111TH CONGRESS
1st Session

COMMITTEE PRINT

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MEETING ON

PRIORITIES FOR THE NEXT ADMINISTRATION: USE OF TARP FUNDS UNDER EESA

COMMITTEE ON FINANCIAL SERVICES

U.S. HOUSE OF REPRESENTATIVES

ONE HUNDRED ELEVENTH CONGRESS

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PRIORITIES FOR THE NEXT ADMINISTRATION: USE OF TARP FUNDS UNDER EESA

Tuesday, January 13, 2009

U.S. HOUSE OF REPRESENTATIVES,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The committee met, pursuant to notice, at 2:04 p.m., in room 2128, Rayburn House Office Building, Hon. Barney Frank [chairman of the committee] presiding.

Members present: Representatives Frank, Kanjorski, Waters, Maloney, Watt, Ackerman, Meeks, Moore of Kansas, Capuano, Clay, McCarthy of New York, Baca, Lynch, Miller of North Carolina, Scott, Green, Cleaver, Bean, Moore of Wisconsin, Hodes, Ellison, Klein, Wilson, Perlmutter, Donnelly, Foster, Carson, Minnick, Adler, Kilroy, Driehaus, Kosmas, Grayson, Himes, Peters, Maffei; Bachus, Castle, Royce, Paul, Manzullo, Jones, Biggert, Hensarling, Garrett, Price, McHenry, Bachmann, Posey, Jenkins, Lee, Paulsen, and Lance.

The CHAIRMAN. This gathering will come to order. We will have probably a full complement of members. Now the microphone seems to be on.

Mr. BACHUS. Yes, mine is on.

The CHAIRMAN. All right. They are on when you don't want them to be and then they are not on when you want them to be.

This is a gathering of the membership of the Financial Services Committee. We have not yet been formally constituted as a committee by action of the House, but the membership has been completed, I believe, on both sides. So this is the membership. I will say that the ranking member and I were unsuccessful in our effort to reduce the size of the committee. We mean no disrespect to our newer members, but we are the second-largest committee in the House, and it is unwieldly. And I apologize to all members on both sides. It takes longer to get to people in terms of questions. We try to accommodate that. If we get any bigger, we will have no spectators at all, because membership is eating into the public sector. We regret that.

I did want to reassure people the ranking member and I tried very hard, but it is a committee that people wanted to serve on, so here we are.

This meeting is to discuss legislation to set conditions with regard to the second $350 billion of the rescue plan that we adopted last fall. When we adopted that, we put into it that there would

be a two-part operation: that the Administration could in fact with a signed declaration access $350 billion; but before they could access the second $350 billion there would have to be a period during which they notified Congress, waited 15 days, and any Member of Congress could then bring a resolution to the Floor to disapprove this. There were people who at the time said that this was mere window dressing. It is clear that they were wrong.

This restriction on the second half has turned out to be very important, and I think helpful, because there was a great deal of dissatisfaction in the Congress, reflecting dissatisfaction in the country with the way in which the first $350 billion was spent.

The question now is: Why are we acting at this point? I have received a letter from members of the Minority, including the ranking member, saying that they wanted to hold off. But here is the problem. President Bush, at the request of President-elect Obama, triggered a 15-day period yesterday. The House has 6 days before a resolution must come to the Floor; a resolution of disapproval, because we wrote into this bill very powerful rules that allow any Member of the House to get a bill to the Floor. The Senate I think has an even shorter period of time.

I think it is important that at least the House of Representatives be able to express its views on this before a resolution of disapproval comes up. Members will have a right to vote on the resolution of disapproval. There will be no effort, I am sure, to stop it; and no such effort, if it came, could be successful because of the way we wrote this bill.

There is one issue. As I read the law, apparently we may have to vote on Sunday. I think we might be able to get some agreement so we don't have to vote until Wednesday. It said within 6 days. And there will be conversations going on with the leadership. So there will be a vote. Many of us believe that before voting yes or no, we ought to be able to say "yes but." And that is what this bill is. I take it back. Not "yes but," but "yes if." The incoming Administration believes strongly that this $350 billion will be helpful.

Having given $350 billion to the Bush Administration, I believe it is reasonable to make it now available to the Obama Administration, but with much more in the way of restriction.

It is probably the case that we will have a hard time getting a bill signed into law. The legislation that we intend to bring forward does not confer new powers on the Administration. It does mandate that they do things within the existing powers. That is, everything in the bill could already be done if they were ready to do it.

It reminds me of what Harry Truman said: "Being President of the United States means trying to get people to do what they should have done in the first place on their own if they had any brains." And that is what we are trying to do with the TARP. We are trying to get an Administration to do what it should have done in the first place. We believe that if these conditions are met, that will make it a very useful thing.

What we expect is that—and I would hope that before we in the House voted on a motion of disapproval, we could pass a bill that tells the Administration what we think is necessary, and that we get a commitment from the new President of the United States that he will abide by it. I have a good deal of confidence in the new

President of the United States. But we are putting the bill forward because I have also learned from a prior President of the United States, who in turn learned from the head of the Soviet Union—and I am of course referring to Ronald Reagan's wisdom he passed along for Mikhail Gorbachev—trust but verify. This is the trust-but-verify bill with regard to the Obama Administration and the TARP.

But let me give you an example, and my time is running out, and I am going to hold everybody to the time. If we do not get the second $350 billion, I do not see any way that we can get substantial foreclosure relief. If we get the second $350 billion, I believe it should be conditioned upon the Administration promising us very substantial foreclosure relief, improving HOPE for Homeowners, building on the work of FDIC Chairman Bair, acting as Secretary Preston, the current Secretary of HUD, says we should do in buying up home mortgages.

I also believe that we can get to a situation where the larger banks having gotten money, we can now advance money to the smaller banks, the community banks, under conditions that will make sure that it is used appropriately, and in most, although not every single case, re-lent.

We will therefore be proceeding in this manner. We will do what the rules allow, which is to have 20 minutes of opening statements on each side. I will be holding members very strictly to a 5-minute rule.

And I now recognize—or within the 20 minutes, I now recognize the gentleman from Alabama for such time as he—he says 2 minutes, he wants?

Mr. BACHUS. Mr. Chairman, before I start, I wanted to advise our members that we will all be doing 2 minutes, those who have requested time.

The CHAIRMAN. All right. That makes it easy for the timekeeper. So, 2 minutes for each of the Republican members.

Mr. BACHUS. Mr. Chairman, you and I agree on one thing, which is that the $350 billion second affirmation is very important. In other words, before we can spend the second half of the money, it has to get congressional approval. And if you will recall, the purpose of this relief plan or rescue plan, as the chairman is saying, or bailout as the American people call it, the purpose was to stabilize the financial system. We were presented with a doomsday scenario that the markets were going to melt down and our financial system was going to collapse. And as a result of that, this bill passed.

What confuses us is, in a letter to House Republicans just this past week, Chairman Paulson said this: "We have in fact met our original stated objectives, which were to immediately stabilize the financial system by strengthening financial institutions, arresting the wave of financial organization failures, and establishing a basis for recovery.

If you all recall when this passed, six major institutions had collapsed over a short period of time. The markets were going up and down a thousand points. That is no longer the case. And Secretary Paulson says he has accomplished the purposes of the program.

Having done that, and prevented maybe a doomsday scenario perhaps, we are seeing something else very different. We are seeing now this thing transition, if we approve this second half, into a grab bag where people can just reach in and get taxpayer money. And as most of you know, people are lining up to get this money.

But today we are asked within about a 72-hour period—we are going to go to the Rules Committee at 5 o'clock with very few specifics—we are being asked to vote about a bill we know nothing about; we have not been told why we need it, we have not been told what we are going to do with it. We are not informed. We don't have the facts. But we are told that we need to pass it. And we are not informed. That is not the way to do legislation. We understand Americans are struggling, that people are out of work, but that is no excuse to rush to judgment and really take $350 billion from the very people that we are concerned about.

Thank you, Mr. Chairman.

The CHAIRMAN. The gentleman consumed 2 minutes and 52 seconds, so we will make an adjustment.

Next, for 2½ minutes, Mr. Kanjorski.

Mr. KANJORSKI. Thank you, Mr. Chairman. Mr. Chairman, I have a prepared statement I will submit for the record. I just want to say that we know that ultimately this bill will not become forceful, but it is a message being sent to the incoming President. And I think it is a good message, that there has been disappointment on behalf of this Congress. I think it is bipartisan disappointment.

I, for one, worked very hard for the passage of the original TARP bill. And I feel that there has been less than openness on the part of the present Administration to indicate to the American people exactly what the funds were used for, and primarily to stimulate positive activities on the part of banks to constitute an increase in the lending and moving out of the frozen nature of our credit system.

That all being said, it seems to me very important that we realize that this was a commitment of $700 billion. It still is a commitment. But most of all, it is not because it is a commitment, it is because to date we do not have an affirmation that the system has worked. It has worked insofar as we have not collapsed into total meltdown, but it is still in the process of "working." And it seems to me that in this nature it behooves all of us, this Congress and the American people, to adopt a plan. And as we originally recognized with the Secretary of the Treasury and the President, some mistakes will be made, some moneys will be lost, but this is too important a problem for the American people, that we cannot stop halfway through the course.

So I highly support the message sent in this bill to the new Administration that we will be watching them. We expect them to adhere to the principles set forth in the bill. But also, we have to send a message to the American people that we have faith in the system, that the program will work, and that we are going to stay with it as a Congress.

So on that behalf, Mr. Chairman, I offer my support for the chairman's bill. I yield back.

The CHAIRMAN. The remaining time will be 1 minute and 55 seconds for each of the Republicans to stay within the allotted time.

And the gentleman from Delaware is recognized for 1 minute and 55 seconds.

Mr. CASTLE. Thank you, Mr. Chairman. Thank you for calling the meeting to begin this dialogue on the final $350 billion tranche of the Treasury's TARP funds. As I indicated at the last TARP oversight hearing, I remain very concerned that we do not have an accurate accounting of how each institution receiving TARP funds is spending this money. In fact, to me it seems to become fungible rather quickly, and it is very hard to follow the bouncing ball in this area.

This program was intended to free up credit and stabilize our financial system. Today, we have achieved a level of stability. But many mortgages and mortgage-backed securities remain unchanged, despite our efforts directing the Treasury to adjust these important economic symptoms.

Further, we do not have a complete accounting of how the first tranche of taxpayer money has been used by the institutions that now possess these funds, which is unacceptable.

I support the idea put forth by Mr. LaTourette, and I applaud the chairman for his support of that amendment. We need to understand whether or not institutions receiving TARP funds have increased lending.

I have offered legislation on safe legal harbor, which has recently become a law, and is already incorporated in this legislation, which would incentivize loan servicers to work with borrowers and investors and renegotiate loan terms. However, I am disappointed that many struggling homeowners remain unable to refinance their loans.

I see in the chairman's proposal he has revisited this issue, and I look forward to working with him and the committee on that very important matter. Before any additional funds are released, we need to ensure that these matters are fully addressed. I yield back, Mr. Chairman.

The CHAIRMAN. The gentleman from Massachusetts, Mr. Capuano, for 2½ minutes.

Mr. CAPUANO. Thank you, Mr. Chairman. Mr. Chairman, again I want to state very clear and very strong support for this general proposal. I wish we could have done it the last time, but the last time we had this bill before us we had a President who said you either do it my way or you have a veto, leaving people like me with a choice of either voting yes or letting the economy possibly go down the tubes. I wish we could have had these things the last time.

I also hoped that even without them specifically in law, that we could have taken people at their word, that they would have actually done some of the things that we are now saying in this bill that they have to do. I don't think these are very difficult things. Individual reporting of what happens when we give money to a specific bank. How is that difficult? How is that impossible? Yet we had administrators who said they weren't going to do it. That is insane. It was never set in the law, and anybody who says they wouldn't do it I think is being misfeasant, malfeasant, and every other feasant I can think of.

I personally think that this particular bill is very good. It is a step in the right direction. I am looking forward to the new Administration hearing us. My hope is that this bill is part of the disapproval or approval of the next funds. I hope they are not separate. I really think that this bill has a lot of things in it that we should have had, that I think will serve our taxpayers well and will help this economy, and will get us the reporting that we need to make wise decisions in the future.

With that, Mr. Chairman, I yield back the remainder of my time.

The CHAIRMAN. The gentleman—I lost my place here—the gentleman from California, Mr. Royce, for a minute and 55 seconds.

Mr. ROYCE. Thank you, Mr. Chairman. I would just point out that thus far, if we look at Congress' track record on addressing foreclosures, it has not been that impressive. If we compare that to the private sector and with the HOPE NOW Alliance, we have made significant progress there. We have had in 2008 alone, 2.2 million foreclosures that were prevented by the HOPE NOW Alliance. And I think Mike Castle, had his legislation gone through earlier, stemming some of those class-action lawsuits, we could have had more of those foreclosures prevented.

I want to say that I am encouraged that the chairman has included the provisions building on Mike's work in terms of the lose-or-pay provision in H.R. 384. I think that will further protect loan servicers and make sure we have more workouts. But the second $350 billion tranche, frankly, is a continuation of a bailout policy that I believe has done little good. And I think the ultimate destination of this bailout trend should give us all pause.

With the near certainty of future deficits approaching 6 or 7 percent of GDP, with the Fed's balance sheet expanding nearly $2 trillion, with the promise of another stimulus package nearing another $800 billion, we are becoming increasingly dependent upon our rescuers: the American taxpayers and U.S. debt purchasers. And eventually, bondholders will begin to reconsider purchasing U.S. debt. While such an occurrence would be catastrophic, avoiding such a scenario would require us to take a step back from where we are and eliminate unnecessary spending.

Another ill effect of the bailout trend is the rapidly increasing role of the government within financial firms. And if you look at the December 17th Wall Street Journal, they ran a story entitled, "U.S. Ratchets Up Citi Oversight," in which they described the active role regulators are playing in the day-to-day operations of Citigroup. So it should come as no surprise that Citigroup has now announced it would support legislative efforts to allow bankruptcy judges to rewrite mortgage contracts, a provision they have historically opposed.

The CHAIRMAN. The gentleman from California, Mr. Sherman, is recognized for 2½ minutes.

Mr. SHERMAN. Thank you, Mr. Chairman. If we reject the $350 billion second tranche—and I doubt that the Senate will do so—that is not the end but is, rather, a beginning to try to write a better program. But I think it is better to try to improve the existing program before we have to vote on the second $350 billion on January 21st.

Chairman Frank has a bill that would improve the program. Frankly, I think at this stage it is insufficient. I hope that the bill is improved by both managers' amendments and other amendments on the Floor. Unfortunately, the chairman's bill will not be law on January 21st. The Senate is unlikely to act that quickly. So I hope that the Obama Administration will give us an explicit, unequivocable, and morally binding commitment to follow the House-passed bill, and hopefully also to follow some of those amendments that would have passed the House had they not been blocked by the Rules Committee, if indeed the Rules Committee blocks some important amendments.

So I think members need to know how the Obama Administration is going to carry out this bill, and we need to know not just statements of principle, but what they are willing to bind themselves morally to do. These should deal with dividend and stock repurchases by companies holding TARP assets. We should deal with warrants. And I know the chairman's bill already deals with warrants. I think the manager's amendment, as I understand it, will make those provisions stronger and better.

We need to deal with executive compensation. We need to deal with salaries and deal explicitly with stock options, not just focus on cash bonuses. And we need to focus on perks. And this would include—and this is a minor point, but one of importance to my constituents at least—not only leased and owned luxury aircraft, but also chartered luxury aircraft.

So I look forward to working on the House Floor and working with the transition team so that on January 21st, those of us who were skeptical of the first bill can see sufficient improvement to vote to release the second $350 billion. I yield back.

The CHAIRMAN. The gentleman from Texas, Mr. Paul, for 1 minute and 55 seconds.

Dr. PAUL. Thank you, Mr. Chairman. This continued debate that has gone on about our rescue programs that we have been devising is confirmation, I believe, that there is very little understanding as to how we got into this mess. And as long as we continue to do the wrong things, I don't see any solution. But if we got here by spending too much money, borrowing too much money, inflating too much money, the Federal Reserve being too involved in central economic planning through manipulation of interest rates, and Congress passing too many regulations, as long as we think that is benign and has nothing to do with it, then I guess it seems very logical that we come up by spending more money, borrowing more money, printing more money, and writing more regulations, and thinking that we are going to get different results. But we don't.

It seems to me today that the big argument is who the central economic planner is. Is it the Treasury or is it the Congress, is it the FDIC, is it the Federal Reserve? Believe me, central economic planning doesn't work. That is why we are in this mess. And that is why we have all the malinvestment, all the bad debt. If we are looking for a solution, we have to have liquidation of debt. We don't want to prop up the bad debt. The problem was created by bad policy. But as long as you delay the liquidation of debt and the malinvestment, the longer the agony will be.

But to now devise a system where we are going to buy up these bad assets, these worthless assets, and dump them on the American taxpayer is absurd. It makes no sense whatsoever. What we need is a little bit of confidence that a market economy works, and get away from this central economic planning, and quit arguing over who is going to be the central economic planner. Believe me, it doesn't work. It has been tried. The 20th Century was supposed to have proven that it doesn't work. But here we are, we are giving up on it; more government, more spending, and more debt.

The CHAIRMAN. The gentleman from California, Mr. Baca.

Mr. BACA. Thank you very much, Mr. Chairman, for holding this important meeting. I too support the proposal or legislation, and hopefully, with some additional amendments.

Families in my district and throughout America are struggling to meet their needs. They need help. Just look at the unemployment rate. It stands at 7 percent. In my district, it is at 20 percent, and by the year 2010, it is going to be at 12 percent, and the plight of 8,000 families that are foreclosing on homes each day. In my district, the San Bernardino-Riverside area, we have the fifth-highest foreclosure rate in the Nation. And in my area, the credit unions, Arrowhead Credit Union just closed four branches.

The original TARP laid out certain requirements to make sure that underserved communities and homeowners received assistance. Why didn't they? That is a question we have to ask ourselves. Unfortunately, the Treasury decided to do its own thing with capital infusion. We have to change that. There has to be accountability. There has to be oversight.

