priority. I would again urge you to do so, and I would also urge you to make these data available to outside researchers. Only by taking these key steps will we

obtain the credible, independent research that is so vital in evaluating a program and convincing the public that TARP achieved the desired outcomes in a cost-effective manner.

I would also suggest that we begin to recognize that there are two parts of TARP: one, the set of programs, designed to assist financial institutions in the midst of the financial crisis, the other, programs that were largely directed at stimulating the economy.

As our September report makes clear, there is a much broader consensus about the effectiveness of the former than the latter programs. As part of this effort, I suggest that we need to take a careful look at how much money should have been initially allocated to TARP. Changes to TARP in the Dodd-Frank legislation indicate that Congress felt, in retrospect, that we could have gotten by with 450 billion instead of the original 700 billion allocated. But, I am guessing that a more careful analysis would reveal that some of the programs not directly aimed at stemming the financial crisis may have been better part of alternative legislation. In my opinion, making this distinction would help generate more support for what I consider the more key components of TARP that we would certainly like to have at our disposal during future crises.

Finally, as economist Kenneth Rogoff pointed out in written comments to the Panel for our September report, “A proper cost-benefit analysis thus needs to price the risk taxpayers took during the financial crisis. Ex-post accounting—How much did the government actually earn or lose after the fact?—can yield an extremely misguided measure of the true cost of the bailout, especially as a guide to future policy responses.” I would add to Professor Rogoff’s statement that focusing on ex-post accounting of this single program also fails to take into account the myriad of other costly government programs which provided significant assistance to major banks and financial institutions.

Again, I’m not questioning the wisdom of these programs; it is clear—but, I believe, it is clear that, by providing additional support to large financial institutions that received TARP funds, these programs made it possible for the institutions to repay their TARP funds and allowed some of the costs of TARP to be shifted to other less scrutinized government programs. I believe that, at an intuitive level, the American people recognize the costs of putting so much money at risk and the ability to shift costs across programs; therefore, the public remains justifiably skeptical of the claims that TARP was a success because of—most of the money will be paid back. That is why I believe we need a more comprehensive evaluation of the true costs of TARP and the overall financial bailout if we are ever going to convince the American people that any part of TARP can be considered a success.

Mr. Secretary, as this Panel wraps up our oversight responsibilities in the coming months, I believe that these are the issues we are going to be grappling with the most: what parts of TARP were successful, and how can we demonstrate their effectiveness? As I indicated at the start of my comments, I am confident that your testimony today, and any future testimony you provide, will be of great assistance in our efforts. I look forward to your comments today, and I thank you again for appearing before us.

[The prepared statement of Dr. Troske follows:]

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Congress of the United States

CONGRESSIONAL OVERSIGHT PANEL

Opening Statement of Kenneth Troske

Congressional Oversight Panel Hearing with Treasury Secretary Timothy Geithner

December 16, 2010

Thank you Senator Kaufman.

Mr. Secretary, I would like to thank you for agreeing to appear again before this Panel. I know your previous testimony has been quite helpful to us as we carry out our oversight responsibilities, and I am confident that this trend will continue.

During my time on the Panel, I have become more and more concerned about the public's perception of TARP and the impact this perception has on the government's ability to adopt similar measures during any future financial crisis. (As an aside, I would add that any objective reading of American economic history shows that, despite the repeated efforts on the part of the government, we have experienced periodical financial crises for our entire history and are likely to continue to experience financial crises in the future.) As we indicated in our September report, the consensus among the academic economists and other experts that we consulted was that TARP played an important role in helping to end the financial crisis, a view I largely share. Yet, despite this consensus among the experts, I think it is fair to say that to the general public, TARP remains one of the most vilified pieces of legislation ever enacted—viewed largely as an effort on the part of former Wall Street executives to bailout current Wall Street executives.

I would argue that a large part of the public's disdain for TARP can be traced back to the original way it was proposed—a three-page bill submitted to Congress asking for the authority to spend $700 billion with almost no oversight—and how it was implemented. Changing the focus of the program from one designed to purchase toxic assets to one where Treasury began purchasing equity in private sector, for profit, firms only increased this disdain. I would also argue that the previous administration's decision to classify GM and Chrysler as financial firms in order to use TARP money to bailout these firms increased public skepticism even more. Let me be clear, I am not questioning the wisdom of these decisions; instead, I am focusing on the public perception of these actions.

I recognize that, in trying to overcome the public's hatred of TARP, you are forced to deal with these past actions. However, I think that there are a number of actions that Treasury could and should be taking right now to try to help turn the public's perception.

One important way that any government can show that its programs are effective is to periodically have independent researchers conduct thorough and rigorous evaluations of its programs. This is true whether the program is designed to retrain displaced workers, to rescue

banks in a financial crisis, or to assist struggling homeowners. When performing this type of analysis a government needs to collect comprehensive data on both program participants and non-participants (in order to have a meaningful comparison group). Yet, despite the Panel's repeated urging in various reports for Treasury to expand significantly its data collection efforts, it does not appear that Treasury has made comprehensive data collection for TARP programs a priority. I would again urge you to do so, and I also urge you to make these data available to outside researchers. Only by taking these key steps will we obtain the credible, independent research that is so vital for justifying the existence of a program and convincing the public that the TARP achieved the desired outcomes in a cost effective manner.

I would also suggest that we begin to recognize that there are two parts of TARP. One set of programs includes the portion of the Capital Purchase Program (CPP) that went to large banks, the AIG Investment Plan, and the Targeted Investment Program, that were designed to stem the financial crisis. The other set of programs included the portion of CPP that went to small banks, the auto industry assistance, and the mortgage foreclosure relief; these programs were largely directed at stimulating the economy. As our September report makes clear, there is a much broader consensus about the effectiveness of the former than the latter programs. As part of this effort, I suggest we need to take a careful look at how much money should have been initially allocated to TARP. Changes to TARP in the Dodd-Frank legislation indicate that Congress feels, in retrospect, that we could have gotten by with $450 billion instead of the $700 billion originally allocated. But I am guessing that a more careful analysis would reveal that some of the programs not directed at steming the crisis were unnecessary if our goal was restoring financial stability. In my opinion, making this distinction would help generate more support for what I consider the more key components of TARP that we would want to have at our disposal during future crises.

Finally, as economist Kenneth Rogoff pointed out in his written comments to the Panel for our September report, "A proper cost-benefit analysis thus needs to price the risk taxpayers took during the financial crisis. *Ex post* accounting (how much did the government actually earn or lose after the fact) can yield an extremely misguided measure of the true cost of the bailout, especially as a guide to future policy responses." I would add to Professor Rogoff's statement that focusing on *ex post* accounting of this single program also fails to take into account the myriad of other costly government programs, such as Treasury's bailout of the GSEs, the Federal Reserve's Primary Dealer Credit Facility, the purchase of potentially toxic mortgage backed securities from banks, and the FDIC's Temporary Liquidity Guarantee Program; and all of these programs provided significant assistance to the major banks. Again, while I am not questioning the wisdom of these programs, it is clear that by providing additional support to large financial institutions that received TARP funds, these programs made it possible for the institutions to repay their TARP funds and allowed some of the costs of TARP to be shifted to other, less scrutinized, government programs. I believe that at an intuitive level, the American people recognize both the cost of putting so much money at risk and the ability to shift costs across programs; therefore, the public remains justifiably skeptical of claims that TARP was a success because most of the money will be paid back. This is why I believe we need a more comprehensive evaluation of the true costs of TARP, and the overall financial bailout, if we are ever going to convince the American people that any part of TARP can be considered a success.

Mr. Secretary, as this Panel wraps up our oversight responsibilities in the coming months, I believe these are the issues that we are going to be grappling with the most: what parts of TARP were successful and how can we demonstrate their effectiveness. As I indicated at the start of my comments, I am confident that your testimony today, and any future testimony you provide, will be of great assistance in our efforts. I look forward to your comments today, and I thank you again for appearing before us.

The CHAIRMAN. Thank you, Dr. Troske.
Superintendent Neiman.

STATEMENT OF RICHARD NEIMAN, SUPERINTENDENT OF BANKS, NEW YORK STATE BANKING DEPARTMENT

Mr. NEIMAN. Thank you.

Mr. Secretary, when you last testified before this Panel in June, the major regulatory reforms that might have avoided the need for a TARP had not yet passed Congress. Additionally, a small business lending fund was not established, and well over $100 billion of losses were expected for the TARP program.

In the past 6 months, however, a Dodd-Frank regulatory regime is being implemented, and a new small business lending fund has congressional approval. The expected cost of TARP is much lower, with the CBO's projection of TARP's cost of $25 billion.

Given these developments, and that TARP successfully prevented a depression-like crisis, it might be fair to expect the public perception of TARP would be—have improved, and for the administration to get due credit for its management of the program it inherited.

But, public perception remains negative, perhaps because first impressions continue to linger. The reason probably has more deep-rooted element. Many people simply feel their lives have not gotten better during this period, even as the financial system has stabilized and banks have returned to profitability. The government must continue to work to finally fill TARP's unchecked boxes; namely, to encourage bank lending and prevent needless foreclosures.

It is my hope to discuss these two areas today. Specifically with regards to foreclosures, we must hold mortgage services fully accountable for the non-HAMP mortgage modifications they put homeowners into. These mortgage modifications must truly be helpful to homeowners, and sustainable. Non-HAMP modifications now outnumber HAMP modifications by about three to one.

More importantly, looking forward, I believe Dodd-Frank's vision of an effective CFPB must be realized in the foreclosure area. In order to protect homeowners and promote future financial stability, the CFPB has been specifically empowered to write mortgage rules. This must include national standards for mortgage servicers, who are critical players in the foreclosure crisis. No such national standards exist today.

Some States, like New York, have comprehensive servicer regulations in place that can serve as a model at the Federal level. Regardless, the CFPB cannot tackle mortgage servicing alone. The new agency will need the cooperation of the States and the Federal banking regulators to enforce any new rules, hopefully together in a new era of cooperative federalism.

With regards to small business lending, the public wants and needs the small business lending fund to be successful. But, loan supply is not the only reason bank lending is down. Other reasons must be integrated into our collective solutions, such as loan demand, underwriting standards, regulation, and uncertainties.

Finally, I think, nearly 2 years after the establishment of this oversight body, it should be highlighted that you have been a valuable—and available to this panel. We have an important oversight

job on behalf of Congress and the American public. You have appeared before us five times publicly and several times privately. Your openness has helped us to do our job better, and the public is better off as a result.

I thank you. And I look forward to our discussion this morning.

[The prepared statement of Mr. Neiman follows:]

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Congress of the United States

CONGRESSIONAL OVERSIGHT PANEL

Opening Statement of Richard Neiman

Congressional Oversight Panel Hearing with Treasury Secretary Timothy Geithner

December 16, 2010

Mr. Secretary, when you last testified before this Panel in June, the major regulatory reforms that might have avoided the need for a TARP had not yet passed Congress.

Additionally, a small business lending fund was not established, few states were participating in Treasury's Hardest Hit Fund foreclosure mitigation program, and well over a hundred billion dollars of losses were expected from the TARP program.

In the past six months, however, a new Dodd-Frank regulatory regime is being implemented, and a new small business lending fund has Congressional approval. The expected cost of TARP is much lower, with the Congressional Budget Office last month projecting TARP's total cost at $25 billion.

Given these developments, and that TARP successfully prevented a depression-like crisis, it might be fair to expect the public perception of TARP would have improved, and for the Administration to get due credit for its management of the program it inherited.

But public perception remains negative, perhaps because first impressions linger. The reason probably has a more deep-rooted element though: Many people simply feel their lives have not gotten better during this period, even as the financial system has stabilized and banks have returned to profitability. The government must continue to work to finally fill TARP's unchecked boxes – namely, to encourage bank lending and prevent needless foreclosures.

It is my hope to discuss these two areas today. Specifically, with regards to foreclosures, we must hold mortgage servicers fully accountable for the non-HAMP mortgage modifications they put homeowners into. These modifications must truly be helpful to homeowners and be sustainable. Non-HAMP modifications now outnumber HAMP modifications by about 3 to 1.

More importantly, looking forward I believe Dodd-Frank's vision of an effective CFPB must be realized in the foreclosure area. In order to protect homeowners and promote future financial stability, the CFPB has been specifically empowered to write mortgage rules. This must include national standards for mortgage servicers, who are critical players in the foreclosure crisis. No such federal regulations exist.

States like New York have comprehensive servicer regulations in place that can serve as a model at the federal level. Regardless, the CFPB cannot tackle mortgage servicing alone. The new agency will need the cooperation of the states and the federal banking regulators to enforce any new rules, hopefully together in a new era of Cooperative Federalism.

With regards to small business lending, the public wants and needs the small business lending fund to be successful. But loan-supply is not the only reason bank lending is down. Other reasons must be integrated into our collective solutions, such as loan-demand, underwriting standards, regulation, and future uncertainties.

I look forward to our discussion this morning.

The CHAIRMAN. Thank you, Superintendent Neiman.

I have to comment that each five panelists made up their remarks separately.

[Laughter.]

The CHAIRMAN. I mean, as—I was just sitting here thinking about how incredible it is that five people come up with testimony that's so similar. Really, we all say the same thing.

Thank you, Secretary Geithner, for coming today, and we're interested in your opening statement.

STATEMENT OF HON. TIMOTHY GEITHNER, SECRETARY, U.S. DEPARTMENT OF TREASURY

Secretary GEITHNER. Thank you, Mr. Chairman, and all of you. I agree with much of what you've said in your opening remarks, not all of what you said, but I hope we have a chance to talk about the concerns you still raise ahead, and I'll be open with you about the things that I think are the challenges we face going forward.

I want to provide, as you suggested, a broad overview of the impact of these programs on our economy and our financial system, and the challenges we face ahead.

I think it's also very important to recognize at the beginning that it's very hard to separate the impact of TARP itself on the economy and the financial system from the combined impact of the broad strategy this government embraced. And, of course, as you know, that strategy included a very creative, powerful set of programs by the Federal Reserve, a set of very powerful actions by the FDIC, the substantial support, in terms of tax incentives and investments, that came in the Recovery Act, the support for Fannie and Freddie that was required to avoid a collapse alongside the TARP programs. None of them would have been as effective without the overall package. Monetary policy doesn't work without a functioning financial system. TARP would not have been nearly as effective without those other instruments. That's an important thing to recognize.

I think it's important to recognize that the shock that caused this great recession, that caused this crisis, was larger and more powerful and more dangerous, in the view of economic historians, than the shock that precipitated the Great Depression. And yet, despite that, 2 years after the peak of the crisis, and 2 years after TARP was first passed by the Congress, the economy has now been growing for 18 months; we've had roughly 1.2 million jobs created by the private sector, more and more quickly than for the last two recessions; household wealth has improved very, very substantially over this period of time.

The tax package that was approved by the Senate yesterday and, based on the comments made by the House leadership—both Republicans and Democrats—that's likely to pass the House this afternoon, provides a very powerful package of support for middle-class families, for working families, for the unemployed, and a very powerful package of incentives for businesses, which we believe, and I think most economists believe, will add substantially to our prospect for getting the economy growing more rapidly and more people back to work in the coming 2 years.

I think it's fair to say that the worst part, the most dangerous part, of this financial storm has passed us, but the crisis has left a huge amount of damage in its wake. Millions and millions of Americans are still out of work, at risk of losing their homes. Unemployment remains, on average nationally, at 10 percent, but much higher in many parts of the country. And it's going to take years, not months—it's going to take years to fully repair the damage caused by this crisis.

Now, the government's financial programs, including TARP, but not limited to TARP, were not designed to and cannot solve all those problems, and cannot, on their own, solve all the damage caused by the crisis. But, these programs did what they had to do, what they were designed to do—which was to protect the value of America's savings, to restore a measure of stability to a financial system at the edge of collapse, to reopen access to credit, and to restart economic growth. And these programs did so much more powerfully, much more effectively, much more cheaply, much more quickly than I think really anyone, including the architects, thought was possible 2 years ago.

Now, you can see independent evidence of that conclusion—support of that conclusion from a range of different sources, including the work of the Panel. Mark Zandi and Alan Blinder published, I think, the most definitive independent study of the effects of these programs over the course of the summer. And, as you know, they concluded that, without these programs, the economy would have fallen by another 3 and a half percent, would still be declining; unemployment would be above 16 percent; we'd be at risk of a downward spiral of deflation.

No one knows for sure how bad it would have been. But, as I said, if you look at the magnitude of the shock that caused the Great Depression and how that crisis turned out for this country, against the evidence of what these policies have provided in this brief period of time, I think it's a very good record so far. Acknowledging that, as I said, the damage caused by this crisis is overwhelming, still, and it's going to take years—years to repair the damage.

Now, let me just review some of the other basic estimates we used to judge where we are today. As many of you pointed out, these programs achieved their objectives at a fraction of the cost that almost any observer predicted, even as recently as 3, 6, 9, or 12 months ago. The CBO estimates, which we all rely on because they're independent, initially estimated TARP would cost—TARP, itself, would cost $350 billion. Those estimates are now around $25 billion. They are too high, in my judgment. Ultimately, they'll be lower.

The most important thing to point out, it is that the investment programs in TARP means the combined investments we've put in banks, in AIG, to support credit markets, in the automobile industry—those investments together will show a positive return. The losses will be limited to the amount we spend in our housing programs. The investment programs in TARP will show a positive return, not a negative return. The taxpayers will earn a positive return on those investments.