I thank the chairman for moving fast to draft H.R. 384, which creates necessary reform, and I state necessary reform that wasn't there to correct the TARP programs. I hope the chairman will also consider additional provisions which I think will help put the Treasury back on the right path, such as: tenant protection to ensure renters don't become homeless if their landlord is foreclosed; the inclusion of regional public-private partnerships in the loan modification program; and the clarification existing in statutes to ensure credit unions have access to TARP funds.

I look forward to working with the chairman. I yield back the balance of my time.

The CHAIRMAN. We will now do a couple of Republicans in a row because of the way the allocations are. We are out of balance.

The gentleman from Illinois, Mr. Manzullo, for a minute and 55 seconds.

Mr. MANZULLO. Thank you, Mr. Chairman. Unfortunately, all the plans submitted dealing with bailing out people's mistakes and using taxpayers' dollars to buy out bad loans, that is called a trickle-down theory of bailout. Let me give you a trickle-up that will work, that only will cost $75 billion, a lot less expensive than the trillions we are throwing at it.

In 2007, 17 million new cars were sold. That dropped to 10 million. That means that we lost $175 billion directly in the economy. That comes out to a trillion dollars by the time you extrapolate that through economic control.

Second of all, when cars and trucks start selling, it moves inventory from dealers and factory jobs, pays salaries of dealers' employ-

ees, refurbishes local and State sales tax funds, restarts manufacturing, the economy begins to boom, people pay the mortgages, and they start buying houses.

Third, by offering a tax credit or voucher of $5,000 for a brand new automobile, we could restore the auto industry in this country from the bottom up, put people back to work, and get everything going again.

Nobody is talking about remedies, we are just talking about patchwork, throwing money in from the top. That won't do any good. Ford now needs money because it doesn't have enough sales. This is so simple. We have to restart manufacturing in this country to come out of this slump. Don't knock on my door asking for a bailout. Let me give you a voucher for $5,000 to buy a brand new car, and you could buy a brand new Patriot, made in my district for a little over $200 a month for 5 years.

Mr. Chairman, we have to restart the economy. Restoring manufacturing is the only way. Everything else simply wastes time and it wastes money. And I have had enough lobbyists knocking on my door wanting their fair share. I yield back.

The CHAIRMAN. The gentlewoman from Illinois, Ms. Biggert.

Mrs. BIGGERT. Thank you, Mr. Chairman. We passed the Emergency Economic Stabilization Act in October, and we did that after we had first had not passed it because we were concerned about the fact that it was not vetted; we didn't have the time to look at it. And here we are again looking at the tranche for another $350 billion.

With all due respect, Mr. Chairman, I think that you believed that your HOPE for Homeowners program would help 400,000 homeowners refinance. To date, HOPE for Homeowners has only had 373 applications and 13 loans closed.

We also had never looked at the insurance, which was part of what the Secretary of the Treasury was to use. And we never have seen any of the purchase of those toxic assets by the Treasury, as the bill called for. Instead, we have had the purchase of—or putting cash equity into the banks so that they could make loans, which they are not making.

What has happened here? The Government Accountability Office faults the Administration for not tracking what the banks are doing with the money. There are no answers to that. And now we are supposed to take on another bill that is going to cost us $350 billion. How can we go ahead when we haven't seen it? Process is important. It is important that we have the opportunity to really vet this bill. We have already made so many mistakes. There are so many mistakes that have been made by the Administration that we really need to have more time. I yield back.

The CHAIRMAN. The gentleman from Georgia, Mr. Scott, for 2½ minutes.

Mr. SCOTT. Thank you very much, Mr. Chairman. We are at a critical point in our economy. We have 15 days in which to either approve or disapprove of President Obama's request through President Bush for these funds. But I think that we have no choice in this matter, the economy is in such dire shape. Nowhere is it in as much dire shape as in the foreclosure and the getting help to homeowners. And I believe that if we are successful in moving for-

ward on this $350 billion, it is very critical that in these 15 days we move simultaneously to make sure Chairman Frank's bill moves at the same time. If not, we will be making the same mistake that we made, or the Administration made, with the first $350 billion. They moved it, they moved it out, but they didn't have the accountability there. They didn't have the transparency there. They didn't put the chief inspector general in place. We didn't have the oversight committee in place.

What this measure will do, Chairman Frank's bill will put the accountability, the transparency there, and most significantly, will put the foreclosure relief in place and a plan. I think one of the most important parts about this bill is Title II, the Foreclosure Relief Plan. To be able to get a plan in place, get it up to $100 billion,that is what is needed.

And it is about time that we give money to the American people, to get the American people involved in this, and no better way we can do this than to help them to stay in their homes. And I believe if we are able to put this plan together with up to $100 billion set aside in which we could move, working with the FDIC, with Chairman Bair and that plan that has been laid out, we will go a long way to establishing this.

This appealed to the Obama Administration. We not only need the Obama Administration to come and ask for the money, we need for them to come and ask for the accountability and the transparency that goes with it. If they come and just work for the $350 billion and try to move this bill out without having the chairman's bill along with it that brings the transparency, that brings the accountability, and, most importantly, the money to be able to get the homeowners so that they can stay in their homes.

This is what needs to be done. Ladies and gentlemen, this economy can no longer sustain 6,300 homes being lost to foreclosure every day. This bill will help solve that. Thank you, Mr. Chairman.

The CHAIRMAN. The gentleman from Texas, Mr. Hensarling.

Mr. HENSARLING. Thank you, Mr. Chairman. If government could spend its way out of the financial crisis, we would probably already be out of the pickle that we find ourselves in. We have $7 trillion to $8 trillion of taxpayer exposure liability on the books already. And we have a potential $1 trillion stimulus plan coming down the pike, although most economists agree the last stimulus plan didn't work.

Now we are looking at the second tranche of $350 billion, and we may be faced with a number of lousy options. One option is to hand the money over carte blanche. I must admit I find it somewhat ironic that those who have become the biggest critics of the legislation, frankly, had a lot to do with writing it and voting for it in the first place. And I think it underscores again that haste can make waste. As important as it is for us to act quickly, it is more important for us to act smartly when it comes to $350 billion of the taxpayers' money.

I appreciate the fact that the chairman has put a plan on the table. And certainly when it comes to institutions receiving funds, accounting for how they spend the money, I am in accordance with him. I think that is an important provision.

But I am worried about several aspects of the plan. Number one, I fear it may put us on the road to picking winners and losers with the express language dealing with the auto industry. I want to know how the people in the Fifth District of Texas—they want to know are their employers going to get bailed out or is it just select employers who get bailed out?

Second of all, this government putting observers in the boardrooms, it may start out observing; soon they will be suggesting, and next they will be mandating. That is no way to run a railroad. The institution that brought us the single-largest deficit in the history of mankind all of a sudden is now going to tell American free enterprise how to run their business? No thank you. With that I yield back, Mr. Chairman.

The CHAIRMAN. The gentleman from in New Jersey, Mr. Garrett.

Mr. GARRETT. Thank you, Mr. Chairman, and Mr. Ranking Member, for holding this important hearing. And I would like to at this time introduce an op-ed by financial institutions and monetary policy consultant Bert Ely, that appeared in the Wall Street Journal entitled, "Banks Don't Need to be Forced to Lend." It provides a very useful explanation of the role that capital plays in our financial institutions, and I recommend it to all members. Take the time to read it. With no objection.

President-elect Obama said Sunday on This Week with George Stephanopoulos: "I, like many, are disappointed with how the whole TARP process has unfolded. There hasn't been enough oversight. We found out this week in a report that we are not tracking where the money is going."

I believe that the President-elect is exactly right, and that these are concerns that many of us voiced early on, prior to the passage of the chairman's original bill. If we had taken the time to carefully review, hold hearings, and conduct a markup over TARP, perhaps we could have foreseen certain problems and included provisions to ensure they do not occur.

Now it appears that we are heading down the same road all over again with the chairman's next bill, a bill, by the way, the chairman I believe indicated he does not anticipate becoming law. When Congress originally debated and passed TARP, I believe a number of the problems that we have experienced could have been prevented had we taken the normal order. However, his original legislation was simply cobbled together and rushed through the process.

Unfortunately, it appears we are heading down the same road again today. Chairman Frank released his draft this past Friday, and now less than a week later, we are considering that exact bill on the Floor this week. So I was pleased to join the ranking member in writing a letter to the chairman asking him to put this through regular order so we don't make the same mistakes that we did last time.

I was also pleased to join the ranking member when I say that we have not seen a compelling case to release the second tranche of the TARP funds. In fact, I have seen no case made as to why it is necessary to release the other $350 billion of taxpayer funds. I have also not seen any evidence that it was the original $350 billion that has achieved its original purpose of our Nation's financial

system. Rather, it was actions by the Fed and private marketplace that helped in that regard. I yield back.

The CHAIRMAN. The gentlewoman from California, Ms. Waters.

Ms. WATERS. Thank you very much, Mr. Chairman, for arranging today's hearing. From the beginning of this financial crisis, I have been vocal about the link between the housing crisis and the financial crisis we are facing. The economy will not recover without immediately addressing the housing crisis. In fact, the housing crisis is the main reason why I initially supported the Emergency Economic Stabilization Act. However, the mismanagement of the first $350 billion has led to banks receiving funds without mandates to provide loans to consumers or mortgage loan modifications to struggling homeowners.

The use of TARP funds for unintended purposes has shaken the confidence of this Congress. We intended for TARP to remove toxic assets and nonperforming loans from the marketplace, modify mortgages, and increase the availability of credit. To date, no TARP funds have been directed to systematic loan modification or increased lending. This is especially shocking given the fact that the housing market remains in a free fall. Credit Suisse estimates that 8 million homes, representing 16 percent of all mortgages, will be in foreclosure in the next 4 years, with 1.7 million foreclosures in 2009. According to Case & Shiller, housing prices have fallen 18 percent in the last year, and the bottom is nowhere in sight.

The need to address the foreclosure crisis head-on is why I introduced H.R. 7326 in the last Congress and H.R. 37 in this Congress, legislation to enact Federal Deposit Insurance Corporation Chairwoman Sheila Bair's loan modification plan into law. This systematic approach has been successfully implemented at IndyMac Federal bank, and has resulted in over 5,000 IndyMac borrowers avoiding foreclosure.

Mr. Chairman, I want to thank you. And I am pleased that you have included my legislation, H.R. 384, the TARP Reform and Accountability Act that the House will soon vote on, because it is clear that the economy cannot recover without the recovery of the housing market. The housing market must be repaired through our efforts with TARP.

And Mr. Chairman, let me just say for the record, I will be giving to you a copy of information that has been released by the voluntary program HOPE NOW, leading people to believe that they have done 2 million mortgages. That has not happened. That is why it is so important that this bill passes, so we can do some real loan modifications.

The CHAIRMAN. The gentleman from Georgia, Mr. Price.

Mr. PRICE. Thank you, Mr. Chairman. Today, we are once again examining an important issue that says a lot about what we believe the role of government to be. We are being asked to entrust Treasury with the authority to spend an additional $350 billion, a huge sum of money, and allow them to take on additional risk to the taxpayers by pursuing modifications that have not proven a wise investment.

We can all agree that the oversight of the TARP program has been wanting. Treasury has failed to answer basic questions, strug-

gled to track the billions of taxpayer dollars, and seems to have no way to measure the success of the program.

When Secretary Paulson initially approached Congress with an urgent request for funding and broad authority to stabilize the economy, a representative from Treasury admitted that the Department was arbitrarily asking for a number that would be so large that it would undoubtedly calm the markets. In fact, when asked how they came up with the $700 billion they said, "We needed a really big number." Not very encouraging.

There have been no indications that the last tranche of funding is needed to further stabilize the economy. There have been no emergency meetings to explain why this money is necessary and how it would be used effectively to justify the release. In fact, just a few days ago, on January 8th, Mr. Kashkari described our financial system as "fundamentally more stable" than when EESA was passed.

Ultimately, we have seen through the failures of the TARP program and HOPE for Homeowners that the government is not the solution to all our problems. We have seen bailout after bailout, yet there doesn't seem to be any relief for our constituents. It is because of the hasty passage of TARP that we are now in a position to consider sweeping changes to the program.

Regular democratic process would ensure that all Members of Congress can make their voice heard on this important issue. To say that there isn't time to have a markup is disingenuous and not true. We should take the time necessary to ensure that we are truly acting in the best interests of the American people. Perhaps if we had taken that time to allow markup the first time, we wouldn't be in the situation we find ourselves now.

Rather than entrenching our government in $350 billion of additional debt, I think it is time we start considering a positive solution that embraces American principles, American values, and American vision, none of which appear in the current bill.

The CHAIRMAN. The gentlewoman from Minnesota, Ms. Bachmann.

Mrs. BACHMANN. Thank you, Mr. Chairman. Today this committee is meeting to discuss the detailed ways in which the $350 billion of TARP might be spent, but yet we have not held one single hearing on the merits or necessity of releasing this second tranche. The committee is proceeding as if the decision has already been made to release this second $350 billion without holding any substantial debate on whether or not it is necessary to stabilize the financial markets.

When the original bailout was passed, we were told that $700 billion was a big number, as the previous Congressman had said, picked out of thin air, needed for one purpose, to calm the markets. We were not told that the U.S. Treasury must spend every penny of it.

I am concerned, Mr. Chairman, that the committee is moving forward with undue haste. Is it necessary to release the second tranche for the state of our financial markets? While I agree that TARP does have serious flaws and we should look at ways to address them, Congress should not rush to vote on this bill in the very next few days. In fact, I think it is highly ironic that today's

discussion will focus on legislation that supposedly implements more transparency and oversight of a government program, and yet Congress is once again moving away from those principles upon the very consideration of this bill. Congress owes it to the hardworking taxpayers of our country to take a careful look this time rather than repeating the mistakes of last October. And I yield back.

The CHAIRMAN. The gentleman from Texas, Mr. Green, for 2½ minutes.

Mr. GREEN. Thank you, Mr. Chairman. I will be submitting a statement for the record. I will be as terse as possible with my oral statement.

Mr. Chairman, this bill is necessary, and I am grateful that you have introduced it, because the public is concerned about two things primarily. One, how has the first tranche been utilized, how has that money been spent; not what banks did it go to, not what financial institutions received it, but how was it utilized within the financial institutions? This bill addresses this.

The second thing that the public is concerned about is foreclosure relief. This bill addresses foreclosure relief. We were under the impression that we would get some help for the toxic assets in the first tranche. Not enough has been done in this area. This bill addresses the toxic assets. If we don't address the toxic assets, as Congresswoman Waters, Chairwoman Waters has indicated, we are not moving forward on the reason that many persons supported the first piece of legislation.

I absolutely, Mr. Chairman, endorse what you are doing. I support it. And I beg that we move as expeditiously as possible, because the foreclosure crisis has not gone away. It is being exacerbated by our failure to act on the foreclosure crisis. And I will submit the remainder of my statement for the record, and yield back the balance of my time.

The CHAIRMAN. I thank the gentleman. We have a minute and a half remaining on our side, which I am going to use to say that—a couple members said we should not be making the decision to release the TARP. We are not. I know people don't always read what they voted for, but I would have thought they might have had somebody read it to them after the fact rather than wait for the movie. George Bush decided to release this yesterday.

The bill that members here debated, and which we put in as a safeguard, said the President could ask for the second $350 billion, and Congress would then have 15 days within which to consider legislation. So when I am asked, why are we moving now—because George Bush, a person for whom members on the other side used to have some regard—I understand that they don't like it now when we bring him up and they cannot dissociate themselves from him quickly enough, but he is the President still. And he triggered it yesterday. He did it at the request of the new President. We are now in this situation—

Mr. BACHUS. Mr. Chairman?

The CHAIRMAN. If the gentleman is asking me to yield, I yield.

Mr. BACHUS. A point of procedure. Is this part of our opening statements?

The CHAIRMAN. I said, if the gentleman had been listening, that we had a minute and a half left. And I was using it.

Mr. BACHUS. I apologize.

The CHAIRMAN. Several other members on this side yielded back time. And I will give myself an extra 10 seconds for that.

Mr. BACHUS. I think an extra 20 seconds.

The CHAIRMAN. The point is that George Bush said he wants this spent. If we do nothing, if we follow the timetable members of the other side want, by the time we do anything it would be moot; i.e., it would be irrelevant. We are acting now, and we started this process last week in anticipation of this happening. So that is the reason for the legislative schedule.

The bill that passed the Congress and was signed into law set a timetable of 15 days, after which congressional action will be irrelevant, and George Bush has triggered that.

Mr. GARRETT. Would the chairman yield?

The CHAIRMAN. Yes.

Mr. GARRETT. Just on a clarification—and I may be wrong—was it not President-elect Obama that requested President Bush to—

The CHAIRMAN. Not only was it, I said that. I understand. I am sorry. I guess I am having a harder time with my diction than usual. Because I said—

Mr. GARRETT. Because a second ago, you just said it was President Bush who wanted to spend. It is Obama who wanted to spend it.

The CHAIRMAN. I will take back my time. And the gentleman is very much in need of clarification. I said in the statement I had just finished, President Bush did it at the request of the President-elect. The President-elect, I didn't say his name, that is Obama, the President-elect. So when I said it was done at the request of the President-elect, I made exactly the point the gentleman just made. Yes, but George Bush did do it. He is still the President. And the timetable is controlled by that.

We have 6 days from yesterday within which time the House has to vote. We could just do nothing and have an up-or-down vote. Many of us would rather have a chance to say what we think ought to be in there and get the new President's response before the up-or-down vote.

The witnesses will now begin. We have two witnesses from the financial regulatory area. We will begin with Vice Chairman Donald Kohn of the Board of Governors of the Federal Reserve. Mr. Kohn.

STATEMENT OF DONALD L. KOHN, VICE CHAIRMAN, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Mr. KOHN. Thank you, Mr. Chairman. I will read a shorter version of my testimony, and I ask that my full testimony be submitted for the record.