Now, if you look more broadly, as many of you suggested, at the combined costs of everything the Fed did, everything the FDIC did, the losses we still face because of what Fannie and Freddie did before the crisis, and TARP, together, on reasonable estimates about the future, those total costs are likely to be less than 1 percent of GDP, which is less than one-third of the cost of the savings and loan crisis, which, as you know, was a much milder, much more limited financial crisis. And if you look at the costs of crises across many countries over time, the direct financial costs of these programs, all in, including the GFCs, the Fed, FDIC, and these programs, is likely to be a small fraction of what we have seen almost anywhere in history over this period of time.

Now, we are moving very, very aggressively to exit from the government's investments, from the guarantee programs, from the emergency crisis response as quickly as possible. And we are way ahead of schedule in achieving that objective.

We've recovered a very substantial fraction of the investments in banks. When I came into office, the government had invested—and they needed to do it, it was a necessary thing to do—it had invested in banks that represented about three-quarters of the entire American banking system. Our remaining investments today are in banks that represent only 10 percent of the American banking system. That's happened in just over 20 months. As you know, we're—and I'm happy to go through these in more detail—we're substantially far along the road to definitive exit from the automobile industry, from AIG, and, of course, all the Nation's banks.

Now, as many of you said, a key test of crisis response is: Are you leaving the system stronger than it existed before the crisis? And, in contrast to what you said, Mr. Silvers, the American financial system today is in a much stronger position than it was before the crisis. There's been a very dramatic restructuring of our financial system. The weakest parts of the system no longer exist today. The remaining institutions had to pass a very rigorous test for market viability. They have much stronger capital positions than they had before the crisis, and they are much higher capital positions than is true for their international competitors.

And the Dodd-Frank bill gives us tools for oversight, for crisis prevention, for crisis resolution, to limit moral hazard risk, that I believe will be the model for the world going forward, and address the critical weaknesses that helped cause this crisis.

So, for those reasons, because the system is in a much strong position today, if economic growth in the future proves weaker than we would hope, it will not be because of the remaining challenges in the financial system; it'll be because this was a crisis caused by millions and millions of people taking on too much debt, and it takes time to grow out of this crisis. It will not be because the financial system is providing a constraint on access to credit on a scale that would limit future growth.

And, Mr. Chairman, you—could I just make a few final remarks then——

The CHAIRMAN. Sure.

Secretary GEITHNER [continuing]. I'll move into——

The CHAIRMAN. We'd like—questions and then——

Secretary GEITHNER [continuing]. I'll move into conclusion.

The CHAIRMAN. Yeah.

Secretary GEITHNER. Now, we face a lot of challenges ahead, and we're going to go through those. I just want to list what those are, in my perspective.

Obviously, there are housing; small banks; access to credit, for small businesses in particular; the challenge you referred to, Mr. Chairman, of winding down prudently, carefully, protect the taxpayers' interest in what's a—still very complicated set of investments in the remaining financials in the system; implementing Dodd-Frank; and laying out a broad reform for the GSEs and the housing finance system. That is a lot of work.

Overwhelmingly, though, the biggest challenge facing the country is how to get the economy growing at a more rapid rate so we can bring down the unemployment rate as fast as possible. That's the most important thing we can do for housing, for small banks, for access to credit more generally, and that's going to have to be the principal focus of the administration and the Congress's efforts.

I want to just conclude briefly with two final remarks. I think it's very important that—you have been very gracious, but it's important to step back and give credit to my predecessor, Secretary of the Treasury Henry Paulson, to the Federal Reserve Board and staff, to the men and women of the New York Federal Reserve Board, and to Chairman Sheila Bair, and the architects of these programs at the Treasury, including—and I want to list them for you, principally—they are Lee Sachs, Herb Allison, Tim Massad, and Matt Kabaker. They designed a very complicated set of programs in a very short period of time, for which there had been no precedent, in modern financial history, which, as you have acknowledged, have been much more successful than almost anybody expected. And, of course, they did the necessary thing.

And I want to conclude by just acknowledging how important the work of this panel and the other oversight bodies that were established to look at what we were doing.

I think one of the great strengths of our country is that we subject the judgments of public officials to very difficult, rigorous, independent oversight. I don't agree with all the judgments that you have made or the judgments that the other oversight bodies have made, but you have—you play a necessary function. It's part of rebuilding confidence in public institutions of the United States. And we have been very careful, where you've made recommendations that we were confident would improve our programs, we have adopted those recommendations, and, of course, will continue to do that as we go forward.

I welcome a chance to talk about these things with you. And I look forward to being able to respond to some of the other observations you made in your opening remarks.

[The prepared statement of Secretary Geithner follows:]

Secretary Timothy F. Geithner
Written Testimony
Congressional Oversight Panel
December 16, 2010

Introduction

Chairman Kaufman, members McWatters, Neiman, Silvers, and Troske, thank you for the opportunity to testify about government policies in response to the financial crisis, particularly the Troubled Asset Relief Program (TARP).

At the suggestion of the panel, I would like to take this opportunity to provide a broad overview of the impact of the government strategy to repair the damage caused by the financial crisis. In this context, I will also provide an update on the status of our efforts to return the financial system to private hands, recover government investments with the highest possible returns to taxpayers, and support the housing market.

As the financial crisis spread in 2008, the previous Administration and the Federal Reserve took a series of unprecedented actions, through TARP and other programs, to help stabilize a financial system that was at the edge of collapse. Those actions included:

- Support for the Government-Sponsored Enterprises (GSEs), through the Preferred Stock Purchase Agreements authorized under the Housing and Economic Recovery Act;
- Providing capital to financial institutions through the Capital Purchase Program;
- Providing broad-based guarantees to the financial system, through programs such as the FDIC's Temporary Liquidity Guarantee Program and the Treasury Money Market Fund guarantee program;
- Support for the auto industry, in order to prevent massive additional unemployment and further disruption to the financial markets;
- Initiation of extraordinary facilities, through the Federal Reserve, to support liquidity across the financial system.

The combined effect of the actions taken by the Federal Reserve and the previous Administration helped stop the panic and slow the momentum of the financial crisis. But despite these extraordinary actions, when President Obama took office in early 2009, the financial system was still paralyzed and the economy was contracting at an accelerating rate.

Banks could not operate without government assistance, and businesses were unable to raise capital. Foreclosures were increasing and home prices were falling, and they were expected to fall by as much as an additional 30 percent. For individual families who needed credit – who wanted to buy a house or a new car, or put a child through college – it was more difficult to borrow money than any time since the Great Depression.

Against this background, the Obama Administration, working alongside the Federal Reserve, put in place a broad strategy to restore economic growth, free up credit, and return private capital to the financial system. The Administration's strategy combined the American Recovery and Reinvestment Act, a powerful mix of targeted tax measures and investments, with a comprehensive plan to repair the financial system.

This plan represented an important shift in strategy. The Financial Stability Plan shifted the focus away from broad support of individual institutions to restarting the broad markets for capital and credit that are critical for economic growth. We designed a plan that would maximize the chance that private capital bore the burden of solving the problems of the crisis. We provided support for the housing market and for homeowners in order to facilitate broader economic recovery. And when we did provide extraordinary assistance to individual firms, our assistance came with tough conditions.

Actions

Our Financial Stability Plan had three central components:

- first, to recapitalize the banking system.
- second, to restart the credit markets that are critical to borrowing for businesses, individuals, and state and local governments; and
- third, to help stabilize the crisis in the housing market.

The first piece of the Administration's strategy was to recapitalize the financial system. Towards this end, we conducted a stress test of the nation's nineteen largest bank holding companies. The test forced these banks to disclose significant amounts of information about the risks they faced, so that private investors could differentiate among them and assess the underlying financial strength of each institution.

A test of this scale and stringency was unprecedented, and it required a level of transparency and disclosure that no country has adopted before or since. Banks were forced to raise enough capital to meet the exacting conditions of the stress test, with the knowledge that if they were unable to raise that capital from the private markets, they would be forced to take capital from the government. And that capital, in keeping with this Administration's commitment to accountability, would come with tough conditions.

Our comprehensive strategy proved effective. In the spring of 2009, the Recovery Act had begun to turn the economy around. The improvement in macroeconomic conditions, combined with the government's explicit capital backstop of tested institutions, bolstered market confidence and facilitated investment in major U.S. financial companies. The test itself provided the necessary impetus for banks not only to begin raising private capital, but also to repay TARP investments. Banks were able to raise $150 billion in private capital at a very early stage of the crisis, saving hundreds of billions of taxpayer dollars, helping restore market confidence, reopen credit markets, and restart economic growth.

The second key aspect of the Financial Stability Plan was committing resources in order to restart key channels of credit to households and businesses.

- Through the Term Asset-Backed Securities Loan Facility (TALF), a joint program with the Federal Reserve, we helped restart the asset-backed securitization markets that provide credit to consumers and small businesses. Since TALF was launched in March 2009, new issuances of asset-backed securities have averaged $12 billion per month, compared to less than $2 billion per month during the height of the crisis.

- Through the Public-Private Investment Program (PPIP) for legacy securities, we matched TARP funds with private capital to purchase legacy mortgage-related securities. This program helped return liquidity to key markets for financial assets and clean up the balance sheets of major financial institutions. Since the announcement of PPIP in March 2009, prices for eligible residential and commercial mortgage-backed securities have increased by as much as 75 percent.

- We also launched the SBA 7(a) Securities Purchase Program, in which we committed to help unlock credit for small business by purchasing securities backed by small business loans.

Finally, the Administration took a series of actions to help address the crisis in housing markets. The focus of our strategy has been to provide stability to housing prices and to give Americans who can afford to stay in their homes a chance to do. By reducing mortgage rates, and reducing foreclosures that could be avoided with sensible incentives, these policies helped put a floor under housing prices, helped bring stability to house prices nationally on average, and have given a chance to millions of Americans, a chance to stay in their homes.

The Home Affordable Modification Program (HAMP) has helped catalyze the market to provide millions of loan modifications. More than 3.73 million modifications were started between April 2009 and the end of August 2010 – more than double the number of foreclosure completions during that time. These modifications include nearly 1.4 million trial HAMP modification starts, more than 600,000 Federal Housing Administration loss mitigation and early delinquency interventions, and nearly 1.8 million proprietary modifications reported through HOPE Now data.

The Economic Impact of Our Policies

In any assessment of the response to a financial crisis, there are several important measures of success. What was the response's effect on the availability of credit and economic growth? How quickly is the government able to return the financial system to private hands? What was the direct financial cost of the interventions? And, finally, has the response left the financial system able to support rather than impede economic growth?

Macroeconomic Impact

At the peak of the crisis, banks were not making new loans to businesses, or even to one another. Businesses could not get financing in our capital markets. Municipalities and state governments could not issue bonds at reasonable rates. The securitization markets, which provide financing for credit cards, student loans, auto loans and other consumer financing, had stopped functioning. And where credit was available, it was prohibitively expensive.

In response to the combined actions of the President, the Congress, and the Federal Reserve, the cost of credit has since fallen dramatically. For businesses, the cost of long-term investment grade borrowing has fallen from a peak of roughly 600 basis points over benchmark Treasury securities to just 320 basis points over Treasuries today. American families are spending less each month on mortgage payments. At the peak of the crisis, a family with an average 30-year mortgage was borrowing at almost 6 percent. Today, that family is borrowing at approximately 4.5 percent, saving more than $2,500 each year.

As early as the middle of 2009, due to the combined impact of the government's financial programs, borrowing rates fell sharply for businesses, individuals, and state and local governments. Companies were able to fund themselves in private markets by issuing equity and long-term debt. Housing prices began to stabilize. The value of the savings of American workers began to recover and the economy began to grow again.

The economy as a whole has made substantial progress since the recession ended last year. Real GDP has risen for five straight quarters, and private sector firms have started to hire again. The housing market remains weak, but there are signs that it is beginning to stabilize.

Our strategy to force a fundamental restructuring of the auto companies has not only helped save a million jobs across the country, but has restored these institutions to profitability. Since GM and Chrysler emerged from bankruptcy, the industry has created 75,000 jobs, and for the first time in six years, Ford, GM, and Chrysler are all operating at a profit.

Although we can never know with certainty where we would be today without these emergency policies, one of the most comprehensive independent analyses of the overall impact of our response, by economists Mark Zandi and Alan Blinder, concluded that without the Recovery Act, TARP, and other government actions, GDP would still be contracting in 2010 – at the astonishing rate of 3.7 percent – unemployment would have reached 16.5 percent; and we would be experiencing deflation.

Exit and Wind-Down

We have moved very quickly to reduce the dependence of the financial system on emergency support and to return these institutions to private hands as quickly as possible. Federal agencies moved aggressively to reduce the market's dependence on programs by allowing them to expire, including the Temporary Liquidity Guarantee Program and the Temporary Guarantee Program for Money Market Funds. Through the stress test, we provided confidence to the market and helped private capital return to the system. And Treasury has exited from its investments as quickly as practicable.

When President Obama took office, the U.S. government had made investments in banks representing 75 percent of the entire banking system by assets. Today, the remaining investments are in banks representing roughly ten percent of the banking system. We have recovered $229 billion of the funds invested in banks and other institutions to date, and over the last month, there has been significant progress in exiting our remaining investments.

Treasury received $13.5 billion in the GM IPO. We have now recovered about half of our $50 billion investment and have reduced our stake in GM by roughly half, from 60.8 percent to 33.3 percent. On December 6, Treasury sold its remaining 2.4 billion shares of Citigroup common stock for $10.5 billion, which resulted in a $12 billion profit on our overall investment of $45 billion in the company. And last week, we entered into definitive agreements for the restructuring of AIG. The restructuring will accelerate the government's exit on terms that are likely to lead to an overall profit on the government's support for AIG, including the value of Treasury's interests in AIG held outside of TARP.

Cost

In terms of direct financial cost, TARP will rank as one of the most effective crisis response programs ever implemented. Independent observers, such as the Congressional Budget Office (CBO), estimated early on that TARP would cost $350 billion or more. Now, because of the success of the program, TARP is likely to cost a fraction of that amount. CBO today estimates the cost of the program to be as low as $25 billion.

The cost of TARP is likely to be no greater than the amount spent on the program's housing initiatives. The remainder of the investment programs under TARP – in banks, AIG, credit markets, and the auto industry – will likely, in the aggregate, ultimately yield a positive return for taxpayers.

Furthermore, the cost of the government's broader response efforts is remarkably low when compared to past systemic crises. An IMF study found that the average net fiscal cost of resolving roughly 40 banking crises since 1970 was 13 percent of GDP. The GAO estimates that the cost of the U.S. Savings and Loan Crisis was 2.4 percent of GDP. In contrast, the direct fiscal cost of all our interventions, including the actions of the Federal Reserve, the FDIC, and our efforts to support the GSEs is likely to be less than one percent of GDP. The true cost of this crisis to the economy, however – the jobs, wealth and growth that it erased – is much higher, but that damage would have been far worse without the government's emergency response.

Restructuring of the System

Our response to the crisis has brought about a fundamental restructuring of the system. The weakest parts of the financial system no longer exist. The firms that remain were subject to a stress test that demonstrated their viability without government assistance. Our financial system today has substantially higher levels of capital relative to risk than before the crisis and are also better capitalized than their international competitors. And the Dodd-Frank Act has provided the government with critical tools it did not have during the crisis – including the ability to wind down firms that pose a significant threat to our financial system.

Remaining Challenges

Even with the progress I have identified, we are still living with the scars of this crisis, and both our financial system and the economy as a whole continue to show signs of significant damage. Although the economy has been growing for more than a year, unemployment remains close to ten percent. Although household wealth has begun to recover, many families are still struggling to regain financial security. And although many businesses are growing again, others, particularly, small businesses, continue to encounter difficulties accessing credit.

Outside of TARP, we are working to help these businesses access credit through the Small Business Lending Fund (SBLF) and the State Small Business Credit Initiative (SSBCI). The SBLF will provide up to $30 billion in capital to small banks with incentives to increase their lending to small businesses. Second, the SSBCI strengthens state small businesses initiatives threatened by budget cuts and is designed to spur $15 billion in lending.

The housing market also remains weak. We are continuing to support new housing credit and apply downward pressure to mortgage rates through agreements with Fannie Mae and Freddie Mac. Our goal remains to help as many eligible homeowners as possible, and along with improvements to HAMP, we are implementing a range of additional programs, including Treasury's second lien program, which provides a simultaneous modification of the second lien when a first lien is modified; a foreclosure alternatives program for borrowers who don't qualify for a modification; a principal reduction program; and a forbearance program for unemployed borrowers. Treasury has also allocated $7.6 billion to 18 states and the District of Columbia to tailor localized solutions for borrowers facing unemployment and negative equity.

On October 3, Treasury's ability to make new commitments under TARP expired. We are well on the way to fully winding down the exceptional actions the government has taken over the past two years. These actions have been remarkably successful in helping repair the damage caused by the financial crisis.

We have brought stability to the financial system and the economy at a fraction of the expected costs. We have returned the financial system to private hands far more quickly than anyone would have thought possible. And in doing so, we have returned hundreds of billions of dollars of unused TARP authority to Congress. As we manage our exit and confront any remaining difficulties, we will continue to be aggressive in protecting taxpayer dollars. But today, thanks to a comprehensive and careful strategy to address the financial crisis, we are in a much stronger position to address our still very substantial remaining economic challenges.

The CHAIRMAN. Thank you, Mr. Secretary. In your written testimony—and member of the panels have said this—discussing the CBO $25 billion number—are you comfortable with that number as being the total cost for——

Secretary GEITHNER. I think it'll——

The Chairman [continuing]. TARP?

Secretary GEITHNER [continuing]. Be a little high. You know, these things are very uncertain. It depends hugely on what happens to the overall economy and to financial markets. But, based on the things you can observe today, where there's a market price for an investment, and based on what's reasonable to expect, I think, about the trajectory of our housing programs, I suspect the number will be high.

The CHAIRMAN. You've talked in panels too, about how well things are doing right now in the financial system and corporations and things like that. What—you know, and the main reason for this hearing is kind of figure out, What do we do to finish this out and do the best we can, realizing October 3rd, limited modifications we can make? What's your thoughts on what you can do, in the rest of TARP, to get the banks to start lending more money?

Secretary GEITHNER. TARP's contribution to the financial—to the remaining challenges in our finances, is largely over. We have authority, still, to continue this set of housing programs to make sure they reach as many people as we can. Beyond that, TARP's contribution will be very limited. The principal thing we can do to help small banks manage through this, is to make sure that we're doing as much as we can to reopen access for small businesses to credit. The burden for that is going to fall on the small business lending facility that Congress passed in September of last year.

The CHAIRMAN. So, just—I mean, you basically feel that, under TARP, there's—the fact that banks are—have all this—trillions of dollars on hand, and not loaning, is something that has to be dealt with in a different way, other than under your TARP.

Secretary GEITHNER. Yes. I think this is a really important thing to look at. What matters in crisis response is to get credit flowing again, because it's the oxygen that economies require to recover.

How should you measure how effective these programs were in this context? The only real measure you can look at is what happens to the price of credit—how much it costs for somebody to borrow, a business to borrow, for a person to send their kid to college, for a municipal government to borrow to finance critical services, the costs of a mortgage. And all those measures of the costs of credit, as you know, were at panic levels in the——

The CHAIRMAN. Sure.

Secretary GEITHNER [continuing]. Fall of '08. And were at panic levels in early '09——

The CHAIRMAN. Right.

Secretary GEITHNER [continuing]. And then have come down dramatically. If you look at how much banks are actually lending, lending volumes are lower than they were before the crisis.

The CHAIRMAN. Yeah.

Secretary GEITHNER [continuing]. But, that is no surprise, because this was a crisis brought on by the reality that people had borrowed too much. And when the economy shrinks, the actual out-

standing volume of loans is going to fall. But, the test of whether credit is more available or not——

The CHAIRMAN. Right.

Secretary GEITHNER [continuing]. Has to be measured in the price of credit.

The CHAIRMAN. I got it. And I understand. And that's a major objective of TARP. But, I think—a number of panels talked about perceptions, and I think one of the real problem—when I travel around, I talk to people that go to banks and people—not just in the home-building market; small business people, everyone—it's like, "The banks won't lend me the money." Now, again, they, many times, say it's the regulators. I don't—and many times I don't believe it is the regulators. I think they just don't want to loan the money. And so, I'm just saying—and I understand everything that you said—we—I may agree—I agree with most of it, I may not agree with all of it. But, in the next—you know, with the rest of the TARP—for the balance of the TARP, you do not feel there's anything really——

Secretary GEITHNER. Not through TARP.

The CHAIRMAN [continuing]. Under that——

Secretary GEITHNER. Again, the——

The CHAIRMAN That's a good enough answer.

Secretary GEITHNER. Right.

The CHAIRMAN. That's good enough.

Now, how about—now, the other problem we have—again, it's not a perception, though; it's a real problem. People are out there not having jobs. And corporations have—earnings are up, Dow Jones is doing great. You know, you—and you have corporations with trillions of dollars on their balance sheet, in cash, and they're sitting there. And some corporations are going to the point of actually, you know, buying back their stock. And you're sitting there saying, "Hey, man. This is like, 'let 'em eat cake.' "

So, my point is, is there anything you can do, under TARP? And I—and the reason I raise this is because everyone here, all six of us, have talked about TARP successes, credit, all those things, but we've all said the same thing, and that is that the problem we have out there now is, people don't have jobs and people can't borrow money to get their house or to get their companies going. So, that's why I'm zeroing in on this.

There may be—a perfectly okay answer is "no," but I'm just saying, when you look at the corporations and where they're structured, is there anything you can think of that we can do? Because it's so important.

Secretary GEITHNER. Well, I think the—again, the most important thing for the government, in terms of economic policy now, is to put in place things that'll help raise the rate of economic growth and speed the path of getting more Americans back to work. TARP itself now has done what it had to do——

The CHAIRMAN. Right.

Secretary GEITHNER [continuing]. Which is to get the markets to reopen for credit. But, the burden for achieving a more rapid pace of growth, getting more investment back to work in the United States today, is going to have to come through other policy instruments.

The CHAIRMAN. Oh, to Mr. McWatters. I'm sorry.

Mr. MCWATTERS. Thank you, Senator.

Mr. Secretary, when you consider the potential legal and economic consequences of the following five things, and I'll read them:

One is the foreclosure documentation irregularities; the robosigning problem; the failure of some securitization trusts and others to obtain properly endorsed mortgage loan notes and properly assigned mortgages and deeds of trust, as required by local law; the challenges presented by the Mortgage Electronic Registration, or MERS, System; the exercise of put, or repurchase, rights by securitization trusts, as well; number five is the filing of wrongful foreclosure suits and other legal actions.

Are you concerned that any of the largest financial institutions will experience a solvency, liquidity, or capital crisis as a result of these items?

Secretary GEITHNER. No. I think they pose very substantial challenges to the system, still. And I should be careful to acknowledge that, because of the seriousness of these problems we have a task force, chaired by myself and Sean Donovan, that includes 11 Federal agencies, bank supervisors, FHFA, the FHA, the Department of Justice, the FTC, that is undertaking a very careful, comprehensive look at all those concerns so we can get a better handle on their potential risk, but, more importantly, so that we can fix them and make sure that people who were disadvantaged by the mess are provided some relief, to make sure that, looking forward, homeowners still at risk are given a better chance of staying in a home they can afford, and to make sure we fix the system for the future. Very substantial challenges, still. That task force is likely to be in a better position to provide an evaluation of where we are, what's next, sometime in the first quarter; I hope early in the first quarter.

Mr. MCWATTERS. But, do you foresee having to implement a program to purchase distressed RMBS or trouble loans from the financial institutions themselves?

Secretary GEITHNER. I do not.

Mr. MCWATTERS. Okay. So, as far as you can tell now, no TARP–2.

Secretary GEITHNER. No.

Mr. MCWATTERS. Okay.

What about rating agencies? Do you believe that rating agencies themselves may take a different perspective? And once these, particularly, put-rights are exercised and a judgment or two comes down—and the judgments may very well be large—do you think the rating agencies will react properly, overreact, downgrade the stock?

Secretary GEITHNER. I would never want to predict that rating agencies will react appropriately. Rating agencies, by their nature, because the future is uncertain and these are complicated, are—you know, not to be unfair—react slow and late on these things. So, I wouldn't make any judgment on whether they're going to be prescient or wise or early or late on those things.

Mr. MCWATTERS. Okay. So, to recap, there may be some systemic consequences, but they do not rise to the level of needing a TARP–2 or needing an across-the-board repurchase program.

Secretary GEITHNER. No. I didn't use the word "systemic." I just said they would—they're going to present—these are going to present serious challenges to the system, as they have for a long time. You know, we're not in the first inning of this housing crisis. This started and peaked at the end of 2006. And it's going to take some time, still, for investors, for rating agencies, for creditors to fully evaluate the financial implications of this for individual institutions. The market is finding its way now to feel a little more comfortable about how to dimension the potential risk, but it's going to take—that's going to take a little more time.

Mr. MCWATTERS. Do you anticipate that the Federal Reserve may use part of the funds in QE2 to purchase some of these distressed assets off the books of these financial institutions, much as the Fed did in QE1?

Secretary GEITHNER. You know, I'm very careful not to talk about monetary policy anymore. I respect the basic tradition that the Secretary of Treasury should never talk about monetary policy. So, you should direct that to them. But, I would not—well, I shouldn't go further. You should direct that question to them.

Mr. MCWATTERS. Okay, because my concern is, what I said in my opening remarks, that the reason the Fed was able to purchase a trillion-250-billion dollars of government-backed–mortgage-backed securities was because of the bailout of Fannie Mae and Freddie Mac. If that had not—if Fannie Mae and Freddie Mac had been left to fail, then the Fed could have still done QE1, but it would have purchased at a market price, which would have been below face. So——

Secretary GEITHNER. Well, can I—could I respond to that? Because I think——

Mr. MCWATTERS. Sure.

Secretary GEITHNER [continuing]. That, without talking about the Fed, I—because I'm not sure they understand your suggestion. I believe—and just because I believe it doesn't mean it's true—but, I don't think there was any plausible argument to suggest that the U.S. economy could have withstood, or could withstand today, the effects of letting those institutions, with $5 trillion in guarantees and portfolio outstanding, default on those obligations.

And that is why a conservative Republican President decided it was in the interest of the Nation, and Congress gave him the authority to intervene to prevent that outcome, and to allow those institutions to be managed down more gradually over time. And to suggest—and maybe you're not suggesting this—that we would have been better off, as a country, financially, economically, if we had chose an alternative path, I think, is not a credible argument. And the idea that the overall cost to the economy and to the taxpayer would have been less because of that is not a judgment I would support.

Mr. MCWATTERS. No, that is not the point I'm making. The point I'm making is that the bailout of Fannie Mae and Freddie Mac should be considered when we judge the TARP program.

Secretary GEITHNER. Yeah, that I totally agree with you.

Mr. MCWATTERS. Right.

Secretary GEITHNER. And that's why I said it as I did. And I think this is very important to recognize. When you look at the

overall cost of this crisis, you have to look at two things. One is the direct financial costs of all these programs—FED, FDIC, Fannie/Freddie, TARP, Money Market guarantee fund, et cetera. Now, you have to look at the economic costs, too, and the overall fiscal costs of lost revenues, the cost of unemployment insurance, things like that. But, on that broad measure of direct financial costs, including the interventions in Fannie and Freddie, the overall costs will be incredibly small in comparison to almost any experience we can look at, in the United States or around the world, even in much milder, much less damaging crises. And that's because of the effectiveness of the overall response.

Mr. MCWATTERS. Okay. I agree, all factors should be considered, but sometimes those factors are not mentioned in the sound bites.

That's all.

The CHAIRMAN. Thank you, Mr. McWatters.

Mr. Silvers.

Mr. SILVERS. Thank you, Mr. Chairman.

And before I—Mr. Secretary, before I ask my first question, I think you mischaracterized my opening remarks, to make me more of a critic of your work than I am.

Secretary GEITHNER. Didn't mean to.

Mr. SILVERS. I don't think the financial system is weaker today than it was in 2007 or 2008. I think it's clearly stronger. I think it's, nonetheless, weak.

Now, Mr. Secretary, at our last hearing, your colleague Phyllis Caldwell appeared before us. And it gave me some concern about the administration's policy around foreclosures. I think I perhaps took that concern out on her more than perhaps was warranted, given that you—it may be more warranted to be taken out on you.

Secretary GEITHNER. I would welcome that. And she's really excellent at what she's doing. And—but, she can take it, too.

[Laughter.]

Mr. SILVERS. Well, Mr. Secretary, I concur with your judgment on Phyllis. And I—but I wanted to make—to raise these matters with you directly.

In her testimony, Ms. Caldwell stated in—that slowing down foreclosures—and this is in the context of the debate about a foreclosure moratorium—slowing down foreclosures, quote, "May exert downward pressure on overall housing prices both in the short- and longrun." Now, Mr. Secretary, I would like you to respond to the question, a very simple question, which is: In the view of the administration, do more foreclosures equal lower housing prices or higher housing prices?

Secretary GEITHNER. Could I ask you a question first?

Mr. SILVERS. Sure.

Secretary GEITHNER. Just for context. Do you support a compulsory national moratorium?

Mr. SILVERS. Do I? I personally support a moratorium as part of a larger solution. I think, by itself—and here, we may agree—I think, by itself, a moratorium is not an answer. Like any kind of delay, for instance, it doesn't get you where you need to go. I have felt, for years, going back to 2007, since you mentioned 2007, that a moratorium would be a helpful incentive to the parties to reach private solutions.

But, Mr. Secretary, the question is—I'm happy to answer your question, but——

Secretary GEITHNER. No, I—that's——

Mr. SILVERS [continuing[. This is my turn to ask questions.

Which way—more foreclosures—which way do housing prices go, up or down?

Secretary GEITHNER. Well, I don't think that's quite the——

Mr. SILVERS. All other things being equal.

Secretary GEITHNER. I don't think that's quite the way to think about it. You're absolutely right; if you could prevent—if you can slow the pace of avoidable foreclosures, as we did, effectively, through these programs, that was one factor that contributed to bringing a measure of stability to house prices at a time when house—most people thought house prices were going to fall another 20 to 30 percent.

But, that's not really the right question to ask, in terms of this debate right now. The right question to ask now is: Would a broad, comprehensive, compulsory moratorium——

Mr. SILVERS. No, Mr. Secretary, that's not the question I asked. Because, actually, I don't see that—I don't see the moratorium as the—the moratorium is a subset of a basic question that I think the administration's statements over the last few months have clouded, which is: Are foreclosures good for our country, or not?

Secretary GEITHNER. No, foreclosures are not good for the country, but——

Mr. SILVERS. And are they not good for the country because they lower or raise housing prices?

Secretary GEITHNER. Well, again, I'm not trying to really—let me—well, maybe try it this way. If you were to stop foreclosures from happening and suspend the process nationally for an indefinite period of time, what would that do to house prices? It could hurt house prices, because it would—it might mean that demand for housing slowed, people are unwilling to buy, and people sitting in neighborhoods in homes where—at the epicenter of the foreclosure prices, might see their house prices fall further because the markets would recognize that it was going to take a much longer time to work through this process. So, there's a reasonable economic——

Mr. SILVERS. Mr. Secretary, isn't that only true if you assume that, in the end of the day, everyone gets foreclosed on?

Secretary GEITHNER. No. I don't think that's true at all. No, I think that—well, let me say what I think the right approach is to this. I think that—and we have made this very clear, and I think we will be successful in achieving this. We do not believe that banks should move to initiate a foreclosure process, or continue it, if they cannot be certain that they have the legal basis for doing so, and if they have not given that homeowner every opportunity to participate in a mortgage modification program.

Mr. SILVERS. Right.

Secretary GEITHNER. Now, that approach will——

Mr. SILVERS. But, Mr. Secretary——

Secretary GEITHNER [continuing]. Slow the pace of foreclosures——

Mr. SILVERS. But, Mr. Secretary, that approach—it would appear to me, perhaps naively, that approach would appear to be founded on a belief that foreclosures—all other things being equal, more foreclosures are bad for our society and bad for our economy. I don't understand why the answer isn't simply yes, that they're bad. And one of the reasons that they're bad is because they lower housing prices. And if I were—might refer to Phyllis Caldwell's testimony again, in her testimony she said that 25 percent of current home sales are out of foreclosure. That would appear to be a potent downward force on housing prices. Do you disagree?

Secretary GEITHNER. I disagree with your assessment of the impacts on it and the merits of that approach as an alternative. Yes, I do disagree with that.

Mr. SILVERS. Well, you disagree with the notion that 25 percent of the total sales in the housing market being forced sales under foreclosure——

Secretary GEITHNER. I don't think that's the——

Mr. SILVERS [continuing]. Forces the prices——

Secretary GEITHNER. I don't think that's——

Mr. SILVERS [continuing]. Housing prices down? How can you possibly disagree with that?

Secretary GEITHNER. I don't think that's right way to think about it. Look, the——

Mr. SILVERS. I don't understand why this administration can't answer the simple question of whether or not foreclosures drive housing prices up or down. It seems to me that you're covering for something.

Secretary GEITHNER. [Laughing.]

Mr. SILVERS. And my time is expired.

Secretary GEITHNER. Mr. Chairman, may I just offer one thing?

The CHAIRMAN. Finish, absolutely.

Secretary GEITHNER. You know, Mr. Silvers, you're asking a interesting economic financial question. It's a question for economists. You know both sides of that argument. I think it's pretty good on one side. But, I understand your position on it. But, I think that's not really the question we face. The question we face is, What is the most effective, responsible thing we can do, as a country, to make sure that people who are at risk of losing their home, but have a chance of staying in their home, have that chance to do so? That is our basic objective. Now, we have a lot of other things to worry about, too, because we have to worry how to clean up this mess for the future, make sure we don't get into this kind of mess in the future again. But, our overwhelming preoccupation now is, What can we do to make sure that we're helping people stay in their homes, who can afford to, and make sure we get through the damage remaining at least risk to the innocent people that have suffered so much in this crisis?

Mr. SILVERS. We'll take that up in the next round.

The CHAIRMAN. Thank you, Mr. Silvers.

Dr. Troske.

Dr. TROSKE. Mr. Secretary, so in my opening statements I read a quote from Professor Kenneth Rogoff about how a proper cost-benefit analysis would be conducted and that ex post accounting

can—that it's important to take—that needs to price the risk taxpayers took during the financial crisis.

So, given that, I guess I'd like to get your thoughts on what Professor Rogoff said, the importance of understanding—we put a lot of—the entire financial—you know, all of the financial risk—you put a lot of taxpayer money at risk. And how do we assess that and think about that as a cost?

Secretary GEITHNER. Well, I have a huge amount of respect for Professor Rogoff; I've worked with him in the past. And, of course, what he says is fundamentally right; you have to measure—as any investor would do, you have to measure return against risk. And there's a very thoughtful set of questions you—one should ask about whether we price these investments appropriately. And looking just at the financial return, independent of that, is not a fair way to evaluate whether we got that balance exactly right. But, I believe we did.