Chairman Frank, Ranking Member Bachus, and other members of the committee, I appreciate this opportunity to review some of the activities to date of the Treasury's Troubled Asset Relief Program, or TARP, and to discuss how additional funding could be used to strengthen our financial system and promote economic recovery. A well-functioning, stable financial system is essential for healthy economic growth. Unfortunately, as you know, the financial crisis that began more than a year ago intensified considerably in

September of last year, and manifested in many countries that it had not yet touched. And this led to grave concerns about the stability of the global financial system itself.

Although the economic impact of the worsening crisis has been severe indeed, an international financial collapse, which seemed a real possibility in early October, would unquestionably have led to economic outcomes far worse even than those we are currently experiencing. The existence of the TARP allowed the Treasury to react quickly by announcing on October 14th a plan to inject $250 billion of capital into U.S. financial institutions. Although the Capital Purchase Program has been in place less than 3 months, many banks, both large and small, have applied for and received capital from this program.

The Treasury's actions were complemented by the Federal Deposit Insurance Corporation's expansion of bank liability guarantees and by the Federal Reserve's measures to increase liquidity and support the functioning of key credit markets. Together, these actions helped to bolster confidence in our lending institutions, enabled them to access funds, and make loans.

As contemplated by the legislation, TARP funds have also been used on a targeted basis to prevent potentially disorderly failures of systemically critical financial institutions, failures that would have had highly adverse consequences for the system as a whole. These actions, together with similar measures in other countries, have brought greater stability to our financial system.

Moreover, injections of new capital are moderating the powerful pressures on the financial institutions that received the injections to deleverage by selling assets and pulling back from new lending. The Federal banking regulators, pursuant to their joint November 12th statement, are working to help ensure banks that they are fully meeting the needs of creditworthy borrowers. Bank lending to creditworthy borrowers is good for the economy. It is also good for the profitability of banks and supports their safety and soundness. Regarding the future, the remaining TARP funds will play an essential role in further strengthening the financial system and restoring normal credit flows.

An important use of these funds will be to step up efforts to avoid preventable foreclosures. Preventable foreclosures harm not only the affected borrowers and their communities but also through their effects on the housing market, the broader economy, and the financial system. Although a number of efforts are underway to address the problem of preventable foreclosures, more needs to be done, and it needs to be done quickly.

In my written statement, I outline several possible approaches that appear promising. A second broad use of new TARP funding, besides foreclosure mitigation, would be to support programs to help restart key credit markets. The Treasury and the Federal Reserve recently announced such a program, the Term Asset-Backed Securities Loan Facility, which is designed to stimulate securitization activity in the market for asset-backed securities collateralized by a range of consumer and small business loans. If the program is successful, it could be increased in size or expanded in scope to provide financing for additional types of securities such

as commercial mortgage-backed securities, for which the markets are currently distressed.

Finally, I would expect the bulk of the remaining TARP funding to be devoted to strengthening financial institutions, thereby supporting the normalization of credit markets and the flow of new credit. Some of this support might take the form of additional capital injections, both to offset credit losses and to further expand lending capacity. In addition, prudence requires that funds be held in reserve as needed to address urgent contingencies, such as averting the disorderly failure of a systemically important institution. And the Treasury may also wish to consider whether to supplement injections of capital with steps to reduce the uncertainty about values of assets held by financial institutions. As these resources are committed, it is important that the rationale for the commitment be provided and agreed upon.

History clearly shows and recent experience confirms that because of the dependence of modern economies on the flow of credit, serious financial instability imposes disproportionately large costs on the broader economy. The rationale for public investment in the financial industry is not any special regard for managers, workers, or investors in that industry over others but, rather, the need to prevent a further deterioration in financial conditions that would destroy jobs and incomes in all industries and regions. The public is entitled to demand that a full and appropriate range of accountability mechanisms be put in place to protect the public interest and promote the intended objectives of the program.

In addition, concrete actions should be taken to ensure we do not face a similar crisis in the future. Thank you. I would be pleased to take your questions.

[The prepared statement of Vice Chairman Kohn can be found on page 135 of the appendix.]

Mr. KANJORSKI. [presiding]. Thank you very much, Mr. Kohn.

The next presenter will be Mr. John Bovenzi, Deputy to the Chairman and Chief Operating Officer of the Federal Deposit Insurance Corporation. Mr. Bovenzi.

STATEMENT OF JOHN F. BOVENZI, DEPUTY TO THE CHAIRMAN AND CHIEF OPERATING OFFICER, FEDERAL DEPOSIT INSURANCE CORPORATION

Mr. BOVENZI. Thank you, Congressman. My thanks to Chairman Frank, Ranking Member Bachus, and the members of the committee. I appreciate the opportunity to testify today.

Despite many positive efforts in recent months to stabilize the Nation's financial markets and to reduce foreclosures, credit remains tight and rising foreclosures continue to push down home prices in communities across the Nation. Troubled assets continue to mount at insured commercial banks and savings institutions, imposing a growing burden on industry earnings and restricting lending. Returning the economy to a condition where it can support normal economic activity and future economic growth will require a number of strategies.

As you know, the FDIC has implemented the Temporary Liquidity Guarantee Program (TLGP) to help stabilize the funding structure of financial institutions and expand their funding base to sup-

port the extension of new credit. The program has had a positive impact. There is a high level of participation, and it has significantly reduced credit spreads for participants.

In addition to the TLGP and other Federal Government efforts, the additional funds for the Troubled Asset Relief Program, with appropriate safeguards, would also provide important and necessary support to assist financial institutions in making loans available to creditworthy borrowers and create incentives to avoid unnecessary foreclosures. For example, the FDIC believes that addressing the problem of troubled loans and other assets continues to be vitally important.

Uncertainty about the potential losses embedded in balance sheets is constricting lending to consumers and businesses, and discouraging investors from providing fresh capital. A program to address the problem of troubled assets would help build the foundation for a greater flow of credit and the investment of new private capital into the financial system.

A program to address troubled assets should meet three main principles: accountability; transparency; and viability. It should be a standardized approach that establishes a fair and transparent program, with clear benchmarks for measuring performance.

In addition to these strategies, it is critically important that there be a nationwide program for modifying loans to prevent unnecessary foreclosures. Minimizing foreclosures continues to be essential to the broader effort to stabilize financial markets in the U.S. economy. If we do nothing, we estimate there will be another 4 to 5 million foreclosures over the next 2 years and the very real possibility that home prices could overcorrect on the down side. They are already down 25 percent since their peak in 2006.

There is a strong business case for modifying loans. When a borrower is able to continue making payments after restructuring, investors and lenders are better off than having to deal with a foreclosed property. This is especially true when the housing market has declined sharply.

In previous testimony, Chairman Bair outlined our plan for a nationwide loan modification program. We believe the program could prevent as many as 1½ million foreclosures on owner-occupied homes. It would set standards for loan modifications based on our experience at IndyMac Federal Bank. It also includes the defined sharing of losses on any default by modified mortgages meeting those standards. This would allow unaffordable loans to be converted into mortgages that are sustainable over the long term when the value of the modified loan exceeds that of foreclosure. While we believe this approach will be successful, we recognize there is no silver bullet to address the foreclosure problem, and are willing to work with others in the assistance of the implementation of programs that result in affordable, sustainable loans.

In conclusion, the incoming Administration will face a number of serious economic challenges that require a variety of approaches to successfully restore confidence in the financial system. The additional TARP funds are essential for financial stability. The FDIC supports the request for additional TARP funds. We look forward to working with this committee to address the significant challenges facing the economy and the American people.

I will be pleased to answer any questions the committee might have. Thank you.

[The prepared statement of Mr. Bovenzi can be found on page 100 of the appendix.]

The CHAIRMAN. I want to thank both of you. I want to be clear that throughout this, we have been working on a cooperative and bipartisan basis with the Administration. You represent, obviously, two of the major regulators of our banking system.

I would like to emphasize one point which you made. Some of those who have been critical have said we shouldn't have the release of the second $350 billion—this bill doesn't do that—have made what seem to me to be contradictory arguments. Not everybody has made both arguments, but some have: one, it was never needed in the first place; and two, that it has worked—that there was never a problem, but it has solved the problem that they earlier said didn't exist.

If we had not enacted the original $700 billion, Mr. Kohn, what in your judgment would be the situation today?

Mr. KOHN. If you had not enacted that bill, Mr. Chairman, I think we would be in worse shape today. I think the financial system was in those weeks, late September and early October, on the way to seizing up in a much more fundamental way than it had already done.

There was a palpable loss of confidence across a broad array of investors and lenders, and I think that it was absolutely necessary. If that had continued and intensified, the lending issues that we still see in the economy would be even worse. Businesses and households would have even less access to funds.

The CHAIRMAN. Thank you. Mr. Bovenzi, particularly from the standpoint of a bank regulator, you are probably the bank regulator with the broadest range because of the deposit insurance, what would the state of the banking industry and the system, what would that be like if we had not passed this $700 billion?

Mr. BOVENZI. To me, it is clear that the state of the banking industry would have been in far worse shape without the passage of the funds and the additional programs put in place by the Federal Reserve and the FDIC. They all contributed to helping substantially. Nevertheless, there are still significant problems.

The CHAIRMAN. I appreciate that. And that is part of the problem politically. No one has ever gotten elected to office by going to the public and saying, look, things are lousy but, boy, would they have been lousier if it hadn't been for me. That is the situation that those you administer are in.

My own view is it could have helped more. Now that President Bush, at the request of President Obama, has decided to trigger this, we have a short window in which we, the Congress, can speak out as to what we think ought to be there.

I think there are two major concerns. There are others. One was that money given to the banks, not given but infused into the banks as capital, people did not see relending and did not see any assistance on that. We think going forward we have a better approach. But the single biggest one obviously is the absence of foreclosure, and the bill clearly talked about foreclosure. It was a major part of getting support for it on both sides.

My question has two parts: one, the reason for foreclosure, and I think it is important I guess to say, and maybe I will make it just one part, I don't want to go over my time, there are those who say those people took out the loans and they weren't wise and they shouldn't have done that. What is the argument that says foreclosure diminution is just charity for people who got themselves into trouble in the first place and we ought to stay out of it? What is the broader economic argument for it? Mr. Kohn?

Mr. KOHN. Mr. Chairman, I think foreclosures are contributing to problems in the housing market and the broader economy. Foreclosures impinge on values in the community at large, even for those people still owning their homes and paying their mortgages. When there are foreclosed homes in the community, they see values go down more broadly. And the decline in values, the decline in home values results in more losses for banks and other lenders and it causes them to tighten up credit more broadly.

So I think foreclosure prevention would be helpful in ameliorating the issues in the housing market. It is not a cure-all.

The CHAIRMAN. Let me ask Mr. Bovenzi, because you and Chairman Bair work at an agency whose statutory role primarily is the stability of the banking system. Is it just charity that leaves you and Chairman Bair to be so concerned about foreclosures? Not that it is a bad thing. You could be nice people.

Mr. BOVENZI. Foreclosure mitigation is going to help the economy overall. Foreclosures put a downward pressure on price. If we can create sustainable, affordable mortgages, it helps put a floor under those home prices which will help the overall economy.

For those who look at it and ask why folks are getting a benefit that they are not, there are certainly other programs in place, and steps have been taken to reduce mortgage rates. Many people are looking to refinance their mortgage rates and reduce their repayments through those means. The program we have at IndyMac is also designed to help reduce interest rates to make sustainable, affordable mortgages.

The CHAIRMAN. Thank you. The gentleman from Alabama.

Mr. BACHUS. I appreciate the gentleman's testimony.

To follow up on the foreclosures, as this housing crisis has unfolded, it seems we have had an evolution in the reason for foreclosures. Originally, we were all concerned about the adjusting interest rates on the ARMs. As housing prices then fell, we began to be concerned about negative equity, which is a different problem.

Recently, I think we have a third problem which I think is much harder to address and I want to ask you to address it, and that is the economy, the loss of jobs, and the unemployed. How do we address—when you are talking about default and foreclosures among the unemployed, is it possible to address that situation, Mr. Kohn and Mr. Bovenzi?

Mr. KOHN. Congressman, I think the major way to address that situation is through macroeconomic policy that promotes jobs growth. And I think growth in jobs and the prevention of further unemployment will depend on a number of things that we can do.

Fiscal policy is important, what the Federal Reserve is doing by lowering interest rates essentially to zero and moving on the credit fronts. And I think the TARP money to help stabilize the banking

system and get credit rolling again to households and businesses will also be helpful in limiting the amount of unemployment and turning the economy around.

Mr. BOVENZI. I agree. No one solution can solve this financial and economic crisis, and loan modifications to make them affordable can help where there is no income. However, other fiscal policies, programs, and measures are necessary.

Mr. BACHUS. I am not sure. I guess that is my point. When you are talking about the unemployed, foreclosure modification or these programs are not of much use, would you agree? How would the TARP money be used to help people?

Mr. KOHN. But I think a lot of foreclosures are occurring for people who are still employed.

Mr. BACHUS. I am talking about the unemployed, and that is the growing problem.

Mr. KOHN. That we can move against. I agree, it is very, very difficult, as Mr. Bovenzi said.

Mr. BACHUS. You have heard Mrs. Bachmann and Mr. Price. This number, $700 billion, was a really large number. You spent $350 billion and Secretary Paulson says that it has stabilized our financial markets and it has restored confidence. You said that today to a great extent.

Tell us how you are going to use this other $350 billion. I think we have a right to know.

Mr. KOHN. I think it is really up to the Treasury Department, who will be charged with spending this, the incoming Treasury Department, to say that. I think I laid out a number of suggestions in my testimony: foreclosure prevention; further extension of credit; credit help; capital to financial institutions.

Mr. BACHUS. But you just laid out several broad possibilities. As a Congress, it is pretty difficult for us just to say, here are some possibilities. As you said, the next Administration will have to make those decisions. But this Administration is asking for money on behalf of the next Administration which is kind of a—and I don't think I ever thought I would see this day when an Administration that hasn't told us they need it is asking on behalf of an Administration that may need it, but has yet to tell us what they need it for. Can you see our difficulty with that?

Mr. KOHN. I think the country is in a difficult transition period. And therefore, lines of authority are in the process of being shifted. I think the two Administrations are working together, the incoming and outgoing, very, very well.

Mr. BACHUS. Would you not agree that you spend $350 billion, that adds to the deficit, and a deficit that is already at a trillion dollars a year, does that concern either one of you gentlemen?

Mr. KOHN. I think you need to ask what you are spending it for and whether you are getting value for that spending. And I think reinforcing and stabilizing the financial system is good value for that spending.

Mr. BACHUS. The Secretary of the Treasury made a statement last week that he thought the financial system is stable.

Mr. KOHN. I think it is certainly more stable than it was before.

The CHAIRMAN. The gentleman's time has expired.

Mr. BACHUS. Thank you.

The CHAIRMAN. Mr. Kohn, I want to take 10 seconds, and I believe in your testimony you pointed out that the $350 billion is not all going to be expended, that a substantial part will be returned to the Treasury?

Mr. KOHN. That is right. You are buying assets.

The CHAIRMAN. The gentleman from Pennsylvania.

Mr. KANJORSKI. Thank you, Mr. Chairman.

I am going to do something that is exceptional, and that is to give my friends on the Minority a little credit for raising the question. I think it is a legitimate question, and that is, did we have the time the first time around to go through regular order and consider all of the aspects of the legislation?

The answer in my estimation is "no." We had to make a very quick decision because the Secretary of the Treasury and the Federal Reserve Chairman informed us that we were on the road to meltdown without it and had a very limited time to act. The Congress, unfortunately, and this committee waived some of its regular rules and procedures. As a result, we did not write the best bill in the world, taking into consideration everything we probably should have.

That being said—

Mr. BACHUS. If the gentleman will yield just for one second, I think I was referring to this time we are not in a meltdown, and we should go in regular order and have committee hearings.

Mr. KANJORSKI. I think when you are winning your point, you should stay silent.

That was the state of affairs. I wish this time we had more time to go through regular order and write a bill that would be more representative of the thinking of Congress and the American people. Unfortunately, we are restricted, as the chairman has indicated, with the 15-day period, and that is it. So we have an opportunity now to inject the additional $350 billion with some indications as to where Congress thinks this action should be taken and how, or to take no action, do nothing, and let the incoming new Secretary act in accordance with any way they wish.

I do not think we can correct that very much. But I would suggest that we are also going to be going into a situation to write a new stimulus bill, and that also will have time constraints to it. Already, the President-elect has asked to have that in his possession by the middle of February, I think the Speaker has indicated her desire to do that, and I think it is essential that speed be used. However, may I suggest that I am also one who thinks that we should have regular order, and to get that bill before Congress and to get the additions from both sides of the aisle in the form of amendments and otherwise is very important.

So I would urge my leadership, if I may, to move as quickly as possible to bring that bill to the various committees of jurisdiction so that we can work our input as the American people like.

I humorously have indicated over the last several weeks that I have no intention of becoming the chairman of the Potted Plant Caucus. But sometimes I am getting the idea we may belong to that caucus around here. It is important that the House of Representatives and this committee take back its prerogatives. That does not mean that every time we get an issue like this, by knee-

jerk reaction, the Minority or the Majority have to take positions that are just obviously not credible positions but are really incredible insofar as they do not serve the purposes intended.

So I urge my members on the Minority side to work along with us and cooperate with us. Let us reassert the prerogatives of Congress, and the House in particular.

Do you believe that this Administration, and indeed the next Administration, could just do a better job of informing the American people, and Congress for that matter, as to how these funds are intended to be used, will be used, and are used? In this day and age of the Internet and the Web and everything else that we deal with for the use of public relations and how to get information out, it seems to me we are doing an awfully poor job. The average constituent that I talk to is asking me, "What did they do with the money? What can we expect them to do with the additional money, and is it really important?"

Mr. Kohn and Mr. Bovenzi?

Mr. KOHN. Congressman, I agree with you, the Administration, outgoing and incoming, can do a much better job explaining the strategy behind what they are doing, have it coherent, how it adds up, and inform the public what they have done and monitor the effects that is having. I think improvements are required possibly all around.

Mr. BOVENZI. I would agree. The principles in the bill before the committee—transparency and accountability—are critically important.

Mr. KANJORSKI. I yield back the balance of my time.