And let me tell you the basic theory of the approach we offered, and some evidence for that suggestion. And this is not—this is oversimplifying a little bit, but in a financial panic—in a financial crisis,—what you want to do, where you have to make emergency assistance available, you have to price it below the cost of credit in the market at that time. Because credit is not available—or is at a prohibitive cost—this would be below that—but it has to be more expensive than credit would cost in normal conditions. And the virtue of doing it that way is, as things normalize, you're more easily able to wean the dependence of the market from those programs, because your credit—your investments will then become expensive, relative to the market.

Now, there's no perfect place between those two things. But, you can't say, "Because we've priced our investments below the cost of credit that was available in the market, in a time of a financial panic, that we underpriced those investments." That would not be a fair way to evaluate it or a sensible way to run a financial emergency. In that case, I think we passed what, you know, the central bankers would call a classic "lender of the last resort" classic doctrine. And the best test of that is how quickly we've been able to get out of these investments; how quickly, for example, the Fed's emergency credit programs were wound down; how quickly we were able to get out of the other emergency guarantee programs. They were—they proved to be expensive, as growth started recovering and credit markets started to reopen.

Dr. TROSKE. Next, I—I certainly—I guess I agree with you—I certainly agree with you, that the Zandi-Blinder study is the most comprehensive study out there on the impact of the financial crisis. I guess my own reaction is, I consider that to be very disappointing, given that I would—I feel that it's a fairly cursory study, a fairly short 9-page paper. I usually make students write much longer papers. It's hard to see how, in 9 pages, you could do a fair job evaluating, you know, this complex situation. I think it's—they provide very little documentation of the methods that they use, make some fairly strong assumptions, and consider what I feel to be a fairly faulty methodology.

And so, in my opinion, we need a much more comprehensive—we need—we still are—we're looking for much more comprehensive

studies. And again, I think that part of that is going to be function of the information that's out there that is made available.

In my opening statements, and as we've said a number of times, we've pushed Treasury to provide more data and more data, and collect more data. The most recent report does—continues that.

I guess, you know, give me your thoughts about the—your efforts to do that, and to do a comprehensive—or to allow a comprehensive analysis of the financial situation to be done.

Secretary GEITHNER. First, I completely agree that a necessary condition for people to evaluate is better data. You know, we've been very transparent with all the financial terms of our programs. You can judge their market impact very easily. And I'm happy to continue to look at ways to get more data out there. The financial reform legislation does establish, within the Treasury, the Office of Financial Research, with very broad authority to improve the overall data available to markets, going forward. And again, I'm happy to look at other ways we can get better data out there.

I think we've—there's much more out there than was there before we came in, on all these programs; that provides a rich body of evidence for you to evaluate their effectiveness, but I am happy to try to do better.

Dr. TROSKE. My time is up.

The CHAIRMAN. Thank you, Dr. Troske.

Superintendent Neiman.

Mr. NEIMAN. Thank you.

Mr. Secretary, as you could tell in my opening statement, I spend a lot of time focusing on the non-HAMP modifications, those proprietary mods performed by banks and servicers outside of the HAMP program. In fact, 6 months ago, when you were here, we discussed the same topic and you agreed this was an important part. And I think, because of the additional information that the Treasury has shared since that time, we now know it's even more important. In fact, 70 percent of the modifications are now in non-HAMP mods, really three to one.

What is—do you agree that—what's your assessment? Are these the way forward? Are they sustainable? And what's your assessment on these proprietary modifications?

Secretary GEITHNER. I've actually spent quite a bit of time, in preparation for this hearing, asking this—very similar questions. How much do we know about those modifications? And the quality of debate is not so great, so far. But, I think the general sense of my colleagues is that the majority of those modifications are lowering monthly payments quite substantially. And the—one of the most valuable things we did, in setting an industry standard for modifications, was set a bar that people could strive to. But, I would like more data on that. And we're going to look at ways to do that.

Mr. NEIMAN. So, because—and you're right, I think the information that's coming out about the reduction in modification payments is out there, generally, with respect to non-HAMP mods. But, isn't the heart of the issue the sustainability and the length of those modifications? Under HAMP, those modifications are 5 years; and then reset to the historic low rates of today, we don't know the information, with respect to the non-HAMP mods.

Secretary GEITHNER. I agree. I think that the three measures you want to look at are: What is the magnitude of the payment reduction? How long is it in place? And what is left, in terms of the remaining balance of obligations, after the modification period expires. And, as I said, we're—we'll look for ways we get better information out there to assess those programs.

Mr. NEIMAN. And the HAMP monthly reports have really been improving month over month, and have, now, greater information distinguishing the performance by servicer. Last week, in the New York Times, in a big story focused on large servicers, non-HAMP modifications, and highlighting the differences. So, in the cases of borrowers who were denied a HAMP modification, only 14 percent, for example, received a non-HAMP mod at B of A, but over 40 percent received a non-HAMP mod at Wells Fargo. How do we explain these differences?

Secretary GEITHNER. I don't actually know. I think—but, it's a very good question. And again, I'm happy to pursue that with my colleagues and see if we can give you a better sense.

Mr. NEIMAN. Yeah. I—to the extent that this type of data—and we had the same discussion with Phyllis Caldwell. She said a lot of this data is held by supervisors. And when we talk to the supervisors, it's supervisory material. So, to the same extent that this data has been voluntarily provided, with respect to the HAMP modifies, I think the information, with respect to the non-HAMP mods, would be extremely important to assessing the program.

Secretary GEITHNER. Yes, I agree. And again, we're happy to take suggestions. As you noted, one of the things we have done—and we did it early, in successive waves—is put out very detailed metrics of performance by individual servicers on modifications under HAMP, but also on a whole range of other measures of customer service, which, as you know, has been abysmal. And if there are other ways we can improve the quality of information out there, that would be good. And it's valuable, not just because it gives a chance for people to look at it, it's valuable because it changes behavior.

Mr. NEIMAN. Yeah.

Secretary GEITHNER. It's a—it serves as a form of conscience.

Mr. NEIMAN. Because I think even the data that I cited, with respect to the Times article, may be misinterpreted. It doesn't necessarily mean that Wells is three times better than B of A. The portfolio itself may have characteristics that drive those. So, I think—we've talked about, in the past, also the need for a mortgage performance data system, similar to what we have on the origination side, under HMDA. Do you have a—you know, a view as to the need at this point? Do these types of data needs demonstrate the need for a—national reporting requirements for performance data?

Secretary GEITHNER. Well, I completely agree that we can do a much better job of having much better data out there for the world at large. And again, I'm happy to look for ways we can do that.

Mr. NEIMAN. Thank you.

The CHAIRMAN. Thank you, Superintendent Neiman.

Looking forward and, you know, trying to figure out what we can do in the remaining days. In your written testimony, I was inter-

ested that you talked about both the second lien program and the unemployment program. The second lien program is something that I have become more and more convinced is a major, major problem, especially where you have a servicer that has a second lien and the bank has a first lien and the servicer doesn't want to make a modification. And so, I think the second lien's a program, but it's been around for a while now, and it's kind of, you know, based on the data we see, not as—not what we'd all like to see—and I think I can say all—everybody.

So, do you have any thoughts about how we can get the second lien program up and running and funded and moving and——

Secretary GEITHNER. It took a very long time to get up and running. It's only been in place for a very short period of time. But, I think it's very promising, in the sense that it achieves the simple imperative: If the first lien is modified, the second has to be modified.

The CHAIRMAN. Right.

Secretary GEITHNER. We now have the capacity to do that, we have better incentives to do that. And so, I think it's very promising, but it's going to take a little more time to evaluate the full extent of it.

The CHAIRMAN. Do you have any idea how much money you're going to be able to spend on that program—be able to invest in the program?

Secretary GEITHNER. I thought you might ask me about new estimates of——

The CHAIRMAN. Yeah.

Secretary GEITHNER [continuing]. How much we spend, and——

The CHAIRMAN. Only because I'm trying to get—you know, is this—I mean, I really look at this as a way—and I think the panel does, if you look at the report—this is a big problem.

Secretary GEITHNER. Right.

The CHAIRMAN. And so, the extent that we can get—and I know—and I also realize this is an incredibly complex problem, so getting up to speed's going to take a long time.

Secretary GEITHNER. Yeah.

The CHAIRMAN. And I'm just trying to get a feeling, Is there anything we can do, or you can do, or anybody, to get this program to be all that it can be?

Secretary GEITHNER. We're doing everything we can. I really—we have a tremendously talented group of people, who know a lot about the financial markets and about housing, who are on this all the time. And so, we'll do everything we can to do that. We'd like the reinforcement. And again, the more we can shine a light on relative performance of servicers, the better we can do.

On the cost estimate, I don't know how much we'll end up spending on this. And, you know, we're in the process of looking at doing another reevaluation of how much we expect to spend across these programs. We probably won't be in a position to reveal that until the budget. But, you'll have a chance, at that point, to look at the estimates.

The CHAIRMAN. Good. And the unemployed program, too. While the—you know, right now it's not budgeted for any money, because there are no incentives.

Secretary GEITHNER. Right.

The CHAIRMAN. But—yet clearly we start out on the HAMP program, we weren't going to have any unemployed. And now—I mean, it just shows the difficulty of the problem. So, now we have some—when you look at the debt-to-income ratio on many of these people that need modifications, the reason is because they're unemployed. So, an unemployed program, like a second lien program, is really key to making this whole thing work. So, what are your thoughts about the unemployed program?

Secretary GEITHNER. I totally agree. And, you know, under our programs, servicers are required to provide a period of 3 months forbearance. Usually, that comes later in the unemployment period of an individual; it comes, you know, probably months 5 to 8 in their period of unemployment. So, it has more value than people think, when they just think about 3 months. The other program we have, of course, is our program with a variety of State housing finance agencies; we're providing resources to help them run programs that help the unemployed.

And you made the central point, which is that the principal factor which is driving foreclosures today is not what was at the heart of foreclosures at the beginning of the crisis, which was, as you know, a set of broader lending practices. Now it's really about unemployment. And that's why I think it's very important to emphasize that the most important thing that's going to affect the trajectory of house prices, the overall number of foreclosures, ability of people to stay in their home, is what the government is able to do to get the unemployment rate down much more quickly.

The CHAIRMAN. And a remaining question: Since now HAMP is the—TARP's ramping down, HAMP's ramping down—do you have any thoughts about programs—I mean, this is such an important issue and so much has been learned and—on this—is there some suggestions that you could come forward—don't have to do it right here at the table, but—I think, more and more, that this should be the subject of legislation, that, you know, a new program funded—this is still going to be a problem. You said it, and I agree, that this is a program that's—years out. This is absolutely key to the recovery and, you know, we've earned a lot in the TARP program. But, now we're stymied, in that you can't make any modifications. So, if you would think about—if you have any thoughts, I'd like to have those, but also some kind of a statement on paper.

[The information referred to follows on p. 77]

Secretary GEITHNER. I would be happy to think about that and come back to you, and I'm sure my colleagues would be happy to talk about that in more detail. But, could I just make one point in response——

The CHAIRMAN. Sure.

Secretary GEITHNER [continuing]. To that? Because I think it's important to recognize. There have been a lot of people, very capable people, that spend a lot of time looking at different strategies to address the housing crisis. And there are people in this room and people around the country who have suggested much more dramatic departures of approach in the past. Of course those would all require legislation, and some would require substantial additional resources.

But, I think the fundamental question really is a different question, which is: How many people do you think you can reach? And the principal gap between the roughly 5 million Americans today that are delinquent in their loans and the number of people that are likely to get a modification ultimately is really about the following. And, let's just look at those numbers in broad terms. Of that 5 million, roughly 2 million are now potentially eligible for HAMP and the FHA modifications programs. The other 3 million Americans that are currently delinquent on their loans fall into a bunch of different categories, but many of them are individuals who took out loans for houses that are really quite expensive, above $625,000, or whose mortgage burden today is below 31 percent of income, meaning they can afford to stay in their house, or were investors, or who had a second home. Now, that's not all the 3 million. Some of that 3 million are loans with servicers who aren't—don't participate in our program. Some it is people who—there's no economic case for helping them stay in their home, it's better to help them, in other ways.

But, if you're going to think about a more dramatic change in approach, that would reach millions more Americans, you have to fundamentally decide whether you want to extend the benefits of these programs, using taxpayers' money, to those classes of Americans that fall into those categories. And that's something we looked at very carefully. We did not think that was a reasonable public policy choice, not a good use of taxpayers' money, because, again, a very substantial fraction of those people were investors who had a second home, bought an expensive home, or who can clearly afford to meet their payments.

The CHAIRMAN. But, there's still—and I'll just touch base for a second—there's still—you talk about 3 million people out there who are not in that situation, who need help, who we've learned a lot about how to deal with them, we've learned about the servicers and the problem——

Secretary GEITHNER. Right.

The CHAIRMAN [continuing]. With servicers, we've learned about second liens; we've learned about the unemployed; we've learned about all these things to kind of get those 3 million. And they are extremely important to whether we're going to deal with what everybody on the panel and you have said, and that is: How are we going to get out of this thing? We've stabilized things. How do we move to the next step? And if housing doesn't start being more productive, we—we're in deep trouble.

So, you've got a combination here of people that—the kind of moral obligation to help people that were not subprime people, people that—exactly what you said, people that did it right, they were in the thing, now they've been unemployed, through no fault of their own, and they're about to go belly-up. We have an obligation to help those people, morally. But, what really makes it binding is, we also have an obligation to do it economically, to get the economy moving, so all of us can move on and move on to the next step.

So, that's why it's going to be—no one's—you know, my mother used to have a saying, "Nothing in life that's worthwhile is easy." This is very, very, very, very, very difficult, but it's also very, very, very important.

Secretary GEITHNER. I agree with that. And I think that, as I said, our work is not done.

The CHAIRMAN. Right.

Secretary GEITHNER. We're—the government is not done. The damage is still profound and tragic in its dimensions. And it's going to take a long period of time. And again, the most important thing for governments to understand in financial crises is that you have to keep at it, you have to keep working on it, you can't stop——

The CHAIRMAN. Right.

Secretary GEITHNER [continuing]. Too early. And, as you know, just in looking at the foreclosures at risk still, and unemployment at 10 percent, we got a lot of work to do as a country.

The CHAIRMAN. That's right. And I—but I think the thing is, what we're going to do—and one of the things to do in the next 3 months is put it together so that next time this happens, God forbid, there's a much—and, as Dr. Troske said, you know, some way—and as you said—some way to approach the—to deal with the whole thing. But, in the interim, you know, we're still here, as you said, and we——

Secretary GEITHNER. Right.

The CHAIRMAN [continuing]. We're in a deep hole.

Secretary GEITHNER. Exactly.

The CHAIRMAN. And, you know, anything that we can use, from what you've learned and what your people have learned from HAMP, we shouldn't just, you know, say, "Okay, it's now April 3rd, goodbye," in terms of anything.

Secretary GEITHNER. No, no. We're going to be at this, in HAMP, for a much longer period of time than that.

The CHAIRMAN. But, I think we're going to need something more—as you said, there's lots of things that HAMP is not going to be able to do——

Secretary GEITHNER. Right.

The CHAIRMAN [continuing]. Based on the way it's presently structured. And I am sorry for taking so much time.

Mr. McWatters.

Mr. MCWATTERS. Thank you, Senator.

Mr. Secretary, in your opening statements, you said that the financial institutions are basically stronger today than they were a few years ago; that they have stockpiled around a trillion dollars, at the Fed and excess reserves, earning 25 basis points. So, when we approach the question of lending, when it's not a really question of insufficiency of supply, there's a trillion dollars they can loan tomorrow, if they wanted to, so there has to be a problem with demand.

Why is there a problem with demand? I mean, from my perspective, over the last 2 years there's been a great amount of uncertainty interjected into the economy; to people, who sit around their offices, drinking bad coffee out of Styrofoam cups, who really make decisions on hiring one person or two people at a time, have simply said, "You know, I think we'll hold off on that decision." What's going to change in that perspective over, say, the next 6 months to a year?

Secretary GEITHNER. I think the principal source of uncertainty remaining is uncertainty about what is going to be the pace of

growth and demand for someone's products. That is principally a question about, How fast is our economy and the global economy going to grow?

There is more uncertainty about that than is typical because of the scale of the damage caused by the crisis and the basic shock provided to confidence in the depths of the panic. And the scars of that panic last a long time; I mean, it's just understandable. People are much more—are still more economically insecure or uncertain today than they were, really, anytime in generations in this country, because the crisis was so severe. That's going to take some time to heal, but it is healing.

Now, the best measure of whether this is getting better again is what's happening to the underlying pace of demand, what's happening to the forecasts for demand. And those show gradual healing. And if you look at how companies are behaving, it also suggests a little bit of growing confidence and optimism. I'll just give you one—a couple measures of that:

As I said, the private-sector job growth is faster, stronger than happened in the last two recoveries. And business investment spending in equipment and in software ran at a rate of about 20 percent, the first 6 months of this year; about 12, 15 percent in the third quarter; and still looks quite strong. So, businesses are spending again, because they want to make sure they have the ability to participate in the recovery that's coming. And that's encouraging.

And again, that's going to take a little bit of time to heal, still. But, I'd say the best thing to say is: gradual healing, gradual improvement in confidence. But, ultimately what's going to generate more confidence is just the reality of growth getting gradually stronger.

Mr. MCWATTERS. Okay. Thank you.

November 17th, the Federal Reserve announced another round of stress tests, but, for reasons which I'm not sure if I fully understand, these stress tests will be kept secret, they will not be disclosed. I doubt if you made that decision, but can you comment on it?

I mean, I guess I'm troubled that, somehow, transparency in this is not complete.

Secretary GEITHNER. Well, I think, as you know, I am a very strong advocate and, of course, was the principal architect of the decision, back in early '09, to force our major institutions to go through the stress test, and to disclose the results in enough detail so investors could assess on their own whether they were realistic and appropriately conservative. And that was a remarkably effective approach, because it allowed these firms to go out and raise a lot of capital much earlier.

And if you contrast that experience with what Europe is still going through, you can see the benefits of having a very detailed level of disclosure on conservative assumptions about potential losses. It's a very good strategy. And I am very confident that a regular part of risk management and supervision in the future for our system will be regular public disclosure of stress tests by major institutions. I can't speak to any of the specific things about what the Fed announced recently, but I'm very confident that, looking

forward, we, as a country, will go through regular publicly disclosed stress tests of our major institutions.

Mr. McWATTERS. Yes. I know, though, but every day we read in the papers about putback rights, lawsuits, MERS, robo-signing, and a lot of these stress tests, I think, were initiated based upon that. So, I think it would be helpful to disclose.

Let me ask one other quick question. Do you believe that Fannie Mae and Freddie Mac should ride down the principal of a large number of their underwater mortgages through participation in the FHA's short refinance program?

Secretary GEITHNER. There are—you know, we have a principal reduction program in our—Treasury's housing programs. And we—and the FHA's—what's called, in shorthand, their "short Refi" program—both those things, we think, have a lot of benefits. And we think there's a pretty good economic case for Fannie and Freddie to participate in those programs. And we're in the process of talking to the FHA about those—about the merits of those programs, about their concerns. And I can't say, at this point, whether I think they're likely to adopt them, or not. Again, we're trying to make sure we understand their concerns, and they've got a different set of objectives; in some ways, different constraints. But, I'm hopeful that they're going to find a way to participate in many of these programs as possible.

Mr. McWATTERS. Okay. I need to finish up here.

But, if you are successful in encouraging them—and I think some news reports have said, the Treasury's actually "pressuring"—that's not my word—what's your projected cost of doing this, riding down those loans?

Secretary GEITHNER. Well, the—you—there's two ways to think about the costs in this. You remember the—Fannie and Freddie and the government own all this risk today. So, if you do things that improve the odds that house prices will be higher in the future, that defaults will be lower in the future, then you're going to improve the overall quality of the portfolio of these entities of government, and reduce the overall losses to the taxpayer. So, we have to link it—look at the financial implications of these programs through that broader prism, which is what we do, of course, and we want to encourage the individual agencies to do, as well.

Mr. McWATTERS. Okay. My time's up. Thank you.

The CHAIRMAN. Thank you, Mr. McWatters.

Mr. Silvers.

Mr. SILVERS. Mr. Secretary, first let me say, I appreciated very much your answers to Mr. McWatters' questions. I thought—on both the macro part and your final answer about the FHA/GSE issues, I think you're spot on.

I'd like to follow up some more on the question of—that my colleague, Superintendent Neiman, raised about non-HARP—non-HAMP modifications.

But, first let me ask you this. The CBO, in the—as part of their $25-billion number, is projecting a—only a $12-billion expenditure out of a potential 75. Do you agree with that projection? And do you think that—is that good news or bad news?

Secretary GEITHNER. I think it's bad news, but I think it's a little low, based on what we know today. I think it's too low, too pessi-

mistic. What we set aside was more like 45 or 50. They expect we will spend only 12. I think it's too low. But, as I said, we're going through a comprehensive assessment now of what we think we're likely to spend in these programs. And we'll probably be able to share that with you sometime in the first quarter.

Mr. SILVERS. So, you're not satisfied with the type of overall impact that that projection would sort of—it would appear to presume.

Secretary GEITHNER. Look, my obligation is to make sure that these programs reach as many people as possible. And the more people we reach, the more we will be spending. I think it's a good use of the limited resources we have as a country, because the returns, in helping the country through this housing crisis, are very high, overall.

Can I just say one quick thing, Mr. Silvers? I want to say one thing in response to the question about how you evaluate risk and return on these things. And I think this is straightforward. You have to look at, not just whether you got a—you know, we got a 20-percent return on some of these programs. You could ask, "Relative to what risk?" But, you know, we're the government, we're not a investor, we're not a hedge fund, we're not a vulture fund. And the impact of these programs should be judged by, What did you do to overall economic growth, access to credit, as a whole? So, when you think about the return to the taxpayer, the most important return is not the financial return to the Treasury and investments, it's about the broad impact of these programs.

Sorry, Mr. Silvers.

Mr. SILVERS. No, in fact, Mr. Secretary, that—your remark is very helpful to me, because I wanted to ask you about precisely that issue, in relationship to your—the—a term you used several times, around foreclosure—around mortgage modifications, which is the question of what the homeowner can afford.

What exactly do you mean by that term? Do you mean what the homeowner can afford—consistent with what? Because, if the—to try to be more precise about this, the—we know what the homeowner can—it may be that there's a gap between what the homeowner can afford—all right?—and what a financial institution views as the point at which they would start to lose money on the mod.

Secretary GEITHNER. Well, I——

Mr. SILVERS. Why don't we think about that gap, in light of what you just said about the larger negative externalities of foreclosures, which is what I was trying to get at in my earlier questions.

Secretary GEITHNER. Right. Well, the—no perfect answer to this—the standard we've used in our programs is to say that we want people's payments to be reduced to 31 percent of income.

Mr. SILVERS. Right.

Secretary GEITHNER. Why 31 percent of income? Because, on a bunch of evidence, that's something that suggests that people can sustain over time——

Mr. SILVERS. But, Mr. Secretary, that's not what I'm asking. I mean, I know what the number is. But, when that number supports a payment that's "here"—right?—and the NPV model, which is essentially a model of the economics to the banks, supports a

payments that's "here," that the homeowner can't afford—right?—but—so then there's a gap between what's in the bank's interest and what's in the homeowners' interest.

If that gap—right?—means that you go to foreclosure, then all that negative stuff that comes down on our economy, you were describing earlier, happens. Now, if—in order to close that gap, you've got to hit—you've got to take a hit to principal—all right?—and the bank takes a hit, which they don't like—all right?—which—is that a—it seems like we're basically saying—when that gap opens up, we, basically, let the bank make the call. Am I right about that, or—and why does that make sense? Why shouldn't we be asking—and I think Mr. McWatters sort of gets at this a number of different ways, as well—Why should we be asking the banks to take something of a hit, so we get more of a—across a whole real estate market, better outcomes?

Secretary GEITHNER. It's a very good question. And, you're right that part of the difference between the number of people we've reached through permanent modifications and those we haven't is where there's a—but it's a relatively small number of people—are where the—to use the technical term, "the NPV return is negative."

But, let's think about the implications of what you're suggesting. I think to decide that we're going to take the taxpayers' money so that people can afford to stay in a home that is really beyond their capacity to afford, because we want to avoid the broader negative consequences, collateral damage of more foreclosures, is asking, really, Is that a fair use of the taxpayers' money? And how do you feel about——

Mr. SILVERS. But, Mr. Secretary, I wasn't asking about the taxpayers' money. I'm asking about the banks' money.

Secretary GEITHNER. Well, you—I think, as you know—but, again, this is a broader question that goes to the question that your Chairman raised earlier, is—we do not have the legal authority to compel certain types of performance by banks in this stuff. Now, Congress could decide to give it to us; I suspect they would not. They could. But, that option is not an option available to us at this time. It was not available when we designed the programs themselves.

Mr. SILVERS. But, then—Mr. Secretary, can I just—I mean, I disagree with your characterization of the leverage you have around this question, because I—which I think is implied by your statement about not having legal authority. I think the web of relationships that exist with the GSEs, with the Fed, and the like, give you, I think, a fair amount of ability to open that question up.

But, I want to take you to one last place, with the Chairman's permission. Given this—given the fact that this is a difficult problem, and given, I think, the—what is clearly, as a matter of numbers, the increasing reliance on non-HAMP mods across the market, to drive the mods, I am puzzled by what I read—and maybe I read incorrectly—to be Treasury's opposition to having the State agencies, among the uses of the money that they've gotten from HAMP, use that money to help homeowners get counsel so that they can then have a better shot at negotiating mods. I——

Secretary GEITHNER. Are you referring to——

Mr. SILVERS [continuing]. I think I'd like to——

Secretary GEITHNER [continuing]. Legal aid?

Mr. SILVERS [continuing]. Understand that——

Secretary GEITHNER. Are you——

Mr. SILVERS. Yeah, legal aid. Yeah.

Secretary GEITHNER. It's a good question. We've looked—we've spent a lot of time looking at this. And, of course, we do provide resources to help homeowners determine eligibility for the program and participate in the programs. The specific question a number of Members of Congress have raised is, Can we use these this authority to help provide more financial assistance to legal aid itself? And the way the laws of the land are written, we cannot legally use TARP or HAMP resources for that purpose. There's some amendments pending before the Congress—there's some laws—legislation pending that would change that——

Mr. SILVERS. How did you come to that conclusion, that——

Secretary GEITHNER. Very carefully——

Mr. SILVERS. No, I meant specifically under whose advice?

Secretary GEITHNER. Oh, we consulted with, of course, a broad range of lawyers across the government. And I'm very confident their judgment is right. And I think that's recognized in the fact that some Members of Congress have proposed to——

Mr. SILVERS. The press reports that you relied on outside counsel with significant conflicts. Is that——

Secretary GEITHNER. No.

Mr. SILVERS [continuing]. True?

Secretary GEITHNER. No, absolutely not. We—well, first, we would never do that. We have, like, plenty of lawyers at the Treasury and in the Justice Department to make those judgments.

Mr. SILVERS. So, you did not ask—it's a false report that you asked a particular law firm—if you give me a moment, find the name of it. It's a—it's just false that you asked——

[Pause.]

Secretary GEITHNER. I think I can help you.

Mr. SILVERS. Yeah, you can help me. What's the name of the firm that I'm trying to find?

Secretary GEITHNER. I have no idea. I'm sure we asked people for advice across the—as you expect us to do——

Mr. SILVERS. Right.

Secretary GEITHNER [continuing]. But we don't rely on judgment—we—the judgment we rely on is the judgment of the responsible people in executive branch. And I think that legal judgment is the correct judgment, although I'm not a lawyer.

Mr. SILVERS. The letter from your counsel says that, "Legal aid services are not necessary or essential to the implementation of the loan modification program." Is that the core of your finding?

Secretary GEITHNER. No. And I don't think you were quoting the letter in full. And again,——

Mr. SILVERS. No, I'm not.

Secretary GEITHNER [continuing]. I'd——

Mr. SILVERS. If I read it in full, it would take a long time.

Secretary GEITHNER. I'd have to go back and read the letter again. But, I think it's a—can I make a more simple legal argument, which I think——

Mr. SILVERS. Well——

Secretary GEITHNER [continuing]. I'm not going to do——

Mr. SILVERS [continuing]. I'd like you to address why—I mean, we know——

Secretary GEITHNER. If Congress, by statute, authorizes and provides funding for a particular function of government, then the general judgment of lawyers is: we cannot use another source of funds to supplement or enhance those—that separate——

Mr. SILVERS. But, isn't——

Secretary GEITHNER [continuing]. Authorization. This is an understandable judgment by lawyers.

Mr. SILVERS. But, wasn't that particular authorization passed after the initial decision not to fund?

Secretary GEITHNER. I don't believe that's——

Mr. SILVERS. Not to allow funding?

Secretary GEITHNER. I don't believe that's the case. But, in any case, Mr. Silvers, I'd be happy to respond in writing to any more questions about the legal basis for it.

[The information referred to follows.]

2010-SE-001590

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.

SECRETARY OF THE TREASURY

September 13, 2010

The Honorable Mary Jo Kilroy
U.S. House of Representatives
Washington, D.C. 20515

Dear Representative Kilroy:

I am writing in response to your recent inquiries about the Housing Finance Agency Innovation Fund for the Hardest-Hit Housing Markets (the "HFA Hardest-Hit Fund"). As you know, we designed the Fund to support new and innovative foreclosure prevention efforts in states—such as Ohio—that have been hardest hit by housing price declines and high unemployment rates. I share your strong commitment to maximizing the impact of the HFA Hardest-Hit Fund and to helping responsible Americans keep their homes.

I also understand your interest in whether the HFA Hardest-Hit Fund can support legal aid services proposed by state HFAs. It is critically important that struggling American families receive accurate and helpful advice about how to take advantage of the Administration's housing relief efforts. Accordingly, I asked George Madison, the General Counsel of the Treasury Department, to review the issue closely. Mr. Madison has concluded that legal aid services cannot be funded through programs such as the HFA Hardest-Hit Fund that are authorized under the Emergency Economic Stabilization Act of 2008 ("EESA"). I have enclosed a detailed memorandum that analyzes the legal issues and statutory limitations.

Thank you for your attention to these critical issues. Although we cannot use EESA funds to support legal aid services, we are fully committed to working with you to ensure that the HFA Hardest-Hit Fund successfully provides targeted aid to struggling homeowners and encourages innovative solutions to the housing downturn.

Sincerely,

Timothy F. Geithner

Enclosure

cc: The Honorable Earl Blumenauer
The Honorable John Boccieri
The Honorable Corrine Brown
The Honorable Kathy Castor
The Honorable Peter DeFazio
The Honorable Ted Deutch
The Honorable Steve Driehaus
The Honorable Bob Filner
The Honorable Marcia L. Fudge
The Honorable Alan Grayson
The Honorable Raul Grijalva
The Honorable Alcee L. Hastings
The Honorable Marcy Kaptur
The Honorable Ron Klein
The Honorable Dennis Kucinich
The Honorable Jim Langevin
The Honorable Zoe Lofgren
The Honorable Kendrick Meek
The Honorable George Miller
The Honorable Tim Ryan
The Honorable Kurt Schrader
The Honorable Zack Space
The Honorable Jackie Speier
The Honorable John Spratt
The Honorable Pete Stark
The Honorable Bart Stupak
The Honorable Betty Sutton
The Honorable Dina Titus
The Honorable Debbie Wasserman Schultz
The Honorable Diane Watson
The Honorable Mel Watt
The Honorable Charlie Wilson
The Honorable Lynn Woolsey

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.

GENERAL COUNSEL

September 10, 2010

MEMORANDUM FOR SECRETARY GEITHNER

FROM: George W. Madison, General Counsel CAW for GM

SUBJECT: Funding of Legal Aid Services in connection with the Housing Finance Agency Innovation Fund for the Hardest Hit Housing Markets

This memorandum addresses whether the Department of the Treasury ("Treasury") can support certain proposed legal aid services using Troubled Asset Relief Program ("TARP") funds in connection with the Housing Finance Agency Innovation Fund for the Hardest Hit Housing Markets ("HFA Hardest-Hit Fund").

We understand that you intend to share this memorandum with Members of Congress.

I. Summary Conclusion.

For the reasons discussed below, we have concluded that legal aid services cannot be funded through programs such as the HFA Hardest-Hit Fund that are funded under the Emergency Economic Stabilization Act of 2008 ("EESA"). Legal aid services are not specifically authorized under EESA. In addition, the proposed legal aid services are not necessary and incidental, as a matter of law, to the implementation or effectiveness of the HFA Hardest-Hit Fund, because: (1) Congress has provided other specific appropriations that fund the same type of legal aid services proposed by the state Housing Finance Agencies ("HFAs"); and (2) legal aid services are not necessary or essential to the implementation of a loan modification program.

II. Factual Background.

Treasury has provided funding under EESA for the HFA Hardest-Hit Fund for measures developed by state HFAs to help homeowners in the states that have been hardest hit by the housing downturn. Treasury has designated the HFA Hardest-Hit Fund specifically for implementation in eighteen states, as well as the District of Columbia. Each applicable state HFA (or an eligible entity on its behalf[1]) has developed a range of programs tailored to the needs of its individual state and has submitted funding requests to Treasury. Proposal submission

[1] Under the HFA Hardest-Hit Fund, Treasury is funding these programs by purchasing "financial instruments" from "financial institutions" under section 101(a) of EESA. Some of the HFAs qualify as "financial institutions," while others used existing (or formed) affiliated entities that qualify as "financial institutions." Accordingly, the use of the term "HFAs" throughout this memorandum also refers to their affiliated eligible entity, if applicable.

guidelines instruct the eligible state HFAs that the proposed programs must "meet the requirements of EESA."[2]

Staff members from several eligible HFAs have expressed an interest in funding certain types of counseling and/or legal aid services. Accordingly, they requested Treasury's views on the funding of these types of services. In response, we communicated—through a law firm engaged by Treasury to assist it with the implementation of the HFA Hardest-Hit Fund—our conclusion that certain limited counseling services are eligible for funding under EESA, but that the proposed legal aid services are not eligible. This memorandum describes Treasury's legal position in further detail.

III. Legal Analysis.

As a general matter, government funds may be used only for their intended purpose.[3] EESA does not expressly authorize payments for legal aid services. Section 101 of EESA authorizes the Secretary of the Treasury to purchase "troubled assets from any financial institution." And 109(a) authorizes the Secretary to use "loan guarantees and credit enhancements to facilitate loan modifications to prevent avoidable foreclosures." Consistent with this authority, Treasury has specified that HFA Hardest-Hit Fund proposals must facilitate loan modifications using credit enhancements in the form of payments to loan servicers, investors, and borrowers.