The CHAIRMAN. The gentleman from Delaware.

Mr. CASTLE. Thank you, Mr. Chairman.

Isn't that a two-way street? Are we hearing enough from the institutions about what they are doing with the money? It is confusing to me in watching all of this. You talk about capital acquisitions, but occasionally they go out and buy things and their lending doesn't seem to increase. I am not sure we as a Congress understand what these institutions have been doing. It seems to me that report is very important as we consider these various proposals. Am I correct about that, or am I just missing the writing on the wall?

Mr. KOHN. I think we need to do a better job monitoring what is going on out in the institutions and getting reports from them that then the Treasury and the regulators can forward on to the Congress and the American people to give them a better sense what is going on and to make sure that the funds that are being, as best we can, the funds that are being allocated are being used for the purposes intended.

Mr. CASTLE. Maybe we can start by demanding that they account more themselves and then we review whatever that accounting is.

Mr. KOHN. Exactly. We need to be monitoring. A principal way of monitoring would be to have them report to us what they are doing.

Mr. CASTLE. Mr. Bovenzi, looking at your testimony on page 9, you talk about the original intent of the TARP funds, which was to purchase troubled assets in the original economic stabilization bill. You speak pretty strongly about that.

One question, how much of the $350 billion should be used for that, if you have a number? And are you, by making that suggestion, being critical of the capital acquisitions and the other things that the money was used for instead of the troubled asset purchase program that is stated in your testimony, and a lot of us thought, was what was the original intent of the legislation?

Mr. BOVENZI. The point I am trying to make is that there are still assets in the balance sheets of banks and thrifts with uncertain value that are causing disruptions in the market system. They require some form of government guarantee or assistance to help stabilize the markets before government can step out of the picture.

I don't have an exact number for what amount of the $350 billion should be used for such a program. My point is to demonstrate that there is still an issue with financial institutions.

Mr. CASTLE. My concern is we didn't do that originally, and now do we have sufficient dollars to put into this program to do it now to be really of help? I am not sure that you can answer that. It is a concern we all need to have since it would be shifting gears if that were to happen.

Changing subjects for a moment, Mr. Kohn, as I understand it, the Federal Reserve is a member of the HOPE for Homeowners Board of Directors. I don't know your direct involvement in that, but obviously that program has not lived up to expectations. The original projections we heard were 400,000 troubled borrowers would be helped by this, and it is a de minimis fraction of that.

Can you give us your assessment of that program as it was intended and why it has not worked and what, if anything, should be done to help with that?

Mr. KOHN. I think there were a number of issues there. It was not sufficiently appealing to both borrowers and lenders. They felt it had a lot of troublesome aspects in terms of the requirements, the operational requirements to engage in the program. It was relatively expensive, they felt, relative to the values they would get out of it. Now the HOPE for Homeowners board has made some changes to try to make it more attractive for lenders to participate. Whether that is sufficient to get participation up, I think, is a very open question.

Chairman Frank has in his bill some more efforts to really put in essentially public money more into that program to make it more attractive, and I think they could be successful.

I think it is conceptually a good way to proceed or a good aspect of foreclosure mitigation, to help people with the principal writedowns, and then reinsure through the Federal Government the loans after that. But we need to simplify and we need to make it less expensive.

Mr. CASTLE. Thank you. I yield back.

The CHAIRMAN. The gentlelady from California.

Ms. WATERS. Thank you very much. I would like to thank our panelists for being here today.

Basically, we have been struggling with how to deal with the foreclosure crisis. Again, I think that Chairman Bair of the FDIC has shown us how you can be successful in getting the homeowners to come in, in the way that you talk to them and the letters that you send, and I like the idea that she has inserted into her pro-

gram the writedown of interest. I think that is extremely important to modifications.

And also, I like the HOPE for Homeowners program that allows the bank to write down the mortgage 10 percent and to help funnel those homeowners into refinancing with FHA. I think these two programs are very solid and they make a lot of sense and are a good way to modify or refinance.

What is the difference between these two programs and what Fannie Mae and Freddie Mac are doing?

Mr. BOVENZI. I can talk a little bit about the IndyMac program versus Fannie and Freddie. They are very similar in a lot of ways. I think at IndyMac what we did—

Ms. WATERS. I know what you did at IndyMac. What is the Fannie and Freddie program? How is that different?

Mr. BOVENZI. They are looking to write down interest rates as well. They have started from the premise of looking at loans that were 90 or more days past due, whereas at IndyMac we started looking at loans 60 or more days past due. You still have to do a net present value analysis to see if a modification is worthwhile. But that is one difference between the two programs.

Ms. WATERS. I have concerns about having to be 60 to 90 days delinquent. What if Mr. Jones comes in? He is current on his mortgage, but there has been a change in income, as I have witnessed in talking with some of the people who are in potential trouble, and his fixed income is reduced by the increased cost of living. His automobile insurance has gone up, his utilities have gone up, and he comes to you and says, look, I have been doing well with my payments, but now I can't afford them in the same way because my income has not increased but my expenses have, because I have to pay more for automobile insurance and these other things; what can you do for me?

Mr. BOVENZI. Let me talk about two different situations. At IndyMac, there were some loans that the institution owned directly, and so the FDIC took ownership of those loans. There were other loans that IndyMac serviced for other investors or owners, so we would need the consent of those owners in order to modify a loan.

It is more difficult to show the investors on a loan that is performing why it should be modified. That becomes a more problematic solution for what you are suggesting.

For the loans that are owned directly by the group that is doing the servicing, where they have the financial interest, they can look at the kind of situation you talked about and say, yes, this borrower's income has gone down, and make an assessment. If it looks like they won't be able to continue to afford the same payment, then they can make a decision whether to modify the loan or not. So there is greater flexibility.

Ms. WATERS. Are you telling me that an investor, that we have a loan, where we have a willing citizen who will pay, and all you need to do is stretch that loan out to 30 or 40 years or slightly reduce the interest rate, that they would not be willing to participate in keeping that homeowner in their home and not losing any money?

Mr. BOVENZI. In some circumstances, they may be willing. And in others, they may look at the loan and say it is performing as-is. If I have an obligation to maximize the value to the different investor groups, why should I reduce the value by stretching it out?

It becomes a more complicated situation when there are servicers and other investors involved than when it is just owned directly.

Ms. WATERS. Thank you.

Mr. Chairman, I think that is a problem and we should be willing to take this warning and work with people in ways that do not cost the government or anybody else a dime just by rearranging and modifying that loan.

Mr. KANJORSKI. [presiding]. Thank you, Ms. Waters.

I yield 30 seconds to the gentleman from Alabama.

Mr. BACHUS. Mr. Chairman, Mr. Jones is yielding back 4½ minutes, and I am going to take 30 seconds of his time. Can I do it now?

Mr. KANJORSKI. Yes.

Mr. BACHUS. I remember a time when it was the banks who loaned money to people and not the other way around. Now it appears that the people are loaning money to the banks. Do you think it would be better to get back to the old way of doing things?

Mr. KOHN. If what you are referencing is that in the old days, in previous times, there wasn't as much securitization of the debt.

Mr. BACHUS. The banks loaned money to the people instead of the taxpayers loaning money to the bank.

Mr. KOHN. I certainly would like to get back to where the taxpayers weren't loaning money to the banks.

Mr. BACHUS. It certainly would be better the other way around?

Mr. KOHN. It certainly would be.

Mr. BACHUS. I would like your commitment that we get back there as soon as we can.

Mr. KOHN. I think we all share that commitment.

Mr. BOVENZI. I think we recognize the extreme circumstances that came about this past fall leading to this situation, and we all desire to get back to a normally functioning market as soon as possible.

Mr. BACHUS. I believe we would be better off if we were there right now. I think the taxpayers really would prefer, instead of loaning their money to the banks, to have the banks loan them money. Thank you.

Mr. KANJORSKI. Thank you, Mr. Bachus.

Five minutes to Mr. Royce from California.

Mr. ROYCE. Mr. Chairman, I would like to ask Mr. Kohn a question. It goes to an opening statement I made here where I mentioned the ill effect of this bailout trend and the rapidly increasing role of government that it is playing in these U.S. financial institutions, playing in board rooms in this country. I will go back to that December 17th article in the Wall Street Journal where they ran that story, "U.S. Ratchets Up Citi Oversight." And in that story, they describe the active role that regulators are playing in the day-to-day operations of Citigroup.

Yesterday in the paper we had a headline focused on the effort by U.S. banking regulators to encourage Citigroup to shake up its board and to replace the chairman of its board. Win Bischoff is the

chairman there. And the effort, as the government says, is to restore confidence in the beleaguered financial giant.

Being a little concerned about replacing market forces with political pull, one leading candidate, as the story mentions, is Richard Parsons, Time Warner's chairman, and a member of Citigroup's board, who happens to be a member of President-elect Obama's Economic Advisory Board. Additionally, you have the other coincidental change or about face at Citicorp as Citigroup changes its position and supports legislative effort to allow bankruptcy judges to rewrite mortgage contracts. For years, there has been concern in the financial services sector that such a cram-down provision would have the effect of increasing interest rates for everybody who got a home loan if this should happen.

So here we have a change, coincidentally, that comes with the $45 billion of U.S. Government money that goes into the corporation and the increasing bureaucratic manipulation, as reported by the press, that is going on inside the financial institution, inside the firm.

A major reason that we are in the dire financial straits that we are in right now is the market distortions that have occurred. And some of that, a great deal of it, has been caused by bureaucratic and regulatory manipulation of quasi-public entities to begin with. Fannie and Freddie are a case in point. And with those two institutions, as we know, for years they took on excessive risk. They were encouraged to leverage 100 to 1. When the Fed came forward and asked for legislation to deleverage them in the interest of safety and soundness or systemic risk to be able to deleverage, those two quasi-public entities lobbied this Congress and killed the bill that the Fed wanted, killed legislation which I and Chris Shays had offered in order to do that.

In the meantime, we have these quasi-public entities that were encouraged to purchase mortgage-related products tied to Alt-A loans, what we now call liar loans. That was an initiative by the Congress. The 10 percent, the goal should be 10 percent, should be in these Alt-A and these other loans in order to encourage affordable housing. So you get a sense of why some of us would be concerned given the fact that the impact of political pull rather than market forces in the past, once Congress has given itself the ability to influence these decisions and replace decisions which would be made in the market, because nobody would have bought those Countrywide or those subprime loans except for institutions like Fannie and Freddie that needed to purchase them to meet their goals and take on that excessive risk and leverage 100 to 1. And the consequences, of course, were the cascading effect that we are now dealing with now when the mortgage-backed securities market, of which they were the dominant player, went belly up.

So, Mr. Kohn, do you think that these events are linked in any way? Do we risk replacing the forces of the market with the influence of political pull and political bullying, and we have seen a lot of political bullying, whether it is CRA or others like Fannie and Freddie, that came back to haunt us and hurt the very people that we intended originally to help.

This will probably not lead to, what was the term you used a minute ago, a normally functioning market. That is my concern. I ask for your observations, Mr. Kohn.

Mr. KOHN. I think, Congressman, there are a lot of reasons why we are in the fix we are in. As you noted, the Federal Reserve supported reform of Fannie and Freddie for a long time. But I don't think they are the main or the only reason we are here. A lot of private institutions made some very poor decisions, didn't understand the risk they were taking, and probably because they were complacent about the kinds of risk, about house prices, and so a lot of folks made some bad decisions. And the regulators were not sufficiently on top of the situation to stop this from happening.

The CHAIRMAN. The gentleman's time has expired. We have a lot of members, and we need to move on.

The gentlewoman from New York.

Mrs. MCCARTHY OF NEW YORK. Thank you, Mr. Chairman.

Congress is considering a very strong stimulus package, but many economists believe that a fiscal stimulus alone will not be enough to support our economic recovery. Therefore, many of us are supporting President-elect Obama's request and President Bush's request to relieve and put forward an additional $350 billion in TARP money. But one of the problems that we have with the TARP money is the problem from the very first proposal, is that no one knows what the troubled assets are worth. So some of my constituents are requesting that part of this program require a clear indication of the difference between what price Treasury would be buying stock or assets of financial institutions and the market price of those securities. Some assets are highly illiquid, as we know, and may not have a current market quote. But many others could be mark-to-market via comparison with other clearing prices of other assets or through a modeling of an independent third party firm so that the disclosure of the true price would give the American taxpayers a far clearer indication of the premium they are paying to the financial institutions and help us to determine if the benefits of this particular program of buying the troubled assets justifies the cost, as there are many other routes that we could take.

I would like to mention one proposal that has been submitted to Treasury and to the Federal Reserve from the New York State Insurance Department which calls for a modest expenditure of TARP money of $5 billion to get the municipal bond market moving. As you know, the structured finance products have basically frozen that market and governors and mayors have called for leadership from the Federal level to get this moving again. That proposal is before you. It basically would restructure the municipal only insurance companies with Treasury's investment and establish a market acceptance of the insurers for the benefit of municipal insurers, and it would be a relatively small investment into new muni-only subsidies of Ambac and MBIA.

This proposal is before you, and I would like you to get back to me or you can comment on it now, but specifically the question of taking steps to determine what the troubled assets are worth and if you could comment on the proposal put forward by the New York State Insurance Department and other proposals that have been

put out there to get credit out in the community through community banks, through the regional banks, other ways that we can do it. I applaud the chairman's proposal to bring more transparency oversight to help people stay in their homes. But if you can talk about the requirements so that we can understand the true value of these troubled assets and comment on the other alternatives that we can do to get our economy moving again and more stabilized, specifically on the proposal from the New York State Department of Insurance.

Mr. KOHN. Congresswoman, I am not familiar with that specific proposal. I do know that the Federal Reserve, working with the Treasury and other regulators, has been taking a hard look at the municipal market and whether there is a way to utilize the TARP money should it be made available to help get that market moving again. I am sure that is one of the proposals they are looking at. If I can get back to you on that.

Mrs. MCCARTHY OF NEW YORK. They believe if we had a municipal-only insurance company there would be a market for it. It is when it is these structured products that pulls it down.

Could you comment on the steps to understand the true value of the troubled assets?

Mr. KOHN. I think it is a very difficult problem because the market values of these assets are often—are affected by very large liquidity and risk premiums. They are trading at prices below what they would trade at if they were held over a long period of time. Using models is one way to try to do it, but there is no good way to establish values for some of these assets. That is one of the issues that needs to be confronted if we implement in the second stage of TARP lifting these assets off the balance sheets.

But I completely agree with you that the government needs to be very transparent about how it is doing it and what criteria it is using and how it is working.

One of the original ideas behind TARP was to reestablish markets for these assets, and I think this would be helpful in doing that.

Mrs. MCCARTHY OF NEW YORK. But there may not be markets for these assets, and money may be better spent in other avenues to stabilize our economy and get loans out to the public.

As the GAO report said, we have no idea how they spent the money. They won't tell us, and why should we give them more money if they won't tell us what they did with the first $350 billion?

Mr. KOHN. I agree, we need to use the money across a broad front of various attempts to unstick these credit markets because I don't think any one is going to be successful in and of itself.

Mrs. MCCARTHY OF NEW YORK. Thank you. My time has expired.

The CHAIRMAN. The gentleman from Texas.

Dr. PAUL. Thank you, Mr. Chairman.

I have a question for Mr. Kohn. Last week, we were scheduled to have this hearing on Wednesday and it was canceled. And we were told—at least I was told—up until yesterday that Mr. Bernanke would be here. How long has it been that you knew you would have to appear?

Mr. KOHN. Late last week.

Dr. PAUL. We weren't notified. Not that it is all that crucial, but in looking at the schedule, we do know that Chairman Bernanke had a speaking engagement in London that was scheduled a long time ago. It has been a month. And he had a scheduled meeting in Basel, Switzerland, yesterday. So it seems like we could have been told about that.

These hearings I agree are very important, and I think it is vital that we have them. And Chairman Bernanke's speech today was very important. The world listened closely to what he had to say. One thing that we don't know is what happened in Basel, Switzerland, at the Bank of International Settlement because he was meeting with other central bankers. I am interested in as much transparency as possible and I am trying to figure out what is going on. Is that a meeting that we can get the information on and know what transpired and what the agreements and discussions were? Is that something that should be available to us here in the Financial Services Committee?

Mr. KOHN. If there are agreements reached. It is basically a forum for exchanging ideas and for finding out how other central bankers see their economies developing and what issues they see, or giving them a chance to ask us questions and us to ask them questions. It is not a forum for reaching agreements that are binding on particular central banks. If we were to reach an agreement with other central banks to do something, obviously we would tell people about it.

Dr. PAUL. That sounds plausible. But we also know when we ask the Federal Reserve and we ask the Federal Reserve Board Chairman where the funds go that they allocate, we really don't get the answers. And there are trillions of dollars worth of credit that are injected into the economy and we are not privy to exactly what is going on. So there are a few people who get suspicious and wonder what really goes on in these discussions because you don't have minutes, and you don't have really any access. As a matter of fact, those kind of meetings are exempt from our oversight by law. They are exempt. We are not even allowed to have that, if information isn't given to us voluntarily.

I want to ask another question dealing with the process. It seems like we have two vehicles. One, we have where the Congress is involved and we debate and we interject our beliefs and we appropriate money, and we give it to the Treasury and the Treasury does certain things. And then we allow them too much license and then we are unhappy. We have that approach.

The other approach is the Federal Reserve, and there is essentially no oversight of what the Federal Reserve does and we don't know how that occurs. It seems like the Federal Reserve, in my understanding of the law, has a great deal of license to do whatever it wants. It seems like they can bail out anybody, buy up any assets. I am just wondering why the line is drawn where the Fed is involved in trillions of dollars where we have no oversight, but then we come over to the Treasury and we insist that it goes through this process and almost like we are really in charge. But do you see a line drawn? Why do we have to appropriate money sometimes and other times we totally ignore it?

Mr. KOHN. I think there is a lot of oversight of the Federal Reserve. The fact that I am sitting here, and Chairman Bernanke comes to this committee frequently is an important part of this oversight. We publish a great deal about our facilities, what we are lending, the uses that the funds are being put to; is it being lent for commercial paper, is it being lent to banks for lending. We publish on a weekly basis that material.