EESA does not cite, much less authorize, spending for legal aid services. However, appropriations law does not require that all government expenditures must be specifically or expressly identified by Congress.[4] It is well-settled that when Congress makes an appropriation for an expressly-stated purpose, it also authorizes by implication expenditures that are "necessary or incident to" the implementation of the expressly stated purpose.[5]

The Comptroller General of the United States has held that three factors must be considered when determining whether a federal government expense is necessary or incidental—as a matter of law—to the implementation of the object of an appropriation (in this case, the implementation of a mortgage modification program under EESA).[6] All three factors must be satisfied.

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[2] *See* "Guidelines for HFA Proposal Submission," March 5, 2010, pages 2-3, found at http://www.makinghomeaffordable.gov/docs/HFA%20Proposal%20Guidelines%20--%20030510%20FINAL%20(Clean).pdf

[3] "Appropriations shall be applied only to the objects for which the appropriations were made except as otherwise provided by law." 31 U.S.C.A. § 1301(a).

[4] "An express statutory provision is not required for every item of expenditure." 42 Comp. Gen. 226, 228 (1962).

[5] 29 Comp. Gen. 419, 419 (1950).

[6] 63 Comp. Gen. 422, 427 (1984).

First, the expenditure must be "reasonably related to the purposes for which the appropriation was made."[7] *Second*, the expenditure "must not be prohibited by law."[8] And *third*, the expenditure "must not fall specifically within the scope of some other category of appropriations"—in other words, the expenditures are only authorized if they have *not* been provided for more specifically by some other appropriation or statutory funding scheme.[9] The last requirement applies even if the more appropriate funding source is exhausted and therefore unavailable.[10] If a federal agency funds an activity under a broad appropriation, despite the fact that the activity been specifically funded by another appropriation, the agency would violate the Anti-Deficiency Act (31 U.S.C. § 1341).[11]

In our view, the expenditure of EESA funds for legal aid services under the HFA Hardest-Hit Fund is prohibited, because it does not satisfy the third factor of the Comptroller General's test. Congress has otherwise appropriated federal funds for the same types of legal aid services proposed by the state HFAs. This conclusion, by itself, is dispositive and means the proposals cannot be funded under the HFA Hardest-Hit Fund.

In addition, we have concerns about whether the HFA proposals satisfy the first factor of the Comptroller General's test. Although the precise legal standard governing this factor is unclear, numerous opinions require a close nexus to a specific statutory purpose—*i.e.*, that expenditures be "necessary" or "essential."[12] We recognize that typical legal aid services, such as those proposed by the various state HFAs, are reasonably related to foreclosure prevention efforts generally. However, we do not believe they are necessary or essential to loan modification programs under the HFA Hardest-Hit Fund.

A. Legal Aid Services Fall Specifically within the Scope of Another Appropriation.

The third factor of the Comptroller General's test prohibits the payment of any expenses if another appropriation "makes more specific provision for such expenditures."[13] In this case, the

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[7] 63 Comp. Gen. at 427; *see also Ass'n of Civilian Technicians v. Federal Labor Relations Authority*, 370 F.3d 1214, 1218 (D.C. Cir. 2004), citing United States General Accounting Office, Office of the General Counsel, 1 Principles of Federal Appropriations Law 4-14 to 4-22 (2d ed.1991).

[8] 63 Comp. Gen. at 427.

[9] *Id.*; *see also* 370 F.3d 1214, 1221 (D.C. Cir. 2004), citing 6 Comp. Gen. 619.

[10] 63 Comp. Gen. 422, 427-28 (1984), citing 38 Comp. Gen. 782, 785 (1959).

[11] 63 Comp. Gen. at 428.

[12] B-223608, 1988 WL 228374, at *2 (1988); 29 Comp. Gen. 419, 421 (1950).

[13] 29 Comp. Gen. 419, 419 (1950).

question is whether the legal aid services proposed by the state HFAs fall within the scope of other existing appropriations.

The answer is yes. Congress has specifically provided funds for legal aid services through annual appropriations to the Legal Services Corporation (the "LSC").[14] The LSC uses appropriated funds to make grants to non-profit legal aid programs, which in turn offer legal services to low-income individuals and families. Those services include helping "homeowners prevent foreclosures or renegotiate their loans."[15]

Moreover, Congress recently authorized legal aid specifically related to foreclosure prevention efforts. On July 21, 2010, the President signed into law the Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-517 (2010) (the "Dodd-Frank Act"):

- Section 1498 of the Dodd-Frank Act authorizes HUD to establish and administer a program that funds foreclosure legal assistance to low- and moderate-income homeowners and tenants related to home ownership preservation, home foreclosure prevention, and tenancy associated with home foreclosure;
- Section 1498(d)(1) requires that the legal assistance only be provided to "homeowners of owner-occupied homes with mortgages in default, in danger of default, or subject to or at risk of foreclosure;" and
- Section 1498(f) appropriates to the Secretary of HUD $70 million for fiscal years 2011 and 2012 ($35 million each year) for these legal aid grants.

In short, Congress already has funded legal aid services through existing appropriations and statutory funding schemes. Accordingly, we believe that providing additional funding for legal aid services under the HFA Hardest-Hit Fund would be contrary to opinions of the Comptroller General and it might violate the Anti-Deficiency Act.

B. Legal Aid Services May Not Constitute a "Necessary Expense."

The first factor of the Comptroller General's test requires that necessary and incidental expenses must be "reasonably related to the purposes for which the appropriation was made."[16] As

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[14] *See, e.g.*, Consolidated Appropriations Act, 2010, Div. B, Title IV, Pub. L. No. 111-117, 123 Stat. 3034, 3148 (2009); Omnibus Appropriations Act, 2009, Div. B, Title IV, Pub. L. No. 111-8, 123 Stat. 524, 593 (2009).

[15] LSC's website states that "[m]ore than 25 percent of cases involve helping to resolve landlord-tenant disputes, helping homeowners prevent foreclosures or renegotiate their loans, assisting renters with eviction notices whose landlords are being foreclosed on, and helping people maintain federal housing subsidies when appropriate." http://www.lsc.gov/about/lsc.php.

[16] 63 Comp. Gen. at 427; *see also Ass'n of Civilian Technicians v. Federal Labor Relations Authority*, 370 F.3d 1214, 1218 (D.C. Cir. 2004), citing United States General Accounting Office, Office of the General Counsel, 1 Principles of Federal Appropriations Law 4-14 to 4-22 (2d ed.1991).

previously noted, we are not relying upon this analysis, because the HFAs' legal aid proposals clearly do not satisfy the third factor of the Comptroller General's test. Nonetheless, various Members of Congress and other interested parties have raised questions related to this issue. Therefore, we have considered it and concluded that the legal standard may not be satisfied.

Despite a "vast number of decisions over the decades," the Comptroller General has not applied the first prong of its test in a clear and consistent manner.[17] Instead, the Comptroller General has used a variety of different formulations when discussing the standard. "If one lesson emerges, it is that the concept is a relative one."[18] Nonetheless, in numerous opinions, the Comptroller General has required a close nexus between a specific express statutory purpose and any proposed expenditures—*i.e.*, the expenditures must be "necessary" or "essential."[19]

In this case, legal aid services may be reasonably related to foreclosure prevention efforts generally; however, they are not necessary or essential to running a loan modification program.[20] Typically, legal aid lawyers who represent struggling homeowners perform a variety of functions, other than just negotiating mortgage modifications. For example, legal aid lawyers represent borrowers in arbitration proceedings against their lenders; file injunctions and bankruptcy petitions to prevent foreclosure sales; and, when foreclosure sales occur, file exceptions proceedings in state court.

Notably, the HFAs' legal aid proposals do not focus on obtaining modifications under the HFA Hardest-Hit Fund or under Treasury's Home Affordable Modification Program ("HAMP").[21] Instead, they fall within two general categories: using EESA funds to pay lawyers to represent

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[17] 65 Comp. Gen. 738, 740 (1986).

[18] *Id.*

[19] For example, almost fifty years ago, the State Department proposed to build a "pneumatic tube communication system" to the White House. The State Department argued that the expenditure was "reasonably related to the general purposes for which the appropriation [was] made." The Comptroller General, however, disagreed and held that the expenditure was not "necessary" to the *specific* purpose of the appropriation, *i.e.*, extending and remodeling the State Department Building. 42 Comp. Gen. 226, 226 (1962). Similarly, in another case, the Army Corps of Engineers proposed to use appropriated funds to purchase plastic ice scrapers imprinted with a safety slogan. The Corps argued that it was statutorily required to establish and maintain safety programs, under the Occupational Safety and Health Act of 1970. The Comptroller General rejected the proposed expenditure and held that "the Army has failed to establish a connection between the ice scrapers and the purposes of the Act such that the scrapers can be considered essential to the carrying out of these purposes." B-223608, 1988 WL 228374, at *1-2 (1988).

[20] We previously have concluded that sections 101 and 109(a) of EESA specifically authorize the Secretary to implement a loan modification program to "prevent avoidable foreclosures."

[21] Presumably, this is because lawyers serve the overall interests of their clients and must examine all available options. For example, a lawyer representing a borrower might determine that it is in his or her client's best interest *not* to agree to a HFA Hardest-Hit Fund or HAMP modification, but instead to pursue a different strategy, such as a non-TARP modification, a short sale, litigation, or simply walking away from the home.

distressed borrowers in state foreclosure proceedings, or using funds to provide general support to legal aid programs related to foreclosure prevention. Given the breadth of the proposals, legal aid services frequently would result in outcomes other than loan modifications. Accordingly, they are not—by definition—necessary or essential to loan modification programs under the HFA Hardest-Hit Fund. Moreover, even if the HFAs' proposals were more targeted, most borrowers can obtain modifications without traditional legal services. That is, there is no need for representation in court proceedings, no requirement to file papers or cite legal authorities, and no need to negotiate contracts (because the modifications are standardized).

We recognize that some Comptroller General opinions suggest that expenditures merely need to be "reasonably related" or "contribute materially" to an authorized statutory purpose.[22] Here, one could argue that a general statutory purpose of EESA is to prevent foreclosures and that any expenditures reasonably related to that purpose are permissible.[23] We believe that such an interpretation sweeps too broadly. It would authorize an almost unlimited number and variety of government expenditure—*i.e.*, anything that is reasonably related to preventing foreclosures. It also would render meaningless the express provisions in EESA that together provide authority for the HFA Hardest-Hit Fund: Section 101 authorizes the Secretary to purchase "troubled assets from any financial institution," and 109(a) authorizes the Secretary to use "loan guarantees and credit enhancements to facilitate loan modifications to prevent avoidable foreclosures."[24] Lastly, such an interpretation would be contrary to how Treasury has implemented EESA.

C. Certain Limited Intake and Follow-Up Services Are Eligible for EESA Funding.

Finally, it is instructive to compare the HFAs' legal aid proposals to the much narrower intake and follow-up services related to TARP-funded modifications that are provided by homeowner counseling agencies. We previously have concluded that these services satisfy the Comptroller General's test and *are* eligible for EESA funding.[25]

[22] 66 Comp. Gen. 356, 359 (1987); 42 Comp. Gen. 226, 227 (1962); *see also* 70 Comp. Gen. 720, 721-22 (1991); B-223608, 1988 WL 228374, at *2 (1988); B-193769, 1979 WL 13004, at *2 (1979); 50 Comp. Gen. 534, 536 (1971).

[23] Section 2 of EESA directs the Secretary to use the authority and facilities provided by the statute in a manner that, *inter alia*, "protects home values" and "preserves homeownership."

[24] The Comptroller General has observed that "[g]eneral statutory sections setting forth legislative policy and purpose neither constitute an operative section of the statute nor prevail over more specific provisions." B- 285066, 2000 WL 675589, at *4 (2000), citing *Bissette v. Colonial Mortgage Corp.*, 477 F.2d 1245, 1246 (D.C. Cir. 1973).

[25] Broader-based foreclosure counseling services—such as debt counseling—cannot be funded under EESA for the same reasons described in this memorandum. Such counseling services are not expressly authorized by EESA; Congress has otherwise provided federal funding for these services; and they are not necessary to the implementation of HFA Hardest-Hit Fund programs.

Most HFAs have submitted proposals to Treasury that include services narrowly tailored to obtaining modifications under the HFA Hardest-Hit Fund programs, such as: (i) making prequalification assessments of eligibility and submitting the qualified applications to the HFAs; (ii) obtaining supporting documentation from the borrowers and providing it to the HFAs; (iii) ensuring that borrowers execute the necessary documents for HFA Hardest-Hit Fund programs; (iv) conducting post-closing meetings with borrowers receiving assistance to ensure that they are complying with the HFA Hardest-Hit Fund programs; and/or (v) verifying the steps that the borrower has taken to find a job.[26]

In contrast to legal aid, these particular services do not fall within the scope of other existing appropriations.[27] Moreover, they are "necessary" and "essential" to running a mortgage modification program, within the meaning of the Comptroller General opinions. The HFAs have represented that in the absence of intake and follow-up services, both the number of applicants and the number of approved participants will be materially smaller. These services are necessary for many borrowers to participate in the HFA Hardest-Hit Fund programs, and it will be very difficult for many of these programs to run effectively without such services. In addition, intake and follow-up services are directly related to the HFA Hardest-Hit Fund programs. They will neither be available to nor assist applicants to other, non-TARP funded programs.

IV. Conclusion.

We recognize that legal aid services—such as representing a borrower in court to avoid a foreclosure, or advising a borrower about his or her legal rights—may be helpful to preventing foreclosures. However, EESA does not expressly authorize payments for such services, and Congress has provided other federal funds for the same types of services proposed by the HFAs. Moreover, unlike the specific counseling services that HFAs have proposed, legal aid services are not necessary or essential to the implementation of the particular HFA Hardest-Hit Fund programs, within the meaning of the Comptroller General opinions. For all these reasons, Treasury has determined that legal aid services are not eligible for EESA funding from the HFA Hardest-Hit Fund.

[26] These activities could of course be provided by an individual who is a lawyer. The critical issue is not whether the person providing the services is a lawyer, but rather the nature of the services provided.

[27] Existing appropriations do fund some relevant counseling services, but those appropriations provide only for *generalized* foreclosure prevention counseling. Existing appropriations do not provide for the specific intake and follow-up services that the state HFAs have proposed to fund in connection with the HFA Hardest-Hit Fund.

Secretary GEITHNER. I want to say that I think you were right that there's a very good public policy case for using resources to help people take advantage of government programs, manage through a very complicated, difficult modification process. There's a very good case for doing that. And I have been, personally, very, very supportive of more government resources for counseling, for legal aid, generally. And, where we had a legal authority to do that, we have made TARP funds and HAMP funds available to help reinforce that objective, for the reasons you support. But, there's a legal constraint on the amount—our ability to use TARP for legal aid directly, that law would have to be changed to rely on.

Mr. SILVERS. Mr. Secretary, it puzzles me that when hedge funds get TARP money, under PPIP, I believe they get to pay for lawyers. And it puzzles me that a vast amount of TARP money has been expended on legal counsel for the benefit, obviously, of the government. It seems as though lawyers are understood to be a necessary and essential component of all the transactions that TARP—that HAMP and TARP under—that TARP undertakes, except when homeowners need the lawyers. It——

Secretary GEITHNER. It puzzled——

Mr. SILVERS [continuing]. Troubles me.

Secretary GEITHNER [continuing]. Me and troubled me, too, when I first was confirmed. And I spent quite a lot of time trying to figure out how we could fix it, but I'm very confident that the legal judgment our lawyers and Justice made is the right one. And we'll figure out—see if we fix that through legislation.

Mr. SILVERS. Well, I appreciate your engagement with me on that. Thank you.

The CHAIRMAN. Dr. Troske.

Dr. TROSKE. Mr. Secretary, I—I think I'm going to switch gears here a little bit. I mean—and we'll maybe talk about cars for a little bit.

So, as you're aware, in December of 2008 the decision was made to use TARP funds to provide financial support to the—General Motors and Chrysler. Would you have done that? Would you have made—reached the same decision, if you had been Secretary at the time?

Secretary GEITHNER. It was not my decision to make, as you implied. But, I was aware of the—the merits of the choice at the time. And I thought what my predecessor did was the right thing.

Dr. TROSKE. So, I guess—I mean, and essentially this was for them to avoid going into bankruptcy, with—I think that was the alternative at the time. In—and you made the—you alluded to the estimate that a million jobs would have been lost through bankruptcy. So, firms as large, if not larger than General Motors and Chrysler, such as Texaco, United Airlines, Delta, American, and Polaroid have gone through bankruptcy, as did Lehman Brothers, and our economy survived. So, would the world really—would the world today really have looked much different, had General Motors and Chrysler gone through bankruptcy in December of 2008? How different would the unemployment picture be? And so—and tell me why—whether you think that's true, and what you based that decision on. You know, what are your thoughts on why it would look different? What's different?

Secretary GEITHNER. Look, market economies require failure. They don't work unless you allow firms to be—to fail when they cannot make things people want to buy. And, in normal recessions even, not just in normal expansions, bankruptcy is a central part of the functioning of a market economy. But, everything is different when you're in a financial crisis like what we faced in the Great Depression or what we faced in this basic crisis. And, in those circumstances, bankruptcy itself cannot provide an effective way to protect the economy from the collateral damage of, for example, the failure of major financial institutions, or in—even in the auto case, the failure of a concentrated number of major providers. And I think that—so you have to think about those two different worlds.

In a crisis, you have to do things you would never do in a normal recession, and certainly would do in an expansion. And I think that bankruptcy never works, of course, without there being a source of lending that is in a position with financing to help facilitate a reorganization, because companies need funding to go through that. And in a financial crisis, there will be no source of Debtor-in-Possession financing on significant scale. And so, in some cases, the government has to step in to provide that temporary financing. But, what matters most—and this is true in the auto case—is, if you do that, you have to do it on the condition that you bring about a restructuring that will allow the firm to emerge profitable without government assistance. And that's what the auto piece of our strategy was able to achieve. And I think there's no doubt that unemployment would have been much higher, there would have been millions more jobs lost, if we hadn't gone through that. And I thought that was a very well-designed use of government resources in an acute crisis.

Dr. TROSKE. Let's talk about GMAC a bit, and the exit plan. The government's relatively speedy exit from General Motors contrasts with the lack of clear exit strategy from the government stake in GMAC. The GMAC management team has discussed publicly the idea of a 2011 IPO. Given that the company has reported three consecutive quarters of profits, what is the current thinking on a timetable for an IPO?

Secretary GEITHNER. As quickly as we can do it. I think you—if you look at what we've done across the board, and if you—again, we're way ahead of anybody's expectations—we are going to move as quickly as we can to replace the government's investments with private capital, take those firms public, figure out a way to exit as quickly as we can. And we're working very hard with the management and board of GMAC to achieve that outcome. I don't quite—I don't know how quickly, but it's going to be much sooner than we thought 6 months ago.

Dr. TROSKE. To change subjects again and talk about executive compensation a bit, when Mr. Feinberg testified before our panel, he stated that if the culture of pay on Wall Street is not changed in the wake of the TARP, then I think our work has not been successful and it's not being—and, if it's not being followed, it is a problem. Do you agree with him?

Secretary GEITHNER. I would agree with that. If that were the case, I would completely agree with that.

Dr. TROSKE. And do you think that's not the case?

Secretary GEITHNER. Very good question, and a good time to be asking that question. And I guess I would say the following:

We did two things over the last 6 months or so, one in the Dodd-Frank Reform Act and one in a set of standards that the Fed is responsible for enacting—for enforcing, to try to bring about very substantial changes in compensation practice, looking forward. The first was a requirement for disclosure and to give shareholders the right to vote on compensation packages. That's the SEC's responsibility. And the second is a set of standards on the design of compensation incentives that that Federal Reserve and the bank supervisors are responsible for enforcing. And we'll know more about the results of both those things on behavior in the early part of next year.

To date, what you can say is, there's been a substantial shift in compensation. So, there's less in cash, more in equity. It vests over time. It's more at risk of being clawed back if firms don't end up performing as well as people had hoped. That's very good. But, I would say, you cannot say today—I would not claim that we have seen enough change yet in the structure of compensation. And that's a very important thing for us to achieve, because, as you know, those incentives were so skewed to encouraging risktaking that they played a material role, I think, in what caused the crisis itself.

The CHAIRMAN. Thank you, Dr. Troske.

Superintendent Neiman.

Mr. NEIMAN. Thank you.

Mr. Secretary, I think you may have anticipated my questioning around servicer performance, because you may have preempted me by characterizing servicer performance as "dismal" during our last exchange. But, I do believe, you know, it deserves further discussion.

In fact, Speaker Pelosi, who appointed me to this panel, made public a letter that she sent, along with other members of the delegation, to the Department of Justice, to the Fed, and to the OCC, a letter that describes, in 20 pages, excruciating detail of examples of real stories from homeowners in dealing with servicers. It demonstrates their frustrations and clearly, despite good-faith efforts on the part of the homeowners, failures of—by the servicers. You know, it highlights areas of failures to respond in a timely manner; the timeliness of proceeding with foreclosures while at the same time proceeding with modifications; as well as a continual evidence of losing and misplacing documentations.

Do we need national standards for mortgage loan servicers?

Secretary GEITHNER. I think we do.

Mr. NEIMAN. Do you—you know, there are a number of States, including New York, that have models out there. We, over 2 years ago, have put in place, not only a registration of mortgage loan servicers, but one of the most comprehensive in the country, that imposes "duties of care," specific conduct of business rules around fair dealing with customers, with homeowners, in requiring modification, requiring trained personnel, and requiring data reporting requirements. Is this something that could serve as a model at the Federal level?

Secretary GEITHNER. I think it could. I'm not familiar, in detail, with what you've done in New York, although I know a number of people think very highly of it. But, we'll look at that model and others. But, I think you're making the right point.

Mr. NEIMAN. In the—in your efforts to stand up the CFPB, do you see this as an early priority, this as one of the mortgage areas, one of the mandated statutory responsibilities for rulemaking?

Secretary GEITHNER. I'm not quite sure how early that will come, realistically. And, of course, as you know, right now we're focused, overwhelmingly, on trying to make sure we're fixing the existing problems in servicer performance and making sure enough people—that we reach as many people as we can, in terms of modification programs. But, it'll be a very important priority. You know, as you know, we have a whole set of complicated work on defining new underwriting standards, defining what's a qualified residential mortgage, what should be the basic future of the housing finance system, more generally. You have to look at these things all together. Not that we want to take too much time to do them, because it's so consequential, but we have some time. This is—we got this terribly wrong, as a country; we want to make sure we get it right; and we're going to do everything we can to make sure we have a durable set of fixes.

Mr. NEIMAN. So, how do we proceed with national standards to avoid 50 States proceeding down the road, requesting data from servicers in 50 different formats? Does not this have to be a priority? If not——

Secretary GEITHNER. Oh, it will be a priority. I just don't know yet—I can't be honest with you and tell you whether it's something where we'll have a proposal in 6 months or 12 months. Just can't tell you. But, it's absolutely very important. And again, we'll look to the model in New York and other States to see what's the best way to proceed.

Mr. NEIMAN. With respect to the CFPB, do you see a new era of cooperation? My reference to a cooperative federalism, particularly between States and the agencies——

Secretary GEITHNER. I——

Mr. NEIMAN [continuing]. Particularly the CFPB?

Secretary GEITHNER. I think we do. And, you know, we're going to have a test of that in the—in how we deal with this broad—these broad set of mortgage documentation problems that have been the subject of many of your earlier comments, where we have a broad task force of agencies looking at this and working very closely with the State AGs. We've got a standing mechanism we call the "financial fraud task force," that works very closely with the State AGs. The council, that the Congress established by law to look at financial stability, gives a seat at the table to representatives of State securities regulators, insurance regulators, and banking regulators. You know, we're a country, and we have a national financial system, and so, if we're going to do a better job, in the future, of preventing future crises, we have to make sure that these entities are working much more closely together.

Mr. NEIMAN. Well—thank you, my time is expired.

The CHAIRMAN. Thank you, Superintendent Neiman.

Just a big question. What's the current systemic risk from troubled assets remaining in banks? Do you think it's just—how do you see it?

Secretary GEITHNER. I believe that the U.S. banking system has very substantial capital on their books today, in the form of common equity against the assets they hold and the risks they're taking. And I am much more confident today that we made the right judgments in forcing enough—that much capital into the system earlier, and that that'll give us a—very reasonable prospect of coming out of this stronger. So, I think that what matters is the capital, relative to the potential exposure still. But, firms are working down those assets. And most measures you see of performance of those assets now are improving, have been improving for some time, even in mortgages.

The CHAIRMAN. The financial system may be stronger, but we still have more concentration, in terms of the banking system. What are your feelings today on, you know, Dodd-Frank, resolution of authority, if in fact one of—because what's happening more and more is people are just saying—discussions—what—in our hearings here and everything else, it's like it's just assumed we'd be in big trouble if one of these bank fail. So, what's your feeling, right now, based on the increasing concentration of the big banks?

Secretary GEITHNER. Of course, you're right that the system is more concentrated today than it was before the crisis. And that's sort of an unavoidable consequence——

The CHAIRMAN. Right, exactly.

Secretary GEITHNER [continuing]. In a financial crisis. But, I—we're much less concentrated than anything other major economy, in the banking system. You know, we still have roughly 8,000, 9,000 banks, and that's a great strength to our system; we want to preserve that. But——

The CHAIRMAN. But the vast—you—we've got a few banks that are just extremely big.

Secretary GEITHNER. We do, but they—again, not to underestimate——

The CHAIRMAN. Yeah.

Secretary GEITHNER [continuing]. The consequences of this stuff, but they are much smaller, as a share of our economy, than is true for any other country, too. So, if you look at the comparison—you look at Canada, the U.K., Western Europe, Japan—even our largest banks are much smaller, relative to the size of our economy, than is true for them, as a whole. If you look at a list of top 50 financial institutions in the world, in terms of overall size today, the U.S. banks are not distinguished on that list, in terms of their relative size. So—now, that's not to say that it's not a big problem for——

The CHAIRMAN. But——

Secretary GEITHNER [continuing]. The system——

The CHAIRMAN [continuing]. In many of these countries, the banks and the government are so closely aligned. I mean, we did have—like the Scotland Bank—we did have a——

Secretary GEITHNER. We would not want to be like them.

The CHAIRMAN. Right.

Secretary GEITHNER. I agree with you.

The CHAIRMAN. Exactly.

Secretary GEITHNER. Yeah.

The CHAIRMAN. So, I mean, just—under the resolution authority, these are still——

Secretary GEITHNER. They are, but——

The CHAIRMAN [continuing]. Banks.

Secretary GEITHNER [continuing]. The—you know, the most important things——

The CHAIRMAN. Right.

Secretary GEITHNER [continuing]. That Dodd-Frank did were to give us the authority——

The CHAIRMAN. Right.

Secretary GEITHNER [continuing]. To force these large institutions to hold much more capital, recognizing——

The CHAIRMAN. Right.

Secretary GEITHNER [continuing]. The significant risk they pose to the system as a whole—we have achieved that; to give us the authority to apply those requirements for capital, those constraints on leverage, to institutions that are banks, even if they don't look like banks, like AIG or investment banks or a range of other institutions that were not regulated as banks before; and, as you said, resolution authority, which is like a bankruptcy authority for banks, so that, in the event, in the future, a bank like that makes mistakes that cause it to fail, the government can step in and unwind them, put them out of their misery, break them up, without the risk of collateral damage to the taxpayer or to the rest of the economy as a whole. So, I think we're going to be in a much better position in the future to prevent crises of these magnitude, and to manage them more carefully. We will have crises in the future, but the reform bill, to the credit of the architects in Congress today, will help us fix the fundamental failures that caused this crisis.

The CHAIRMAN. But, as you said earlier, when you're in a situation of a financial crisis, bankruptcy or anything like bankruptcy is something you really want to avoid.

Secretary GEITHNER. You cannot—you can't have liquidation be a solution to a financial panic; it just doesn't work.

The CHAIRMAN. So, it's better to do it when it's not.

Secretary GEITHNER. Yeah, that's right.

The CHAIRMAN. Thank you.

Mr. McWatters.

Mr. MCWATTERS. Thank you. I'll keep this short, because I know time is fleeting.

To follow with what the Senator said, there's a trillion dollars of distressed mortgages on banks' balance sheets today. If those mortgages were mark-to-market and the losses booked and the capital impaired, would we have a systemic problem? And, if so, is this thing being—basically being held together today by accounting convention?

Secretary GEITHNER. No. That's what the stress test did. The stress test—what the stress test did was to disclose to the market the scale of potential losses that banks might face in the event we had a much worse recession then we ultimately did, and to force those institutions to hold capital against those potential losses. And because of that, because we brought a level of disclosure and re-

ality to those balance sheets, those firms, on balance, were able to go raise a very substantial amount of capital from private investors. And that's the best measure of the risks banks face, looking forward.

Mr. MCWATTERS. So, if those assets are mark-to-market, the losses were booked, there would not be a systemic problem.

Secretary GEITHNER. The major banks in this country have the capacity to manage the remaining risks they face on their balance sheets that they took on in the crisis.

Mr. MCWATTERS. Okay. Fair enough.

That's all for me.

The CHAIRMAN. Thank you, Mr. McWatters.

Mr. Silvers.

Mr. SILVERS. Just briefly.

The firm I was looking for on the foreclosure issue, on the legal aid issue, is Squire Sanders and Dempsey. You did not ask their advice?

Secretary GEITHNER. I have no idea who they are. But, I'm sure we've asked lots of people for advice, as we do all the time. But, that's not really the relevant question. The question is: On whose judgment and what quality of judgment do we make those decisions? And the judgments are—of course, I'm accountable for those judgments, but they're made by the government's lawyers.

Mr. SILVERS. Mr. Secretary, I'd—I would appreciate knowing whether or not you asked that firm for advice. Not now——

Secretary GEITHNER. I'll be happy to——

Mr. SILVERS [continuing]. Obviously, but if you could——

Secretary GEITHNER [continuing]. Get that to you.

Mr. SILVERS [continuing]. Pursue that.

Now, secondly—and this is, I think, much in vein of the Chair and the prior—and Mr. McWatters' question—there's a lot of numbers in our banking system. I watch one of them, because I feel like I understand it. And that is the value of second mortgages on the books with Wells Fargo. And there's about $100 billion on the—on its books, and that number hasn't changed very much over the last 2 years. That makes me wonder a lot about (a)—the fact that that number's there and the size of Wells's service—first mortgage servicing portfolio makes me wonder about two things.

One is, Does that number bear any relationship to economic reality, per Mr. McWatters's question? And, more broadly, do similar numbers on the balance sheets of the other major four banks bear any relation to economy reality? And (b), if you take that number and the putback risk number, and the continuing inability of at least this panel to understand what the underlying holdings in toxic first-mortgage assets are—going back to our August 2009 Report—take those three things and add them up. They seem to represent a threat to the capital levels of the four large banks. You seem to be quite confident they don't. Can you explain why? And I don't mean with respect to Wells, in particular, but with respect to the picture as a whole.

Secretary GEITHNER. I mean, there's no certainty about judgments. And they're all a probabilistic judgment, and they depend a lot on what is going to be the path of the economy in the future. But, we helped—what we helped do—and this is a necessary thing

for any system to function—is put enough disclosure in the market about the composition of those assets, their quality, the losses you may face on them, how they're performing, so individuals across our financial marketplace, credit agencies or creditors, can judge for themselves whether the capital the banks hold is sufficient against those losses. And again, I would say the judgment I'm reflecting is the broad judgment of most people, that these banks all hold very substantial amounts of capital against the risks they still hold, they took on in the crisis. But, you can look at extraordinary detail every quarter, if not more frequently, about how that stuff is performing and make your own judgments about how it's likely to perform in the future.

Mr. SILVERS. If I might be allowed one final comment, Mr. Chairman.

Do you then feel—do you disagree with—the thing that haunts me about those numbers in relation to the question of the strength of our banks is that when you then take that and connect it to mortgage modifications—and while the—and there seems to be just a very fundamental question there, which is: Are we in a zero-sum game between the strength of those banks—all right?—and our ability to modify mortgages, and thus, both the well-being of the American public and the strength of our housing markets? And I know you—and I can clearly tell, by your gestures, that you don't believe we're in a zero-sum game. But, the evidence that I—that comes before this panel strongly suggests we are. Can you explain why you think we're not?

Secretary GEITHNER. It would require a little more time than I have. And I think it's a fundamental question, I agree. And I think there is a broad perception, you share, that the principal barrier to reaching people we should be able to reach through modifications is weakness, in some ways, among the Nation's major banks. And——

Mr. SILVERS. Can I just say——

Secretary GEITHNER [continuing]. I know, Mr. Silvers——

Mr. SILVERS [continuing]. I'm sorry.

Secretary GEITHNER [continuing]. But the——

Mr. SILVERS. My Chair is——

Secretary GEITHNER [continuing]. Can I——

Mr. SILVERS. I——

Secretary GEITHNER. Maybe we should pursue this in more detail subsequently. But, you have to come back and look at, What's the source of the difference between people who are being reached through modifications today and those who are not? And, as I said earlier, it's principally about how we define eligibility, not about the incentives problem banks face.

The CHAIRMAN. Thank you.

Thank you, Mr. Silvers.

Dr. Troske.

Dr. TROSKE. Mr. Secretary, I want to return to a comment you made, or, you know, expand a little, get you—push you a little on a comment you made earlier about executive compensation and risktaking. And I guess I would argue that a major part of the excessive risktaking was the result of a perception of "too big too fail," which, you know, after a certain point, firms simply didn't

worry about what the left tail of the distribution looked like. And so, I guess I'd like to—do you think we've fixed—have we put situations in place that are pushing firms—that are going to require firms to actually start thinking about what the left tail of the—you know, the likelihood of an extremely bad loss?

Secretary GEITHNER. I think you're exactly right, which is that the two sources of financial crises, classically, are moral hazard, the perception the government will insulate you from the consequence of your mistakes, and a fundamental uncertainty or excessive optimism about how dark the future might be, how you—using the technical term, how adverse the tail is in the extreme event.

I think, in this crisis, both were at work. Of course, moral hazard was the central part of what happened, what went wrong in the GSEs.

But, the failures across the system, in my view, were not principally about moral hazard, they were a much more systematic failure of people to anticipate what might happen in the event we had a deep recession, where house prices actually fell very substantially, because that was not in the memory of most people alive today. Most people ran their banks, their businesses, their personal finances on an expectation that house prices would not fall. House prices fell dramatically, as you saw; and that failure to anticipate and plan for the potential adverse risk was fundamental to that. In parts of the system, moral hazard made that worse, like the GSEs; but the failures were much more systemic from that.

Now, have we fixed that? We'll never fix that completely. But, what the Dodd-Frank bill does is allow us to constrain risktaking with constraints on leverage to offset moral hazard risk and set up a system where, in the event these large institutions are at the risk of failure again, we cannot save them, all we can do is dismember them safely, break them up with less collateral damage. And that will help reduce the expectation in the market, that is pervasive in any financial system, that in the future, when there's a risk of failure, the government will insulate the firm from the consequence. And so, you can't correct it completely, but we're in a much better position to reduce that risk, going forward.