Dr. PAUL. Of course, then we get the information that you want us to have. I have been on the Financial Services Committee for a long time. Would you invite me to the FOMC meeting? That is something we get the minutes later on.

Mr. KOHN. You get the transcript after 5 years, and you get the minutes after 3 weeks. I think opening the Open Market Committee to the public would greatly inhibit the discussion in that committee meeting. I think that it would promote financial speculation and would impinge on making good decisions.

The CHAIRMAN. Thank you. I am going to take 10 seconds to announce that we have spoken to Mr. Bernanke. There will be an oversight hearing on the Federal Reserve's lending of these trillions of dollars in February. So we have asked for a hearing. That is a fairly new phenomenon at that level. So in February, we are trying to clear the date now, we will have an oversight hearing specifically on what the Federal Reserve has said.

The gentleman from North Carolina.

Mr. WATT. Thank you, Mr. Chairman.

Mr. Kohn, I have in my BlackBerry an e-mail that I received dated September 20, 2008, at 4:27 p.m. It was a Saturday afternoon, and it was the first proposal that we received from Mr. Paulson regarding the bailout. It was one page long. And by an hour later, at 5:42 p.m., even though I was watching a football game, I had responded to my staff that we should add a provision that made one of the criteria to the maximum extent feasible avoiding foreclosures and providing homeowners with mortgages on their homes, opportunities to amortize their mortgages and stay in their homes. Some version of that was put into the original bailout bill, although not quite as direct as that. And then Mr. Paulson appeared here and said they didn't have the authority to do what the FDIC had done—as proposed, rather—because that wasn't the purpose of the original bailout.

We finally have from FDIC a proposal that would do something similar to what I proposed within an hour of receiving the original proposal, and I am reasonably satisfied with that part of it. But it seems to me that ever since then we have been engaged in an effort to try to define how much to micromanage the use of this money. We took that one page that Mr. Paulson proposed that Saturday afternoon and converted it to 164 pages, I think the original TARP bill was, and now we are back trying to add some more conditionalities, and one of the concerns I have is—and we all have had—is that we have not wanted to micromanage the use of this money.

So there is a provision in the chairman's mark that has been put out that would require the Secretary to reach agreements between the depository institution and whatever the Federal banking agencies to which they report on benchmarks that the institution is re-

quired to meet in using the funding so as to advance the purposes of this act, to strengthen the soundness of the financial system and the availability of credit to the economy.

One of the concerns that everybody has had is this money has gone out and been used for purposes. Can you tell me what some of the benchmarks might be that we could evaluate on the second half of the money to determine whether it is being effectively used to really unfreeze the credit and keep people from calling me, businesses from calling me, saying I am just getting unreasonable demands from lenders or refusals to even consider loaning to me when I have been a good customer of theirs throughout the last 10 years? What would be some of the benchmarks we would look for?

Mr. KOHN. Congressman, that is actually a very difficult question to answer. I don't think there are going to be any easy metrics by which to gauge whether the program is freeing up loans. There are a couple of problems here. One is you don't know what the counterfactual is. You don't know what would have happened if you hadn't put in the money. So loans, in my view, if that $250 billion hadn't been put in, the situation would be much worse. But that is very hard to measure.

I think the second thing that is hard to measure—

Mr. WATT. You can't give me one benchmark? We are not talking about unfreezing credit, we are talking about actually making loans available. What would be a benchmark?

Mr. KOHN. We can look at the terms and standards that banks are—on which they are making credit available to businesses and households to see whether they are reasonable in the situation.

We can look at the amount of loans they make, although that may be difficult to interpret. We can certainly ask the banks what they are doing and why they are doing it. And I think the combination of all of these things will give us insight into what the disposition of these funds are. But there is not one thing.

The CHAIRMAN. The gentleman from North Carolina, Mr. Jones.

Mr. JONES. Thank you, Mr. Chairman.

Along the lines of my colleague from North Carolina who just spoke, this was in the Raleigh, North Carolina, paper: "I am the president and CEO of Carolina Finance, an automobile finance company. I started in 2000. This is the point I want to make. We borrow our capital from Bank of America which has pretty much stopped lending despite having been given $15 billion to help small companies. Further, I have 50 employees in North Carolina and Virginia I care about. I do not believe the bank bailout funds are being used as intended."

Now I want to go to another business owner, and then I will get to the question:

"The government began to buy ownership in banks by pumping $300 billion into these coffers. We were told this was the only way, and that this would free up funding. It didn't happen. They were not even required to lend the funds out. They kept the funds in their banks to improve their own balance sheet. Then they began to tighten up their own credit standards by squeezing their customers. By squeezing their customers. The bank I have been dealing with for 31 years basically told me that they wanted my children to personally endorse all loans."

Mr. Kohn, this is the problem. I do care about the homeowners. I care about those who are having to give up their homes just as much as anybody else. But these two companies, one has been in business for 30-some years with the same bank, primarily, and now they are changing the rules and regulations. And this poor man with 50 employees in Virginia and North Carolina, he can't even get a loan.

I would like very much to bring those situations to your attention because I don't know how these banks are getting by with fattening their profits because they are in trouble. We gave them money, the taxpayer did, and yet the taxpayer who has a business, small or large, can't even get a loan. If this country is in trouble, it is in trouble because all of a sudden we are bailing people out and we are saying to those people, you keep the money and you don't have to give credit to anybody. That is not going to help this country.

Mr. KOHN. I don't think that is what we are saying. We are saying we are giving you the money and we want you to lend to households and businesses and municipal governments where you can make safe and sound loans. We are working with the supervisors of those banks to ask them what they are doing, and for the supervisors to make sure and to work with the banks to keep lending on a safe and sound basis.

I think you are right, we need to keep working along a number of fronts to open up these credit spigots because they have closed. But if we were not to make the next money available, I would be concerned that people would get even more concerned, and the banks would be more concerned and they would tighten up even more.

Mr. JONES. The issue is if this next $350 billion is allocated out and these small businesses, they won't be around to complain to their Congressmen. They will be gone.

I will bring one to your attention, and I would appreciate very much if you would get back to me because this is absolutely, I sign a contract with you, and now you come back to me and say, I want to change the contract. In fact, I want your children to contract. They are 25 and 30 years old; they are not kids. But it is destroying this country, what is happening right now.

Mr. KOHN. I would be willing to answer your question and inquiry. I would also point out that the Federal Reserve through its credit facilities is trying to help restart the securitization and small business loans. That is one of our objectives, and we are moving along that track although we are not there yet. It is a problem, I agree.

Mr. JONES. Thank you. I yield back the balance of my time.

The CHAIRMAN. Before I turn to Mr. Meeks, I am going to make a request. We couldn't get started earlier today because of Members' travel plans. We have a 6:30 set of votes. I would like to get to the second panel. It is a very good panel. I am getting tired of the first panel. It is not their fault, but there is a certain repetitive nature as to what they are being asked. I would like to get to the second panel, so any member on the Democratic side who is willing to forgo asking questions of the first panel, we will begin with those people for the second panel. Think about it. Please notify a member of the staff because I would like to get the benefit of the

second panel. That is obviously an option open on the other side, but I am not in charge of them. I am not in charge of you either, I am asking.

And now the gentleman from New York, Mr. Meeks.

Mr. MEEKS. Thank you, Mr. Chairman, and I, in trying to determine what we need to do for this, the next $350 billion, I have a quick question about something that the Feds, so, Mr. Kohn, I would ask you, has done already and whether or not and the participation, and that is dealing with the, when the Federal Reserve announced it would initiate a program to purchase the direct obligations of housing-related Government-Sponsored Enterprises, with the Freddie Mac and Fannie Mae, and I know that there were purchases of up to $100 billion in GSE direct obligations in the program and that there were auctions being, not auctions but competitive bids, that were going out to various individuals to purchases of up to $500 billion in MBS, and various asset management, etc.

My question is, given that there is a series of requests for proposal that were issued by the Fed, I would like to know if you could tell me what level of involvement of qualified minority- and women-owned businesses, if any, have participated in the aforementioned Fed endeavor?

Mr. KOHN. I don't know, Congressman. I will have to get back to you on that.

Mr. MEEKS. Could you please get back to me because some of the concerns I think that were articulated by Congresswoman Waters and before, and we had talked about purchasing the illicit assets, it was to make sure that we had a more diversified pool of individuals who would also be involved, because to me, when you have a diversified pool, you also reduce your chances of losing your fund when more people are investing the money.

But let me go to Mr. Bovenzi. Did I pronounce that correctly?

Mr. BOVENZI. Yes.

Mr. MEEKS. Now currently, and I know that in the chairman's mark, there is a provision in there looking to include the FDIC on the TARP oversight board, and I was wondering, I don't know if I stepped out and you indicated before, but whether or not you think that the FDIC could play a very meaningful role on that board and whether that we should therefore move forward and try to do something statutorily in that regard?

Mr. BOVENZI. I think the FDIC would play a meaningful role on that board. Clearly, there is a desire to increase loan modifications, and the FDIC, under Chairman Bair, has been leading an effort to try to promote loan modifications and do it on appropriate standards. In that area alone, the FDIC could play a meaningful role.

Mr. MEEKS. Let me just ask another quick question that has to do with many of the taxpayers' investments and many of the banks through the Capital Purchase Program, and what I think that you are hearing from a lot of Members is that because of taxpayers' money going in, they want more accountability, and they want individuals to make sure that the individual institutions are doing business in a more equitable fashion, etc. And in that regard, I am looking at ways that we could include more people involved in the process. And a perfect example of how inclusion could be increased relates to a more, in my estimation, equitable distribution of the

underwriting liability and fees associated with TGLP debt insurances. And to date, the banks that have benefited from the FDIC backing have issued bonds to maintain their liquidity in uncertain markets.

My question is, it seems as though that, unfortunately, business as usual has continued to take place even though there is taxpayer money that has been involved in this, and the vast majority of fees associated with the government guaranteed bond issuances and this manner of operation I think is inconsistent with trying to diversify and be more equitable with practices that enable a larger range of firms to benefit from the government's activities in connection with the financial crisis. So my basic question is, my time is running out, is does it make sense for those same banks to also earn the lion's share of the fees that are to be earned in connection with the issuance activity?

Mr. BOVENZI. The FDIC has been very supportive of extending programs to all banks of all sizes so they can benefit people around the country. There are two parts to our Temporary Liquidity Guarantee Program. First, there is debt issuance. About 6,900 companies have signed up for the guarantee program in that regard. It includes small banks and large banks. Second, there is the protection for non-interest-bearing transaction accounts that is available to banks and thrifts. 6,700 banks and thrifts have signed up for that program, which represents a vast majority of the roughly 8,500 or so banks. In terms of capital investments from Treasury, we are very supportive of that being made available to banks of all sizes and have been working in that regard as well.

Hopefully, I addressed some of your questions.

The CHAIRMAN. The gentlewoman from Illinois.

Mrs. BIGGERT. Thank you, Mr. Chairman.

Yesterday, I held a roundtable with some of my not-for-profit groups in one of my counties. These groups are counselors who are working with mortgagors to try and keep them in their homes.

Mr. Kohn, in your testimony, you stated that the Federal banking regulators, pursuant to their joint November 12th statement, are working to help banks ensure that they are fully meeting the needs of creditworthy borrowers. Banks lending to creditworthy borrowers is good for the economy, but it is also good for the profitability of banks and supports their safety and soundness.

Does this square with an additional $350 billion bill? Because this is not happening. These not-for-profits said that they are working with the mortgagors. They cannot get the banks to return their calls. And if they do, finally, they will talk to somebody, and then they will be sent to somebody else, and this person says, I haven't seen that; you will have to fax it to me. And it goes on and on. And maybe somebody is at the point where they haven't defaulted, but by the time the banks even get around to bothering with them, they are already in default.

I don't understand why this is happening. Is this something that Fannie and Freddie have requested that banks not do? Is this something that banks are just so overworked that they don't have enough people? We have the counselors, and these counselors are even ones that are provided under statute. They are really having to raise some money themselves to work with these clients. This is

a community service. So I don't understand why there is isn't more money for counselors. And if the lenders don't answer the calls for help, I think it is time that they did respond.

Mr. KOHN. The Federal Reserve has worked closely with nonprofit groups across the country helping them to put lenders and borrowers in touch with each other, to inform them of the rights and options and alternatives they have if they are facing problems. I think the lenders, to some extent, are overwhelmed by the scale and size of the problem. And they are, the servicers and lenders, are working hard to catch up.

But I also think, as I said in my testimony, that we need to do more on foreclosure mitigation. We need programs that can be scaled up more rapidly to address more problems. And that would be one of the uses for TARP money.

Mrs. BIGGERT. The problem is that we have talked about this now since we started working on the TARP, and the bill passed in October, and we did the housing bill, which was done last summer to take effect on October 1st. We are not seeing the results. We are not seeing it with the homeowners where there have only been 373 applications, and only 13 of those that have any closure on this. So, I don't know how—if we are going to throw another $350 billion into this, how is that going to help?

Mr. KOHN. I think it can be used to encourage lenders and borrowers, lenders in particular, to rewrite loans to make them more affordable, both in the interest rate, the term, to some extent writing down the principal under something like an enhanced hope for homeowners—

Mrs. BIGGERT. But the banks aren't doing that. And that was in that original bill. We have already done that.

Mr. KOHN. I think more needs to be done, and it needs to be done now. I agree with you, Congresswoman.

Mrs. BIGGERT. I yield back.

The CHAIRMAN. The gentleman from Kansas—no, the gentleman from Kansas is passing on this round. He is resting on his laurels of saving the airline industry, which he did in the bill.

The gentleman from Missouri.

Mr. CLAY. Thank you, Mr. Chairman.

May I inquire of the two witnesses?

The CHAIRMAN. Yes.

Mr. CLAY. All right. Thank you. Let me start with Mr. Kohn. We have seen the first $350 billion of the TARP directed towards rescuing financial institutions and the whole of the financial sector. Now the Congress had very little control of those funds. I pray that they are well spent. And requests are now being made for the other $350 billion. Let me just ask you some simple questions. Is this not taxpayer money?

Mr. KOHN. Yes, it is.

Mr. CLAY. We agree with that, then.

Mr. KOHN. Yes.

Mr. CLAY. Then why can't we direct this to the rescue of the taxpayers who are really on the front line of all of this? They are getting hit with the devaluing of the 401(k). Some of them have lost 30 and 40 percent. Some of them are already retired and have lost quite a bit of value in that. Would you all be interested—would you

entertain legislation that would actually help them and put some value back into those 401(k)s and retirement plans?

Mr. KOHN. I think the TARP money is intended to unfreeze the credit markets and help the financial markets and build confidence. And to the extent that the TARP and the Federal Reserve policies and the fiscal stimulus coming put a floor under the economy; they will help the financial markets and help those 401(k)s. I think it is, to be sure, the money from TARP is flowing into the financial institutions, but the intent is to help households and businesses, and I think you are right; we need to do a better job monitoring how well it is doing that.

It is an indirect way, but it is absolutely essential when the contract markets, part of what is going on, one reason the financial markets and the economy is in as bad a shape as it is, is that the credit markets are frozen up. People aren't getting loans that need to get loans. This is depressing the economy, and that is putting downward pressure on asset prices of all sorts, houses and equities.

Mr. CLAY. Really, the initial $350 billion was the bailout for Wall Street, correct? We gave Citigroup $45 billion.

Mr. KOHN. It was an injection of capital into financial institutions, and the government has preferred stock in those financial institutions.

Mr. CLAY. Sure. And the stock is worth what? How much?

Mr. KOHN. It yields a certain amount for a few years and more for a few years after that. So there is a return on the stock. It is not traded on the market.

Mr. CLAY. What do we have in value today in Citigroup? What can we put up, tell the taxpayers they own in Citigroup or in AIG?

Mr. KOHN. I think what the taxpayers have is an implicit share of Citigroup. But more important than measuring what they own in Citigroup, I think, is the very difficult to measure financial stability that you are, that we are seeking in exchange for these.

Mr. CLAY. Okay, did the $350 billion helped?

Mr. KOHN. I think it helped, yes, sir.

Mr. CLAY. Has it turned it around? Has it freed up credit?

Mr. KOHN. There are some sectors of the market that look like they have improved some. But the market is still looking very bad. So I think it stabilized the situation, improved it a little, but it is still not a good situation.

Mr. CLAY. Let me ask Mr. Bovenzi really quickly, how much funding do you think would be necessary to use in TARP money to reduce foreclosure?

Mr. BOVENZI. I don't have the specific number for what amount should be used to reduce foreclosures. Chairman Bair had talked about one variation of a loss-sharing proposal on loan modifications that might cost $25 billion. The bill has numbers from $40 to $100 billion. I think it is important to have some money allocated and get started on the process.

Mr. CLAY. Thank you very much.

The CHAIRMAN. The gentleman from New Jersey.

Mr. GARRETT. I thank the chairman.

And I still thank the panel. I am still interested in the first panel.

I find a couple of the questions from the other side intriguing. Mr. Watt, I believe it was, made the comment with regard to benchmarks, which I think is a legitimate question to try to be able to set a barometer of going from the past and going forward as well.

Some might have said that a barometer would be the stock markets and their confidence in the whole credit situation and the like. And prior to the first bill passage, people said if you don't do this, the stock market is going to go down by 500 or 1,000 points, and lo and behold, of course, we did do it, and the rest is history. So that is one barometer and bench market.

Ms. Waters also asked a question, and it just hit my memory when she was asking, gave the example of a constituent coming to a bank having not-so-great credit history but being on time. I actually had a constituent who came and said she called up her bank; she has always been on time; and she is a good credit risk. And she said she hears all of this stuff going on, on TV. So she called up her specific bank and said hey, what are you going to do for me? Can you lower my rate or my length of my term of my contract or my mortgage and what have you? And of course, the bank basically hung up on her. But there is the rub, of course, is that we have a moral hazard here, is that those people who do everything right are the ones who have been penalized, and those people who extended themselves more than they ever should have are the ones who are being benefited here.

Changing the thought here for a second, looking at the Fed's balance sheet, it is extraordinary as you look over a 5-month period, I figure roughly in my head right here, roughly about 150 percent increase.

Mr. KOHN. More than that.

Mr. GARRETT. The same timeframe I am looking at, August 1st, you had $874 billion, and you go up to $2.1 trillion. So if you go back further, of course, it is larger. And that is extraordinary. And the question as to who is responsible and where—responsible as far as the end of the day for the liabilities on there versus the assets on there, and that goes to Mr. Paul's question and some other questions as well. GSE debt on the old balance sheet, prior to August 1st, you would see zero. On September—January 7th, it is up to $19 billion, and now has potential to go up to $600 billion, I think.

The question on the other side of the aisle, which is a legitimate one, was why did we—if you are able to basically, through that mechanism, I think you go through primary dealers in order to buy debt, basically buy assets, toxic assets, I don't know, but assets nonetheless, obviously the Fed has the ability to set up a mechanism to buy assets. Do they have the ability to set up a mechanism to buy toxic assets as well?

Mr. KOHN. No. Our ability to buy assets outright is very limited under the Federal Reserve Act. Basically, we can buy Treasury and agency assets. We can make loans against any collateral as long as we are collateralized to our satisfaction, but we cannot go out and simply buy assets if they are not agencies and Treasuries. We can simply—

Mr. GARRETT. Basically, you can do that, then, can't you? Simply set up a fictitious company and make loans to that company in order to buy those assets?

Mr. KOHN. We need to be—you, the Congress, has told us we should be collateralized and secured. And we take that very seriously. And that is what we are doing.

Mr. GARRETT. What is the collateral then under Maiden Lane Corporation and that situation?

Mr. KOHN. There were a variety of mortgages and other assets there. There was—

Mr. GARRETT. This could be collateral as well through—the assets that we would have bought through this program could have been collateralized here as well, could it not be considered adequate collateral?

Mr. KOHN. Right. I think what a system that looks like I hope will work is one like we are setting up to begin in early February, in which we are setting up a vehicle that can use Treasury capital to absorb the risk while the Federal Reserve—

Mr. GARRETT. I will ask you some of the details on that. I only have a second of time. When you do do those things going forward, will you have the requirements that are set forth in the chairman's bill here as far as all the other restrictions here that we are applying to Treasury on anything that the Fed—

Mr. KOHN. If funds from TARP are involved—

Mr. GARRETT. No. No. No. If the funds, just through the Fed, the activity of the Feds, with Fed dollars, will you apply the same restrictions that we wish to apply, at least the chairman wishes to apply, to the TARP dollars, will you apply them to—

Mr. KOHN. We have not in the past applied those sort of restrictions to ordinary well-collateralized loans from financial institutions and—

Mr. GARRETT. And I am not suggesting that you are, but you can see the distinction that some Members obviously make in this situation between restrictions that I think he is appropriately making here and that we don't have the control over.

The CHAIRMAN. If the gentleman will yield, I did say we are going to have a hearing on exactly that.

And I will say, maybe the Fed should volunteer, there were some restrictions I believe imposed on AIG when it was non-TARP; AIG, they did impose some restrictions in compensation I believe on AIG when it would still be the Fed. But the gentleman's general point is correct.

Next, we have the gentleman from California, Mr. Baca.

Mr. BACA. Thank you very much, Mr. Chairman. First of all, I appreciate the question that Mr. Clay asked, and hopefully, we can find a remedy for the devaluing of the 401(k) retirement plans because throughout all of our districts, people are asking what is happening and what can be done, so hopefully we will find some kind of a remedy.

But my question to note is that I notice that there is no one from the National Credit Union Association invited to testify here. But the credit unions in my district are telling me they can't access TARP funds, and they need assistance. The largest credit union in

my district, Arrowhead Credit Union, just closed four branches and reduced operating budget by 10 percent.

If you look at the original recovery bill language, Congress intended for credit unions to receive TARP funding and included them to be amongst the eligible institutions. Unfortunately, Secretary Paulson decided to take a different route.

Credit unions make a huge impact on our local communities and need all the tools we can get to help them afloat. My question would be, what can we be doing to help credit unions access TARP funds?

Mr. KOHN. I don't know what the particular restrictions are. I think it is difficult when you have essentially a cooperative institution. So, remember, the TARP funds are going in as preferred stock in publicly—

Mr. BACA. But remember that it was included in the original language. And Secretary Paulson decided to take a different route. So what can be done if it was supposed to be in there?

Mr. KOHN. I think we should be looking at that.

Mr. BACA. Will you look at it?

Mr. KOHN. Yes, with the Treasury Department.

Mr. BACA. And will you make sure that it is included in that?

Mr. KOHN. We need to talk to the Treasury Department that is in charge of the program.

Mr. BACA. I would appreciate that very much.

And what is the Federal Reserve doing to help credit unions? I would point out that they are statutorily prohibited from accepting outside forms or capital so they don't benefit at all from the Capital Infusion Program. So again, what is the Federal Reserve doing to help credit unions?

Mr. KOHN. They are eligible to borrow from the discount window if they hold, if they are subject to certain requirements, and I believe credit unions do borrow from the discount window. So to the extent that we have facilities that are open to depository institutions, they are open to credit unions on the same terms.

Mr. BACA. Do you know that they do? Or do you believe that they do?

Mr. KOHN. I will get back to you for certain, but I believe that they do.

Mr. BACA. I would like to get an answer on that.

Thank you very much.

I yield back the balance of my time, Mr. Chairman, and thank you.

The CHAIRMAN. We have seven members left for this first panel, so we are going to get to the second panel at 5 o'clock.

The next is Mr. Posey.

Mr. POSEY. Thank you, Mr. Chairman. Out of respect to your request to get to the second panel, I will accept your offer.

The CHAIRMAN. Thank you. I appreciate that. Thank you very much.

Then the next one is Mr. Paulsen.

Mr. PAULSEN. Thank you, Mr. Chairman. I will be brief.

Mr. Bovenzi, based on some of the testimony we have heard with Congress now encouraging banks to lend more freely through the capital infusions that have occurred, while at the same time, it

sounds like there are regulators that are, certainly through the FDIC and otherwise, that are urging them to be a little more cautious; is there any concern that banks are getting mixed signals here simply to shore up their balance sheets and hold onto the money? What assurances does Congress have or the taxpayers have that the money is actually going to make it out into the system?

Mr. BOVENZI. Banks have many objectives in what they are trying to achieve. And if we have, as a supervisor, a weak or a problem institution, there is going to be an expectation that they get themselves into a healthy state. But the vast majority of banks who are well capitalized can focus on lending activities with the new funds that they are getting. We have recently issued a letter to those institutions telling them that we expect them to be able to tell us how they are using the government programs to promote lending to creditworthy borrowers.

Mr. PAULSEN. Thank you, Mr. Chairman.

I know as we hear more stories of others lining up to access these funds, there will be a concern for those who do want to shore up their balance sheets.

And I yield back, Mr. Chairman.

The CHAIRMAN. I thank the gentleman.

And next, we have my colleague from Massachusetts, Mr. Lynch.

Mr. LYNCH. I will be brief, under the circumstances.

I do want to ask the witnesses, however, one of the concerns I have right now and one of the difficulties that we keep running into is the difficulties with the bond insurance companies. And looking forward, there is a sizable package that has been talked about in terms of a stimulus plan, and yet many of our municipalities are just hogtied right now because of the bond insurance situation. Either they don't have access or the premiums are 40 percent of what they normally should be.

Would you—and in many cases, they are going to be the ones to facilitate a lot of this stimulus going forward. Is there any way or would you recommend some type of assistance from TARP for some of our bond insurers to sort of, to unclog that system?

And I will yield back with the answer. Thank you.

Mr. KOHN. I think we ought to be taking a serious, and we are taking a serious, look at what will help unclog the municipal market. One possible route is through those insurers, but it is not the only route. And I think we need to just keep pursuing that because it is a serious problem. But I don't know if that particular way is the best way to do this.

Mr. BOVENZI. I have nothing to add.

Mr. LYNCH. I yield back. Thank you very much, Mr. Chairman.

Mr. CHAIRMAN. Thank you, Mr. Bovenzi. That does not always stop people from talking.

The gentleman from Illinois.

Mr. MANZULLO. Thank you, Mr. Chairman.

I, in my opening statement, talked about how nobody in the government is even thinking about how to solve the problem. What you are doing is not solving it. You are all assuming that at some time in the future, the economy is going to recover itself and that everybody will be in a position to pay back the banks.

Take a look at the Federal Reserve. Mr. Kohn your organization, agency, had the authority for years to govern instruments, to set underwriting standards. And you did nothing. You did very little.

In fact, when Dr. Bernanke was here in the middle of July, you said we did a top-to-bottom study of underwriting standards, and we are not going to require that you have to have proof of your employment before you can get a mortgage. Wow. That is astounding. He said, but that won't take place until October 1st of 2009. And that was a statement that sucked the oxygen out of the air. And you could have said, no more teasers, no more 2/28s, and the FDIC had the authority, the implicit authority, all along to step in immediately and to increase insurance at institutions. But the FDIC sat back, and a bunch of us were screaming, saying you have to get in there and plug the holes, and then the run came on the banks. And the two agencies that were in the best position to do something, anything, did nothing.

And now, you are back with all the answers again. We will just give $350 billion to Treasury. Let them come up—I hope that you guys stick around to listen to the second panel, to the people who are on the streets, people like Cynthia Blankenship, who was here a couple of months ago. You didn't mention once FAS 157 and the impact that has on community banks. Once they assign a mortgage and they agree to service the loan, did you know that market to marketing goes in even as to the servicing requirements and can suck up hundreds of thousands of dollars if not millions of dollars on their balance sheets? I don't know if you know that. No one seems to care. The Europeans solved market to marketing. They come up with their own way. What do we do? We do nothing. You fellows have no solutions. You just—a giant bridge, a financial bridge to nowhere, just assuming the economy is going to recover. My biggest city is at 12 percent unemployment. And you know what? It will probably get worse because very few people here have the answer. And the answer is simple. You have to get people starting to buy again. The homeowners are back. They are desperate. You can have all the fixes that you want on foreclosures and helping people up, but if people don't have jobs, it doesn't do any good. They will fall behind again, and what I propose is something so simple. You give a $5,000 voucher to anybody to wants to buy a new car, you go to the dealer, you can buy a brand new car for sometimes 25 percent off, money has always been out there. Did you ever ask the community bankers 2, 3 months ago if they had money for cars?

Mr. Kohn, did you do that?

Mr. KOHN. We talked to community bankers quite a bit about their needs and how they are making loans.

Mr. MANZULLO. Right. They have had money, haven't they?

Mr. KOHN. To some extent.

Mr. MANZULLO. Stick around for the second panel. They have always had money for those cars. And so have the credit unions. But you guys participated in the big scare going on around here. And we had people going into the car dealers back home saying we understand there is no money. And the Cynthia Blankenships out there and all these community bankers are just totally frustrated that the government steps in, that caused the problem, and now

you guys have the solutions that won't work. Why don't we do something very, very simple? Why don't you sit down and decide what can you do to get people to start buying more automobiles? Once that happens, the economy restarts itself. The community banks have money. Credit unions have banks. Local branches of national banks have always had money to loan. And I just don't understand it.

The CHAIRMAN. The gentleman's time has expired.

The gentleman from California, Mr. Sherman.

Mr. SHERMAN. Thank you.

Mr. Kohn, under the TARP program, it was allowed for companies who receive TARP funds to continue to pay dividends and to do stock repurchases. Can you think of any reason why the TARP program would have worked worse if we had prohibited basically taking the firm's extra money and giving it to the shareholders of the common stock rather than repay the TARP loans?

Mr. KOHN. Now the companies were prohibited from increasing their dividends with the TARP loans.

Mr. SHERMAN. And even that was not in the statute. It was a practice the Treasury usually followed. But what if there was an absolute prohibition on dividends and stock repurchases until such time as the Federal Government is repaid?

Mr. KOHN. I think what is critical here, Mr. Sherman, is to not only to make the government money available but to bring private money in as well.

Mr. SHERMAN. You could certainly exempt newly issued shares. But why should the people who bet on the bad management, who are holding shares, get our money before we get it back?

Mr. KOHN. And many of the banks that took the money weren't themselves troubled, but they were being strengthened so that they would be resilient against future trouble. The dividend of the regulators, the supervisors have dividend policies that need to be enforced. Banks shouldn't be paying out dividends from things that are not earning and particularly troubled institutions that come into the Federal Government and get—

Mr. SHERMAN. But, to interrupt, you seem to think it is necessary that we give our money to those who then turn it around and give it to their existing common shareholders in part to encourage people to take our money or because the common shareholders deserve dividends and stock repurchases before the American taxpayer should receive the money back?

Mr. KOHN. No, I don't think the common shareholders deserve that. I think the common shareholders don't deserve any more than the bank is able to earn on a sustainable basis. And banks shouldn't be taking taxpayer money and recycling it into dividends that they otherwise wouldn't pay. I agree with that.

Mr. SHERMAN. But if they are taking our money and not giving it back to us, should they be paying dividends?

Mr. KOHN. I think they need to look very carefully at how they can bolster their capital, raise their capital, and get out and repay the taxpayers as quickly as possible.

Mr. SHERMAN. Does paying dividends on existing common shares bolster capital or deplete capital?

Mr. KOHN. Taken alone, it wouldn't bolster capital.

Mr. SHERMAN. It would deplete capital, correct?

Mr. KOHN. But if it is part of a package that helps them raise capital—

Mr. SHERMAN. You could obviously issue a new class of common shares and pay dividends on that, or you could exercise the political power to squeeze money out of taxpayers and to deliver it to management and existing shareholders. They, obviously, have taken the latter course.

Likewise, we were told not to put really strict executive compensation limits in TARP and that maybe we were going too far with what I thought were extremely modest limits. Do you know of a single banking firm that turned down Federal dollars because they wouldn't live with whatever executive compensation limits there are in the existing TARP bill and program?

Mr. KOHN. I am not aware of any.

Mr. SHERMAN. So we could certainly go a little higher with the executive compensation limits since the ones already in place have not deterred a single dollar of TARP investment.

Mr. KOHN. Right.

Mr. SHERMAN. I would like to comment on what Mr. Manzullo said earlier, twofold. One, as to auto loans, the credit unions in my district say they have plenty of money except for the most marginal borrowers. And I don't think we are ever going to go back to the people who were barely able to get loans last year being able to get loans in the future.

The second thing I will point out is that the greatest failure was Wall Street as a unit gave triple-A to Alt-A. It is one thing to say well maybe people will tell you the truth when you ask them their income. But when you turn to people and say, it will cost you $300 on your mortgage not to document, and they choose not to document, you know you are making liars loans.

I yield back.

The CHAIRMAN. I thank the gentleman.

Let me ask unanimous consent to put into the record letters from a group of institutions about commercial lending; from several of our colleagues, Mr. Donnelly, Mr. Thompson, and Mr. Souder, about manufactured housing; and from the National Association of Federal Credit Unions and the Credit Union National Association supporting the inclusion of credit unions in TARP funding.

I ask unanimous consent that they be put in the record.

And the gentleman from North Carolina, I believe, is next.

Mr. MCHENRY. Thank you, Mr. Chairman.

And thank you all for your testimony today.

Mr. Bovenzi, we have had some evolution in the reasons for defaults and foreclosures. Initially, the reasons for the spike in foreclosure was pointed to ARMs. And that soon evolved, and we had negative equity as the next reason for foreclosures and defaults. But as this economy is weakened, and we have entered this recession, the reason now, as it has evolved, is high unemployment, people losing their jobs, which of course is sort of the historic reason for people losing their homes is because they have lost their jobs and they are not able to simply afford it.

How should the government address this? How should the government address these increases in defaults and foreclosures, and how does your program apply to this?

Mr. BOVENZI. I certainly agree that there has been an evolution in the reasons for default, and there are many different reasons for default. A loan modification program can address some of those reasons, but it can't address all of them. It would be one part of a package that has other measures as well. The loan modification proposals can help in situations where an individual's income has gone down, they are in a mortgage they can't afford, and they have gone into a default. It can be restructured at a lower interest rate in a monthly payment that they can afford and sustain, if indeed that gives a greater value than would be the case in foreclosure. In this kind of market, foreclosure results in an enormous cost on financial institutions. So, a great many mortgages can be modified successfully.

But you are right, it does not work in a situation where the borrower has no income because of unemployment. In this case, other measures are needed, generally some kind of fiscal stimulus to try to encourage job creation and employment.

Mr. MCHENRY. So do nothing for the unemployed, in essence?

Mr. BOVENZI. A loan modification program is not the right solution for somebody who has no income. We need other kinds of stimulus measures to create jobs.

Mr. MCHENRY. It is a solution they cannot simply access because they have no income. Is that fair to say?

Mr. BOVENZI. It is fair to say that loan modifications don't work successfully for all cases. But, they can work for a great many cases.

Mr. MCHENRY. In a recent OCC release of data, this last month it shows that after 6 months of these loan modifications, "they seem to not be working." After just after the first quarter of 2008, those numbers were released last month, and it shows that these modification programs are not working for a number of reasons, one of which is that the biggest problem is that the servicers aren't participating in the program. So how is your program going to really change that initial go at it and actually effectively get the servicers to participate?

Mr. BOVENZI. I would make a few points about that. Clearly, foreclosures are going up at a faster rate than loan modifications—

Mr. MCHENRY. You can give me a bunch of that. I don't have much time. Just cut to the chase.

Mr. BOVENZI. That is part of the reason why it is talked about as part of the TARP funding. I think the study you are referring to discusses re-default rates being high and talks about all kinds of loan modifications. Some of these may be very minor adjustments and payments to those like the IndyMac program the FDIC put in place, which lowers monthly payments enough to make them affordable and sustainable. Thus, the right kind of loan modification program can drastically lower re-default rates. That said, there will be re-defaults. Some people will go back into defaults.

Mr. MCHENRY. With all due respect, you still have not answered my question, and my time is limited here. How do you get servicers

to effectively participate in this program? Because the fact is, unless they participate, it is not going to get out to the market.