Dr. TROSKE. So, let me—I mean, just—and so, one final question, just building on that. Until that actually happens—I mean, until we see that situation and we see—firms, businesses see how the government's going to deal with that, do you think that—I mean, do we need to see that before they start believing that that's the case? Or do you think that they actually have started responding to it with just—on the belief that, okay, now——

Secretary GEITHNER. We're——

Dr. TROSKE [continuing]. All the—everything's changed?

Secretary GEITHNER. Remember, you can't run the system on the hope that they behave or market discipline works that way. You have to be—you have to do two things. You have to constrain risktaking, force firms to hold more capital against the risk of a very deep shock. That's a function of government; the government failed to do that. You have to do that, as well as make sure you have the ability to let firms fail without causing collateral damage. The reform bill gives us those two authorities. That's fundamental.

Now, again, we're going to have crises in the future, and how they are managed in the future will depend on the overall cost of them, but we're in a much better position to prevent them being this severe than we were before.

The CHAIRMAN. Thank you, Dr. Troske.

You also have to anticipate where problems may develop with particular firms, right? I mean, that's the——

Secretary GEITHNER. That's really important.

The CHAIRMAN [continuing]. The third part of the——

Secretary GEITHNER. Right. And I think that obviously, you want people running the institutions, running the central bank, running supervision, that have that capacity to anticipate. But, you have to recognize the reality that we don't know what the future is——

The CHAIRMAN. But, it——

Secretary GEITHNER [continuing]. And that——

The CHAIRMAN [continuing]. It is one of the three things——

Secretary GEITHNER. It's one of the key things. But, fundamentally, you have to make sure your system is strong enough to compensate for the failures of individuals to anticipate. Because that will happen. And that's why capital is so fundamental.

The CHAIRMAN. I know. But, I—it's a three legged stool.

Secretary GEITHNER. Yeah.

The CHAIRMAN. If you don't anticipate—because, as you said, when you get to a bankruptcy, it's a totally different deal if you're in the middle of a crisis than it is if they're not.

Secretary GEITHNER. That's right.

The CHAIRMAN. Right.

Thank you, Dr. Troske.

Superintendent Neiman.

Mr. NEIMAN. Two quick questions. Mr. Secretary, we both mentioned, in our opening statements, the unfinished work in bank lending, particularly by smaller banks. Over 50 percent of the loans to small businesses are made by banks under 10 billion, even though those banks only hold 20 percent of all bank assets. Could you give us an update on the status of the implementation of the Small Business Lending Fund?

Secretary GEITHNER. We are working very hard to put out a term sheet in public very quickly so that we can get capital to banks on a large scale as quickly as we can. And we're very close to being able to do that.

Mr. NEIMAN. Very close. Will you—be any more specific?

Secretary GEITHNER. Soon.

[Laughter.]

Mr. NEIMAN. Soon.

Secretary GEITHNER. As soon as possible.

Mr. NEIMAN. And then, finally, you know, in June, when you were here and talking about the fund, you were relatively optimistic about bank participation. What's your assessment today on bank participation? Will it—will the structure of that program, as you envision it, overcome the TARP stigma that was of concern?

Secretary GEITHNER. I hope so, but I can't tell for sure. There's two types of deterrents—discouragement for banks to participate. One is the stigma that it's a sign of weakness.

Mr. NEIMAN. Okay.

Secretary GEITHNER. It's hard to correct, because, you know, people aren't going—getting capital from the government. The other source of deterrence was the fear of conditions, actual perspectives, that would make the assistance uneconomic or not attractive. That was the principal reason why a relatively small amount of the Capital Purchase Program went to small banks; why hundreds of banks withdrew their applications. I think we've probably fixed that problem. I can't be sure we fixed the other problem.

Mr. NEIMAN. And I think that's the concern we're hearing. And, you know, I think of it in two buckets: those that are currently in—those 600 or some banks that are already in the TARP and—will they view this as a Refi?—or the banks who are not in the TARP program. And I think the question they have—and I'd appreciate your assessment—it—will that loan demand be there for them to utilize that capital?

Secretary GEITHNER. The—you know, the question of what's going to happen in loan demand is an excellent question. I think it's worth—it is worth noting that, if you look at the balance sheets of the American private sector, nonfinancial corporate sector, it's not just the big firms; people have a lot of cash. Now, that's not—the averages mask a lot of differences and, of course, lots of small businesses are not sitting on a lot of cash. But, what happens to the loan demand will depend on, not just how quickly the economy recovers, but how quickly people start to work through those balances of cash that they accumulated before the crisis, and built up—many of them built up, even in the early stage of recovery.

Mr. NEIMAN. Thank you.

The CHAIRMAN. Mr. Secretary, thank you for coming today.

I just want to say that, you know, we have 4 months more to go. And, in light of the problem out there—the problems out there, which you talked about and every panel member, we are—we were looking forward to working for you for the last 4 months, right up to the very end, to do what we can to see if we can get one more person employed and one more person into a house without a foreclosure.

So, I want to thank you for your service. And I want to thank you for your testimony here today.

The record of the hearing will be open for 1 week so that the panel may submit questions for the record.

This hearing is adjourned.

[Whereupon, at 12:02 p.m., the hearing was adjourned.]

Questions for the Record for Secretary Timothy Geithner
From the Congressional Oversight Panel, Hearing on 12/16

Questions for the Record from Mark McWatters, Panelist, Congressional Oversight Panel

1. **If you could turn the clock back to the last quarter of 2008, what are the two or three key changes you would make to the Emergency Economic Stabilization (EESA) and the Troubled Asset Relief Program (TARP) legislation?**

The Troubled Asset Relief Program ("TARP") was a success by any objective measure. As outlined in Treasury's two-year retrospective report, TARP provided a remarkably effective response to a crisis of a type and proportion never before experienced in this country. Also, recent transactions such as the sale of Citigroup common shares and the AIG restructuring have demonstrated that TARP is likely to cost the taxpayers far less than anyone anticipated. While there were legislative limits to our authority, Treasury took decisive actions and successfully balanced often conflicting interests, such as maximizing taxpayer returns and minimizing the government's involvement in the private sector.

We do not expect that any subsequent crises will replicate precisely the one that we experienced in 2008, and we do not anticipate needing another EESA or TARP. Instead, to help avoid and mitigate future crises, Congress enacted the Dodd-Frank Act. It provides Treasury and financial regulators with new tools that we did not have in the fall of 2008 such as resolution authority over nonbanks—to prevent problems in our financial system from escalating to crisis levels. Although we cannot predict the future, we believe that the Dodd-Frank Act will enable the government to respond quickly and effectively to problems and challenges that our financial system may encounter in the future.

2. **What are the key roadblocks preventing bank recipients from repaying their TARP obligations?**

Treasury already has recovered almost all of the TARP funds that were invested in banking institutions. Treasury invested a total of approximately $245 billion in banking institutions under various TARP programs, including the Capital Purchase Program, the Targeted Investment Program, and the Asset Guarantee Program. As of March 1, 2011, we almost have broken even on these investments—Treasury has received approximately $243 billion from banking institutions from repayments, dividends, gain on sale of comment stock and warrants sold and, with one exception, all of the largest banking institutions have fully repaid.

Treasury continues to hold $31 billion in outstanding investments in banking institutions. Of that amount, approximately $20 billion is owed by 21 large institutions and $11 billion is owed by 541 smaller institutions. Most of our outstanding investments are in perpetual preferred stock, which does not include an obligation to repay. Moreover, prior to repaying, banking institutions must obtain regulatory approvals to ensure they remain adequately capitalized after such repayments. The larger institutions generally have access to the capital markets. Although we cannot require them to repay, we expect that most of these institutions will repay in the near future, particularly as the dividend rate will increase in late 2013 or early 2014. Many of the smaller institutions do not have access to the capital markets, and many continue to face

challenges with respect to their loan portfolios and may need to conserve capital. We expect that some may refinance their loans under the Small Business Lending Facility, and we continue to work with others toward exiting our TARP investments.

3. How does Treasury balance the often conflicting goals of exiting TARP investments as soon as practicable and maximizing the return on investment for the taxpayers?

It is true that Treasury must balance those goals in managing its TARP investments. The statutory purpose of EESA was to "restore liquidity and stability to the financial system of the United States." And Congress directed Treasury to maximize "overall returns to the taxpayers." In addition, Congress also directed us to minimize potential long-term negative effects of the program. Therefore, we generally believe it is important to exit our investments as soon as practicable and to minimize the government's financial stake in the private sector. We balance these interests on a case-by-case basis and determine—for each investment decision—what is in the best interest of the taxpayers and the overall financial stability of the market. We believe that our approach has been both effective and successful. TARP helped stabilize the financial markets, and we expect the ultimate costs to the taxpayers will much lower than anyone originally anticipated.

4. Do the troubled legacy assets held by financial institutions—estimated at over $1 trillion—pose a systemic risk to the U.S. economy?

In December, when I testified before the Panel, Chairman Kaufman asked a very similar question. I responded by stating:

"I believe the U.S. banking system has a substantial [amount] of capital on their books today in the form of common equity against the assets they hold and the risks they're taking. . . . I think that what matters is the capital relative to the potential exposure still. But firms are working down those assets, and most measures you see of performance of those assets now are improving, have been improving for some time, even in mortgages."

Moreover, I further testified that:

"[T]here's no certainty about these judgments . . . they're all a probabilistic judgment and they depend a lot on what is going to be the path of the economy in the future. But we helped . . . put enough disclosure in the market about the composition of those assets, their quality, the losses you may face on them, how they're performing, so individuals across our financial marketplace, credit rating agencies and their creditors, can judge for themselves whether the capital the banks hold is sufficient against those losses. And, again, I would say the judgment I'm reflecting is the broad judgment of most people, that these banks all hold very substantial amounts of capital against the risk they still hold that they took on in the crisis. But you can look at [the] extraordinary detail every quarter, if not more frequently, about how that stuff is performing and make your own judgments about how it's likely to perform in the future."

5. What strategies should be employed to mitigate the adverse consequences that may arise from such assets?

We believe the primary federal banking regulators continue to work with the institutions under their respective jurisdictions with respect to managing the risks that they face in a prudent

manner. And, as you know, the Federal Reserve is conducting another round of stress tests on the largest institutions.
In addition, the Dodd-Frank Act provides important new tools to help ensure that systemic risks are identified and mitigated. The law provides a clear statutory mandate to the Financial Stability Oversight Council ("FSOC") to identify risks and to respond to emerging threats to financial stability. By bringing together the federal financial regulators, an insurance expert appointed by the President, and state regulators, the FSOC will ensure a coordinated approach to monitoring and constraining risk in the financial system. This was lacking before the crisis.

The Dodd-Frank Act also creates an Office of Financial Research ("OFR"), which will be housed within Treasury and will assist in identifying emerging risks to financial stability. In addition, the Department of Justice Financial Fraud Enforcement Task Force ("FFETF") will help identify and prevent fraudulent activity that could pose a threat to financial stability. The FFETF represents the broadest coalition of law enforcement, investigatory, and regulatory agencies ever assembled to combat fraud.

6. When you consider the potential legal and economic consequences arising from:

- i. **foreclosure documentation irregularities (i.e., robo-signing issues),**
- ii. **the failure of some securitization trusts and others to obtain properly endorsed mortgage loan notes and properly assigned mortgages and deeds of trusts as required by local law,**
- iii. **challenges to the MERS (Mortgage Electronic Registration Systems, Inc.) system, as well as,**
- iv. **the exercise of "put" or repurchase rights by securitization trusts and others,**

are you concerned that any of our largest financial institutions (e.g., Citi, Bank of America, Chase, Wells Fargo, Goldman) will experience a solvency, liquidity or capital crisis in the near to intermediate term?

The Panel previously submitted a similar question for the record to Phyllis Caldwell, Treasury's Chief of the Homeownership Preservation Office. She responded on December 8, 2010 by stating:
"...Treasury is very concerned about these issues and is an active participant in the interagency task force coordinating the work of those agencies, which include the federal banking regulators, the SEC, HUD, FTC, and DOJ. The main objectives of the task force are to determine the scope of the foreclosure problems, hold banks accountable for fixing these problems, protect homeowners, and mitigate any long-term effects this misconduct could have on the housing market. The interagency task force is closely coordinating with state Attorneys General as well. Regulators are conducting onsite investigations to assess each servicer's foreclosure policies and procedures, organizational structure and staffing, vendor management, quality control and audit, loan documentation including custodial management, and foreclosure prevention processes. The task force also is closely reviewing related issues that include loss mitigation, origination put backs, securitization trusts, and disclosure putbacks. These examinations are extensive and resource intensive. For example, the Office of Thrift Supervision has approximately 80 examiners on-site at their four servicers, and the Office of Comptroller of the Currency has 100 examiners at the top eight national bank servicers. Many members of the task force are also

members of the Financial Stability Oversight Council ("FSOC"), which is receiving briefings and updates on the status of the task force's efforts...."

I agree with Ms. Caldwell's statement. As I testified on December 16, 2010 in response to a similar question posed to me by a member of this Panel, these are important issues, and they continue to pose "very substantial challenges" to the housing market and to the overall financial system. I further testified that "because of the seriousness of these problems we have a task force, chaired by myself and Shaun Donovan, representing federal agencies including bank supervisors, FHFA, the FHA, the Department of Justice, the FTC, that is undertaking a very careful, comprehensive look at all those concerns so we can get a better handle on their potential risk." To date, these issues have not resulted in any solvency, liquidity, or capital crises for any particular institutions. However, it would be inappropriate for us to speculate regarding the future.

7. **Is the Administration considering any systemic or holistic solution to these problems including the broad based purchase of mortgage loans and residential mortgage-backed securities (RMBS) by the government or an instrumentality of the government?**

As I have stated previously, Treasury does not anticipate implementing a new program to purchase residential mortgage-backed securities or other troubled loans. Moreover, Treasury does not regulate the relevant financial institutions. The numerous regulatory agencies are reviewing the foreclosure-related issues, and Treasury is participating in an interagency effort to assess the scope of the problems and to consider potential responses. We expect that additional information about this process will be released in the coming weeks and months.

8. **On November 17, the Federal Reserve announced that another round of "stress tests" would be undertaken but that the results of this round will not be made public.**

   i. **Are you aware of why this is the case?**

   Treasury is not involved in these decisions.

   ii. **Would you support the public disclosure of the stress test results?**

   As you know, in 2009, I was a strong supporter of forcing our largest financial institutions to undergo stress tests and of disclosing the results of those tests. I believed that such disclosure would benefit investors and the market. Again, Treasury was not involved in the Federal Reserve Board's recent announcement, and therefore I cannot comment about that particular decision. As a general matter, however, I believe that future risk management and the supervision of our financial system should include regular public disclosure of stress tests by major institutions.

9. **Do you believe Fannie Mae and Freddie Mac should write down the principal of a large number of underwater mortgages through participation in the Federal Housing Administration (FHA)'s Short Refinance program?**

The Acting Administrator of the Federal Housing Finance Agency ("FHFA") recently sent a letter to Treasury dated January 31, 2011 stating that FHFA will not participate in the Federal

Housing Administration ("FHA") Short Refinance program. In the letter, the Acting Administrator stated that "[w]hile these programs may be appropriate for some situations, they do not meet the Federal Housing Finance Agency's ("FHFA") primary goal of conserving the Enterprises' assets. As such the Enterprises will not be participating in either program."

We have discussed the benefits of the program with FHFA, but they have determined—as their letter notes—that it is not beneficial for Fannie Mae or Freddie Mac to participate in the program.

10. Has Treasury encouraged Fannie Mae and Freddie Mac to enter into this program?

As noted in my response to the previous question, we have discussed the benefits of the FHA Short Refinance program with FHFA. As set forth in the FHFA January 31, 2011 letter to Treasury, however, the agency has determined that it is not beneficial for Fannie Mae or Freddie Mac to participate in the program.

11. What would be the expected cost to Fannie and Freddie of writing down principal for underwater mortgages that qualify for this program?

Treasury has not estimated the expected cost to Fannie Mae or Freddie Mac of writing down principal in connection with the FHA Short Refinance program. As you know, Treasury is not the conservator of these institutions.

12. Would their participation in the FHA refinance program increase the chances Treasury will provide additional taxpayer-funded capital injections to support the Government Sponsored Enterprises?

The FHA Short Refinance program is designed to increase the net present value ("NPV") of participating mortgages. In other words, the program is intended to provide assistance only when the NPV of the proposed, modified loan is greater than the NPV of the existing, unmodified loan. Accordingly, if Fannie Mae and Freddie Mac were to participate in this program, we would not anticipate the need for additional taxpayer assistance as a result of their participation.

13. Why have holders of mortgage loans been reluctant to write down mortgage loan principal where the outstanding principal balance of the mortgage exceeds the foreclosure sales price of the residence?

The Panel previously submitted a similar question for the record to Phyllis Caldwell. She responded on December 8, 2010 by stating:

> "...[s]ervicers in MHA were required to comply with the procedures in Treasury's principal reduction program as of October 1, 2010. All participating servicers are now required to consider every loan with an LTV of 115% or more for principal reduction and must provide a plan that describes the circumstances under which they will actually offer principal reduction in conjunction with a HAMP loan. The largest four servicers have provided plans indicating

> that they do intend to offer principal reduction. This is a major policy shift for these servicers."

I agree with Ms. Caldwell's statement.