Mr. BOVENZI. I think you need to align incentives appropriately. In the programs we have had to date, we have worked to show how the modification will improve net present value, so it is in the interests of the investor and thus the servicer. Things that do help the servicer are cost intensive and align their financial incentives, which can be beneficial as well.

The CHAIRMAN. The gentleman from North Carolina.

Mr. MILLER OF NORTH CAROLINA. Thank you, Mr. Chairman.

I did not really intend to ask questions about what caused the subprime crisis or the Community Reinvestment Act, but I do want to address what Mr. Royce had to say earlier.

Mr. Kohn, the Federal Reserve Board recently published a study that 6 percent of the subprime loans in the 2004–2006 period were by CRA lenders, banks or thrifts with federally insured deposits in neighborhoods that were CRA assessment areas, the neighborhoods where CRA encouraged lending. Is that right, 6 percent?

Mr. KOHN. I think that is correct, Congressman.

Mr. MILLER OF NORTH CAROLINA. There was also a recent study by the Federal Reserve Board of San Francisco, I think, that compared CRA loans to loans by institutions not subject to the CRA, independent mortgage companies, Option One, New Century, Countrywide, in the very same neighborhoods that showed that CRA loans were performing substantially better, that the foreclosure rate was twice as high in those same neighborhoods for lenders not subject to CRA. Is that correct?

Mr. KOHN. I think it is correct that they weren't substantially worse. I am not sure they were substantially better. But there was no difference in similar loans made in and out of the CRA—

Mr. MILLER OF NORTH CAROLINA. I am talking about loans in the CRA assessment areas by CRA institutions and non-CRA institutions, the foreclosure rate was twice as high for the non-CRA institutions.

Mr. KOHN. I am not familiar with that result, but I am not entirely surprised in some of the non-CRA institutions where those—

Mr. MILLER OF NORTH CAROLINA. Chairman Bernanke and Governor Kroszner have both said that CRA has played no substantial role. Are you aware of any facts that support an argument that CRA played a substantial role that is not patently ridiculous?

Mr. KOHN. I think the thrust of all the studies that you cited and some others are that CRA did not play a substantial role in this.

Mr. MILLER OF NORTH CAROLINA. The questions I wanted to ask today are more about how this first $355 million has been spent. I don't expect perfection. I have a very realistic view of politics and government. I hold my nose a lot, as I did in October. But I do object to living in a kleptocracy. I am, Mr. Frank, Chairman Frank said he wanted, expected a substantial amount of the $350 billion to come back to us, to get it back. I don't want to get a substantial amount of it back; I want all of it back. And there is very little in the way it has been run that makes me think that is going to happen. You said we are getting preferred stock. The legislation also called for warrants.

Mr. KOHN. And we got warrants—

Mr. MILLER OF NORTH CAROLINA. I have a question about the warrants we got. There was an article in Bloomberg in the last week or two that said all 174 capital infusion agreements were identical; that we made a $10 billion capital infusion in Goldman Sachs in October. The month before that, Berkshire Hathaway, Warren Buffett, had made a capital infusion of half of that amount and got 4 times the warrants. And if we had gotten the same deal, we would have a 21 percent stake in Goldman Sachs, and instead, we have less than a 3 percent stake. If we had gotten the same deal for the top 25 institutions, we would have warrants worth, I think, about $130 billion. Instead, it is a little less than $14 billion. Do you know of an explanation for why we got such a bad deal?

Mr. KOHN. I think we got a pretty good deal, Congressman, and remembering that we were trying to encourage people to participate.

When Goldman went to Berkshire Hathaway, it needed that capital very badly because of the situation it was in. We were trying to encourage, to shore up the system, rather than individual banks, we were trying to encourage participation. If we make the conditions too stringent, we won't get the foreclosure mitigation. We won't get the credit flowing because people won't want to participate. So it is a difficult balancing act.

I agree the taxpayers should get some substantial reward for making the investment, but we don't want to discourage people from, discourage the banks from participating because it is that participation—

Mr. MILLER OF NORTH CAROLINA. Joseph Stiglitz, the Nobel Economic Laureate, said that the argument that we need to make it attractive to banks is code for giving the money away. It seems like if we are getting one-tenth of the upside potential, the warrants, that we have a lot of room for making it attractive to banks without—or making it something that they are willing to do and still protect borrowers, still protect taxpayers.

Mr. KOHN. As I say, I think we are trying to balance those factors.

The CHAIRMAN. The gentleman from Georgia, Mr. Scott.

Mr. SCOTT. Thank you very much Mr. Chairman. I would like to hit two issues right quick if I may.

First, let me ask you, Mr. Kohn, you are a vice chairman of the Federal Reserve system, and as such, let me put this question to you: Why not open up the Federal Reserve liquidity facilities to State and local debt securities, especially as we move to address the issue of stimulating this economy in the area of jobs? We have facilities, airports, infrastructures ready to move with shovel-ready operations. Why not open up the Federal Reserve liquidity?

Mr. KOHN. We are looking very carefully at whether there are ways that we, together with the Treasury perhaps, can open up that municipal market and make that credit flow. So that is under very serious consideration.

Mr. SCOTT. How serious, Mr. Kohn? Are you just saying that to me to give a nice response or—

Mr. KOHN. No.

Mr. SCOTT. This is a very, very serious critical situation we are in.

Mr. KOHN. I agree.

Mr. SCOTT. And the two most critical things we need to deal with are keeping people working and in their jobs and in their homes. Let me ask you this as a part of our bill that we have, are putting forward, that Chairman Frank is guiding us with, in section four, regarding municipal securities, it says that we wish to clarify Treasury's authority to provide support to issuers of municipal securities, including through the direct purchase of municipal securities or the provision of credit enhancements in connection with any Federal Reserve facility to finance the purchase of municipal securities.

Mr. KOHN. Right. So I think these are options that we should be looking at, particularly when the next $350 billion is available to the Treasury.

Mr. SCOTT. May I encourage you to make sure that we open up these Federal Reserve liquidity facilities to help facilitate this because there are projects to do that? Particularly help us stimulate the economy and create jobs.

The other issue, Mr. Bovenzi, I would like to talk with you. I am so afraid that we are going the make the same mistake that we made with this first $350 billion, unless we pass this measure that Chairman Frank has put forward. The biggest concern I have, I voted against the first bailout, the first time around. Chairman Frank asked us to go and put a plan together to address my major concern, which was we didn't do anything to help with this foreclosure crisis. We have in this legislation, in title II, the TARP foreclosure mitigation plan.

Mr. Bovenzi, the FDIC is going to be very instrumental in carrying this out. I want to get your response to this plan of taking up to $100 billion—we haven't put that figure; we are saying no less than $40 billion, no more than $100 billion. My hope is that we get it closer to the $100 billion level because it is about time that we try to get some money into the mainstream, into the average American's hands, that will help them where they need the help most. We have already given it to the banks. And we are going to give them more. But I am concerned that unless we get it in writing, it won't happen.

I was on the Floor trying to work on this bill the last time. They said we couldn't even put—the very same thing we are trying to do now in Mr. Frank's bill was what we were trying to do then, and they said we couldn't write it. We couldn't put it in. Now we have it. And I want to get your response because we have some deadlines in here and some date requirements, that not only did we put that in, that we have the plan in place by March 15th, that you have a plan that the Treasury and the FDIC have a plan in place by March 15th; that it gets approval by the first of April; and that the funds are committed, began being committed, by May 15th.

Can you give me your assessment on this? Is this agreeable with the FDIC?

Mr. BOVENZI. From the FDIC's point of view, we have put forward a plan. We recognize that it is not the only plan. There can be variations that can work as well, and we are willing to work with the new Administration and Treasury to finalize a specific

plan to get in place within those kinds of timeframes. The FDIC is ready to work with the appropriate parties to try to get such a plan in place.

The CHAIRMAN. Remaining, now we have some of the freshmen members who will go in order, through the first and second panel.

Mr. Grayson.

Mr. GRAYSON. Mr. Bovenzi, you mentioned several times today in your testimony the importance of transparency. Can you explain why that is important? .

Mr. BOVENZI. I think the committee has talked about that several times. It wants to see a strategy for how money is being spent, understand how it is being spent, and have reporting back from institutions to indicate whether it is being used for the purposes desired. In order to give assurances to Congress and to American taxpayers that it is being used for appropriate purposes, we want greater transparency and accountability.

Mr. GRAYSON. Is it fair to say that when hundreds of billions of dollars of the taxpayers' money is being spent, the taxpayers have a right to know how?

Mr. BOVENZI. Yes.

Mr. GRAYSON. Mr. Kohn, how much has the balance sheet of the Federal Reserve increased since September 1st?

Mr. KOHN. It has increased from around $800 billion to about $2 trillion.

Mr. GRAYSON. And what was that money spent on?

Mr. KOHN. That money was lent. It was lent to banks, investment banks. It was spent on lending through the commercial paper market. And it was lent to foreign central banks that lent dollars to their banks to take pressure off the U.S. dollar market. So it wasn't spent. It was lent.

Mr. GRAYSON. Which institutions received it, and how much for each institution?

Mr. KOHN. I don't know which institutions, which specific institutions received it, but, by categories of institutions, that is captured in our balance sheet that we publish each week.

The CHAIRMAN. We would like that in writing, Mr. Kohn, for the hearing record.

Mr. KOHN. I am sorry, what in writing, Mr. Chairman?

The CHAIRMAN. The answer that you didn't have right off the top of your head to that question.

Mr. KOHN. But I think I would, you are going to hold a hearing on this, Mr. Chairman, and I think I would be very, very hesitant to give the names of individual institutions. In fact, I think it would be a very bad idea because I think it would undermine the utility of the facilities that we are giving. But I think we should say more about the categories of the institutions.

Mr. GRAYSON. Mr. Kohn, you just said that $1.2 trillion has been lent or spent, as the case may be, that is $4,000 for every man, woman, and child in this country. Don't Americans have the right to know how you spent that money?

Mr. KOHN. Yes, they have every right to know the purposes for which we spent it, the types of spending, the types of lending that is going on, how, the types of collateral we are taking and what we expect to accomplish with that.

Mr. GRAYSON. Specifically, I would like to know how much was given to Credit Suisse, and how much you go in return; how much was given to Citibank, and what you got in return. If you put out $50 billion to Credit Suisse, the taxpayers need to know about it.

Mr. KOHN. I would be very concerned Congressman that if we published the individual names of who was borrowing from us, no one would borrow from us. The purpose of our borrowing is not to support individual institutions but to support the credit markets.

Mr. GRAYSON. Has that ever happened? Have people ever said, we will not take your $100 billion because people will find out about it?

Mr. KOHN. We have never—we have always said we will not publish the names of the borrowers so we have no test of that.

Mr. GRAYSON. What gave you the authority to say that? Isn't that something that we should be deciding, not you?

Mr. KOHN. I think you gave us the responsibility in the Federal Reserve Act to oversee the stability of the financial system through our lending facilities to be the lender of last resort, and we are trying to execute that to the best of our abilities.

Mr. GRAYSON. And you are saying that entitles you to keep secret the expenditure of $1.2 trillion, $4,000 for every man, women, and child in this country?

Mr. KOHN. I don't think we are keeping it secret. I think we are releasing a lot of information about it, but I would personally—I would personally be very, very reluctant to release the individual names of the borrowers.

Mr. GRAYSON. What do you think might happen if people knew how their $1.2 trillion had been spent? Do you think they might be angry?

Mr. KOHN. No. I don't know, obviously. I think that they can judge how the money is spent from what, how the money is lent from what we are telling them and whether it is having an effect. And I think it is having a positive effect in a number of markets. We have seen the commercial paper market, interbank market, etc., so I think it has been effective. But we need to do more.

Mr. GRAYSON. Mr. Kohn, we are talking about secret payments of $1.2 trillion. I think you need to rethink your approach here. By the way, were these assets mark-to-market?

Mr. KOHN. Some of them were. Some of them were loans.

Mr. GRAYSON. Why not mark these assets to market and let people know the current value of this $1.2 trillion that you have spent?

Mr. KOHN. The ones that have market values are marked to market.

Mr. GRAYSON. So how much of them don't have market values? How much of them are worthless?

Mr. KOHN. None are worthless.

Mr. GRAYSON. Then why don't you mark them to market?

Mr. KOHN. We are marking the ones—we are marking the ones to market that have market values.

Mr. GRAYSON. My time is up. Thank you.

The CHAIRMAN. As I said earlier, this is for people to understand, this goes under, the authorities, as I understand, came from a statute passed in the Depression. It was fairly dormant, at least as we

knew it, for a while. We were told in September, Mr. Bernanke summoned a meeting of the congressional leadership committee as well and announced to us with Mr. Paulson in September that they were going to advance $80 billion to AIG. I said, somewhat surprised, to the Chairman of the Federal Reserve, do you have $80 billion? He said, I have $800 billion. He obviously was low-balling what he had. Maybe he made some money in the future. That was in September. I don't think the program has been active before. Clearly, a lot has happened, and as I announced earlier, I spoke to the Chairman last week. We have a hearing that we are setting up. Mr. Bernanke will be up here, and we will be having a hearing specifically on this program, and I say that the question the gentleman raised is a question we will be considering. And I think, at an appropriate time, we will be looking at that statute. I think this is probably not the time with turmoil in the market to be amending it. But the subject the gentleman raised will be the subject of an entire hearing in February.

The gentleman from Connecticut, this panel or the next one.

Mr. HIMES. Thank you, Mr. Chairman.

I have a question directed to Mr. Kohn. I read with interest and heard with interest your testimony that the Treasury may consider methods to reduce the uncertainty about the value of assets held by financial institutions. This objective could be accomplished in several ways, including by directly purchasing troubled assets. I note no irony in that considering the way the TARP was initially set up and designed to do.

But my question is—I am concerned by the fact that we have taken limited or no steps to date to truly separate troubled assets from the balance sheets of our financial institutions. So my question is twofold: one, do you believe that we will achieve stability in the banking sector without separating those assets from the balance sheets of our financial institutions; and two, you outlined two methods by which that might be accomplished, but you are silent on whether there might be a market-oriented method. Have we reached a level of stability where we might count on market players to both value and purchase in quantity those troubled assets?

Mr. KOHN. Right. I think purchasing or isolating the downside risk of those troubled assets from the banks would be an important aspect to stabilizing the banking system, restoring confidence, and bringing private capital back in. I don't know exactly how to do it. I think there are, as I noted, a variety of ways to do it, including keeping them on the balance sheet but writing an insurance policy against really adverse consequences for the banks.

I think valuing the assets is very difficult. To the extent that they have markets and are at market value, I think that ought to be the default of the value they would be purchased at by the government or by the special bank or the insurance. I think the other assets are the loan assets, which aren't on the market, have reserves against them, and that ought to be taken into account. And they are much more difficult to value. But—

Mr. HIMES. But do you believe that we have reached a point of stability that we could count on the distressed debt players and other market entities to actually purchase the bulk of these distressed assets, or do we need to look to a government solution?

Mr. KOHN. I think the government probably still, unfortunately, needs to be part of the solution. I don't think we are yet at a place where the private sector is ready to come in and start buying those distressed assets. I don't think—we hear a lot about money on the sidelines waiting to come in. But through this whole crisis over the last 18 months it has come in from time to time, and then the crisis has gotten worse. And I think people are still very, very concerned about that. I wish that were not the case, but I am afraid it is.

Mr. HIMES. Okay. One other question to either of you, Mr. Kohn or Mr. Bovenzi, the chairman's bill contains at great long last a provision for a national program for foreclosure relief. We don't hear much, nor do we see much, about the nonmortgage debt that American households are carrying. Are we going to hear more about that?

And should Congress right now be thinking about programs or other measures we might take to relieve American households from nonmortgage debt, a very substantial amount of nonmortgage debt that they carry? Do you see that as a risk and therefore something that we should be addressing?

Mr. BOVENZI. I think Vice Chairman Kohn has talked about some of the Federal Reserve programs to try to help in some of these other areas of consumer credit and free up securitization markets. That is a very positive step.

Mr. KOHN. The most important thing we could do is get that credit flowing again to households, to consumers; and we are looking at a variety of ways to do that.

Mr. HIMES. Thank you. I yield back the balance of my time.

The CHAIRMAN. Mr. Peters, this panel or the next one?

Mr. PETERS. This panel, please.

The CHAIRMAN. Go ahead.

Let me say, when Mr. Peters is finished, we are through with this panel. I will ask people to leave quickly, and we will seat the new panel.

Because I have to go to the Rules Committee, we will take 5 minutes. We want to hear from you. Don't thank us. Don't tell us how wonderful your organization is. Don't tell us what we already know. Get right to the point, because we don't have a lot of time.

The gentleman from Pennsylvania will take over for me, and I hope he will be very rude.

Mr. PETERS. I will be very brief. Many of my questions have already been answered.

I will be fairly brief, because I have been hearing from my community bankers. We have heard much about community bankers here but in particular in Michigan, being a very hard-hit area with the auto industry. In fact, there was a front-page story in Crain's Detroit Business just a few days ago which was headlined: "Michigan Banks are Getting the Short End of TARP." In fact, I will put this in the record but read a few parts of it.

With the deadline of the Federal approval fast approaching, a summary of Michigan banks that have received funding from the U.S. Treasury as part of TARP is getting the short end. In fact, in the first round of TARP, according to the figures here in this article, only two of the banks of the 208 banks nationwide that re-

ceived money were in Michigan, and none in southeast Michigan, which works out to about 2/10ths of 1 percent of the TARP funds, which is a figure that is easily surpassed by Puerto Rico right now for us in Michigan.

According to the article, many large and regional banks have branches in Michigan that have been approved, but analysts expect lending in the State based on TARP money to be extremely limited. In fact, our community bankers have gone so far as to say Michigan is currently being red-lined as a result of the troubles in the auto industry and the fact that the economic troubles in the State have gone on much longer than other parts of the country.

So I would like to have you comment on that and any advice you have of what we need do in this TARP to make sure that particularly hard-hit areas like Michigan get the help they need.

I will quote from the article, though, a regulator who is quoted here, before you answer, the regulators aren't going to talk about it. What they are going to say is—I know this because I was a regulator—we treat all our children the same. We apply the metrics fairly. It is the same old baloney.

The truth is, I don't hold out much hope for our community banks getting much TARP money because of the auto crisis. The regulators won't say it publicly, but they are saying it privately, and I know they are. How would you respond to that and what should we be doing?

Mr. BOVENZI. It is certainly a concern that community banks have not received the same participation in the Capital Purchase Program to date. When the program started out, it focused on publicly traded companies, but it is evolving to cover all institutions, including small community banks. However, there have been a few complications along the way.

Many small community banks are Subchapter S corporations, which take a different type of capital investment. Also, mutual ownership creates other complications. Those are things that we are working with the Treasury to resolve so we can have greater participation by smaller institutions in the Capital Purchase Program.

Mr. PETERS. How about specifically in Michigan? Do you see there is a problem with the fact that only two banks have received any funding out of TARP in the State of Michigan?

Mr. BOVENZI. That certainly seems like a concern that there are only two banks there. I am sure there are other States where participation has not been to the extent that perhaps it should be. So, we are trying to broaden the program as soon as possible.

Mr. PETERS. And if we can keep close tabs on that, I would like to have further conversations with you.

And, finally, the one last point, too, which is very important for us in Michigan in the auto industry and moving to sell automobiles, we know that stimulating consumer demand is very important. One step that would help is have the FDIC approve some pending applications for both Ford and Chrysler that would allow their financial ARMs to become ILCs. If you could comment on what is holding this application up at the FDIC.

Mr. BOVENZI. There are a number of applications at the FDIC that are still under review, including those. We have received ques-

tions in a number of situations asking if the process is getting slower and when decisions are going to be made. A number of applications have been approved for new bank charters, and there are still many we are looking at.

Market conditions have gotten tougher, so we are taking a more careful look at applications. But, we are trying to be as responsive as possible. We will try to get back to people as soon as possible on specific applications.

Mr. PETERS. But would you agree that providing this for Chrysler and Ford, knowing that money would be put in the hands of consumers almost immediately to purchase the automobiles and get the economy moving?

Mr. BOVENZI. I don't really want to comment on an individual application. My comments were meant to be more general about the process.

Mr. PETERS. Okay. Thank you.

Mr. KANJORSKI. [presiding]. Thank you very much, gentlemen. Thank you very much. And in accordance with Mr. Frank's instructions, good-bye. Thank you.

Will the next panel please be seated?

We are going to have Ms. Janet Murguia, president and chief executive officer, National Council of La Raza; Mr. John Taylor, president and chief executive officer, National Community Reinvestment Coalition; Mr. Edward L. Yingling, president and chief executive officer, American Bankers Association; Ms. Cynthia Blankenship, vice chairman and chief operating officer, Bank of the West, on behalf of the Independent Community Bankers of America; Mr. Joe Robson, chairman-elect of the board, National Association of Home Builders; Mr. Charles McMillan, 2009 president of National Association of Realtors; Mr. Michael Calhoun, president and chief operating officer, Center for Responsible Lending; and finally, Mr. Chris Mayer, senior vice dean and Paul Milstein Professor of Real Estate, Columbia Business School.

Ms. Murguia?

STATEMENT OF JANET MURGUIA, PRESIDENT AND CHIEF EXECUTIVE OFFICER, NATIONAL COUNCIL OF LA RAZA (NCLR)

Ms. MURGUIA. Thank you.

Good afternoon, everyone. My name is Janet Murguia, and I am president and CEO of the National Council of La Raza. NCLR has been very committed to improving the life opportunities of the Nation's 44 million Latinos for the last 4 decades. It is our 40th anniversary. Thank you all for bringing attention to this very important issue.

The Pew Hispanic Center released a report this week that nearly one in ten Latino homeowners missed a mortgage payment last year. One in six say there have been homes foreclosed on in their neighborhood. These are staggering figures that call for a very bold response.

When Congress approved $700 billion in recovery funds last year, it was definitely a bold move. Unfortunately, TARP has not lived up to expectations. With more than half the funds committed, millions of homeowners have been left out. It is time for Congress and the Administration to apply the same boldness to struggling fami-

lies. Unless we intervene, millions will lose their home and their financial safety net.

My written statement makes the case for a national foreclosure strategy. It describes how TARP has fallen short and shares recommendations.

In my brief time today, I just want to share with you a couple of stories of families impacted by the foreclosure crisis. I testified early last year that 2009 and 2010 would be the peak years for foreclosures in the Hispanic community. Now that 2009 is upon us, I am sincerely concerned that a significant number of our community will lose their homes.

The situation facing Latino families has become infinitely more complicated. Not only are their loans unaffordable, they are losing their jobs, their home values are plummeting, and the cost of daily expenses are going up every day. Meanwhile, their chances of getting help have not improved. Servicers are still taking months to approve modifications. They routinely offer workouts that are simply unaffordable.

One of our counselors in Los Angeles has been working to secure a modification for a family who had their work hours cut, but they have been getting the runaround since October. This week, the servicer told them they could not approve any workouts until their own merger is complete.

In Detroit, a counselor had to get the State Attorney General involved to save her elderly client's home from foreclosure. The modification requested was working its way through the proper channels. However, the servicer sent the file to foreclosure before a determination could be made.

There are stories like this one after the other. Making matters even worse, families in the position to purchase are being shut out. So we are getting hit on both sides. Access to lending is not happening.

In Phoenix, one of our counselors was approached by a local judge who wanted to refinance his home. He owes less than 80 percent of his mortgage, has excellent credit, and has never missed a payment. Despite being a great candidate, he still can't get a loan.

TARP had two key goals that could have helped the Hispanic community: reduce foreclosures; and increase lending activity. From where we stand, working with hundreds of thousands of families every day, TARP has failed these goals. Period.

We are also deeply troubled that there has been no public disclosure of how TARP money is being spent. We must have more accountability.

We are in dire need of a national foreclosure prevention and recovery strategy. The impact of TARP's shortcomings falls squarely on the shoulders of hardworking families. Before approving any additional funding, Treasury and Congress must ask how recipients will ease the impact and burden of foreclosures.

NCLR makes three simple recommendations: First, require Treasury to implement a systemic loan modification program. NCLR has long supported the FDIC approach. Second, require banks to use a portion of TARP funds to increasing lending to communities. And third, report the uses and impact of TARP funds on a quarterly basis.

All of these are reflected in Chairman Frank's legislation that addresses them quite straightforwardly. The bill mandates a foreclosure prevention program and gives Treasury several models to choose from. It includes incentives to jump-start lending and requires key public disclosures.

NCLR strongly supports the minimum $40 billion targeted for modifications, which represent a mere fraction of the investment made in private institutions overall. We won't be able to get our economy back on track until we get average families in a position to pay their mortgages. It is that simple. We look forward to working with all of you toward that goal, and we endorse Congressman Frank's legislation.

I would be happy to answer any questions. Thank you.

[The prepared statement of Ms. Murguia can be found on page 160 of the appendix.]

Mr. KANJORSKI. Thank you, Ms. Murguia.

Mr. Taylor?

STATEMENT OF JOHN TAYLOR, PRESIDENT & CHIEF EXECUTIVE OFFICER, NATIONAL COMMUNITY REINVESTMENT COALITION (NCRC)

Mr. TAYLOR. Yes. Thank you.

Honoring the chairman's request, I am going to skip the amenities and the information about NCRC except to say I am John Taylor from—

Mr. KANJORSKI. We love you all.

Mr. TAYLOR. Wonderful. But I wasn't going to—okay.

First, we think additional TARP funds should be prioritized in the most effective manner that serves homeowners and stems the foreclosure crisis.

NCRC is also pleased that the chairman's TARP reform bill provides significant financing of up to a hundred billion dollars for foreclosure mitigation, addresses many of the barriers frustrating loan modifications, and institutes reforms in the Federal Housing Administration's HOPE for Homeowners Program.

NCRC recommends that a significant portion of the remaining TARP funds be used to address the foreclosure crisis. Financial markets will not stabilize and the economy will not rebound until the foreclosure crisis is addressed by the implementation of a large-scale loan modification program.

Moreover, substantial intervention is necessary to respond to the contagion effects of the foreclosure crisis. Failure to address mounting foreclosures continues to drive home prices down, which results in a wider range of problems for the financial system and the overall economy. Thus, NCRC recommends the investment of the remaining TARP funds in an economic recovery program that promotes infrastructure projects and small business and micro-enterprises that create jobs and rebuilds communities.

Finally, considering the magnitude of the current financial crisis and its potential long-lasting effects, immediate action is needed to address the problems that caused this crisis, which are unfair and deceptive practices that led to the undermining of the national economy. I will begin with the need to use TARP funds to address foreclosures.

To date, TARP funds have been spent on efforts that have only marginally contributed to the stabilization of the financial system. The first $350 billion were used to inject liquidity into the markets through cash investments into financial institutions and emergency loans to the automotive industry. However, the financial markets remain unstable, as preventable foreclosures continue to weaken the national economy and devastate local communities. Recently, the second report of the oversight panel criticized the U.S. Treasury Department for failing to use any of the first $350 billion to mitigate the foreclosure crisis.

Moreover, as detailed in our written testimony, while helpful, Federal programs and voluntary efforts to stem the foreclosure crisis do not address the breadth and the depth of arresting this crisis. Immediate solutions are needed to restore the health of our financial system and overall economy. Therefore, NCRC recommends that a significant portion of the remaining TARP funds be invested in a large-scale loan modification program that will assist homeowners.

In January 2008, NCRC proposed the establishment of a national loan modification program called the Homeowners Emergency Loan Program, or HELP Now. NCRC believes that HELP Now is the type of loan modification program needed to address the magnitude of the current crisis. It would authorize the Treasury Department to buy troubled loans at steep discounts, equal roughly to the current write-downs by financial institutions from securitized pools. This will result in a relatively low cost to taxpayers. The government would then arrange for these loans to be modified through existing entities and sell the modified loans back to the private market.

It should be noted that a number of legal scholars have suggested that there are legal impediments regarding the complexity of selling loans held in securitized pools. Further, we all now know voluntary actions on the part of investors and servicers have proved minimally successful. Therefore, NCRC recommends the alternative approach of using eminent domain with the HELP Now proposal to immediately purchase these loans from investors and servicers.

The current economic crisis would justify the government's use of eminent domain laws for a compelling public purpose.

In addition, eminent domain would overcome several barriers. Through compulsory purchases of troubled loans, reluctant servicers, investors, and lenders would not need to be persuaded to participate.

In addition, as a supplement to a loan modification program such as a HELP Now, judicial loan modification should be strongly considered. Judicial loan modification would assist borrowers facing foreclosures that a TARP program may not reach because of the scale of the crisis. Allowing struggling borrowers to access bankruptcy protection would enable up to 600,000 families to seek immediate help to avoid foreclosure, again at no cost to the taxpayer.

In addition, included in this effort should be funds to support Legal Service attorneys to represent borrowers of modest means. This would ensure that modifications are adhered to and redefaults minimized.

Recently—I will skip this piece here.

While a loan modification program such as HELP Now would help stabilize the U.S. economy, substantial intervention is necessary to respond to the contagion effects of the current crisis. NCRC believes that economic recovery programs that promote infrastructure projects, and small business and micro-enterprises that create jobs are essential to rebuilding communities.

Mr. Chairman, I see that my time is up, so I want to simply ask that I be allowed to also enter into testimony two statements, one from the Association for Enterprise Opportunity, which represents micro-enterprise organizations, to speak about their perspective on use of TARP funds, and also from another NCRC member, an organization in St. Louis that deals with fair housing matters, and to submit that to give you a local perspective of use of TARP funds.

Thank you very much, sir.

Mr. KANJORSKI. Without objection, it is so ordered.

[The prepared statement and attachments of Mr. Taylor can be found on page 182 of the appendix.]

Mr. KANJORSKI. Mr. Yingling, you are recognized for 5 minutes.

STATEMENT OF EDWARD L. YINGLING, PRESIDENT AND CHIEF EXECUTIVE OFFICER, AMERICAN BANKERS ASSOCIATION (ABA)

Mr. YINGLING. I am pleased to testify on behalf of the ABA on the future of TARP.

The ABA sees this hearing and the legislation that is being proposed as an opportunity for a new beginning. Everyone is frustrated about the current confused situation. The public, the Congress, and I can assure you traditional banks, are all frustrated. Strongly capitalized banks that never made one subprime loan and that are the foundation for an economic recovery find themselves lumped together with failing institutions and even institutions that helped cause this crisis. We are committed to work with this committee to clarify once and for all the purpose of the Capital Purchase Program, to target remaining TARP money to where it will do the most good and to provide the transparency needed to restore public confidence.

As our written testimony shows, the nonbank credit markets are not working. All roads point to traditional regulated FDIC-insured banking as the foundation for a solid recovery through the expansion of bank lending and, as the chairman has stated, through applying bank-like regulations to other sectors of the financial services industry. It is time to put together a plan that will get the job done and that has the clarity to restore public confidence. In that regard, ABA has four recommendations.

First, the confusion should be addressed. The various components of TARP should be clearly separated within the overall TARP program. For example, the Capital Purchase Program for healthy banks should be separated from the program to support failing institutions. These are different programs, with different goals, with different costs and require different policies. Unless the programs are more carefully defined, Congress cannot do its job of setting policy, having effective oversight, and measuring costs and results.

The bank Capital Purchase Program, or CPP, is now constantly confused with other uses of TARP, such as the use of funds to support automobile companies, yet they are different and in many ways opposites. The CPP is only for healthy banks, not for troubled institutions. The CPP was not sought by the FDIC-insured banking industry, while troubled institutions have sought TARP help. The CPP is designed to enable the banking industry to be a strong source of credit going forward when other sources, such as securitization, have closed down. And, finally, there is little doubt the government will make billions of dollars on the CPP, while investments in troubled institutions might in some cases cost the government billions. I reiterate that the CPP is very different from programs designed to help troubled institutions.

Our second recommendation is that the original $250 billion allocated to the CPP be made available and made available equally to all FDIC-insured banks. We are not asking for additional funding for the CPP, just that the original program be fulfilled. As it stands, the current $250 billion allocation has in effect been overpromised. In addition, thousands of banks are not currently even eligible to subscribe solely because of their ownership structure. This is unfair to those banks, but, most importantly, it is unfair to their communities, which will not have the same opportunities to have credit made available. For example, many New England communities are served primarily by mutual institutions, and yet mutuals are not yet eligible for CPP funding. I do note that the Treasury today announced that it is going to make the program available to Subchapter S banks, and that will be a big help.

Our third recommendation is that some TARP funds be allocated for foreclosure prevention. The housing crisis is still central to our economic problems, and foreclosures are devastating families and communities. We support using the FDIC proposal as a base, and we have put together a group of experts to provide information to the Congress and the FDIC to make it work.

Our final recommendation is that the Congress, the new Administration, and the regulators adopt a consistent approach to our industry. We recognize this is not easy. There is an inherent conflict in difficult economic times between lending more to help our communities and making sure lending decisions are prudent. However, banks are now constantly pushed and pulled, encouraged to take CPP capital to support lending, and virtually simultaneously told by regulators to build extra capital and tighten lending policies. It is a tough balance, but our government needs to do better.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Yingling can be found on page 200 of the appendix.]

Mr. KANJORSKI. Thank you very much, Mr. Yingling.

Ms. Blankenship?

STATEMENT OF CYNTHIA BLANKENSHIP, VICE CHAIRMAN AND CHIEF OPERATING OFFICER, BANK OF THE WEST, ON BEHALF OF THE INDEPENDENT COMMUNITY BANKERS OF AMERICA (ICBA)

Ms. BLANKENSHIP. Yes. I am Cynthia Blankenship, chief operating officer and vice chairman of the Bank of the West in Grape-

vine, Texas. I am also the chairman of the Independent Community Bankers Association that represents only community banks and has approximately 5,000 members.

My testimony includes recommendations for changes in the TARP and the deposit insurance system. We applaud the chairman for addressing many of these issues by introducing the TARP Reform and Accountability Act of 2009, and ICBA urges its swift passage.

I want to emphasize at the outset that community banks had no role in creating the financial problems we are addressing today. They did not engage in irresponsible subprime lending and have remained strongly capitalized. As a result, we are well positioned to drive economic recovery in our communities. That is why we are pleased that H.R. 384 directs the Treasury to quickly provide the TARP funds for all sizes of institutions, including Subchapter S banks like my bank and mutual banks.

Mutual banks still represent about 10 percent of the banks nationwide. The Treasury's term sheets released so far do not work for these institutions. And, as Mr. Yingling addressed, we understand that there will be a term sheet for Sub S published tomorrow, but still we have nothing for the mutual banks.

Those banks play a vital role in their communities, particularly in the New England States, where they are the predominant small business lenders. While the vast majority of community banks generally have enough capital to serve their current customers, additional capital from the CPP for interested banks would help them serve additional consumers and businesses. We urge Treasury to act quickly to include all banks in the CPP.

Additionally, we suggest that a representative of the Community Banking sector be appointed to the TARP oversight board to ensure that community banks have equal access to TARP programs. The TARP programs are not enough. ICBA is hearing from community bankers across the country about the overzealous and unduly overreaching examiners. They are in some cases second-guessing bankers and professional independent appraisers, demanding overly aggressive write-downs and reclassifications of viable commercial real estate and other assets. This will lead to a contraction in credit. Community bankers avoid making good loans for fear of examiner criticism. Therefore, we recommend that bank regulatory agencies adopt a more flexible and reasonable examination policy, particularly with respect to real estate lending so that community banks can meet their community credit needs.

The chairman's proposal changing the government foreclosure mitigation efforts will also benefit hard-hit communities. H.R. 384 makes changes to the HOPE for Homeowners Program and directs the Treasury to use TARP funds for foreclosure mitigation, which should significantly enhance these efforts.

ICBA is also pleased that H.R. 384 addresses key deposit insurance issues. Congress and the FDIC must deal with expiring deposit insurance and glaring inequities in the deposit insurance system so community banks will have continued access to local deposits, which are their main source of lendable funds. The bill makes permanent the increase in deposit insurance coverage from $100,000 to $250,000.

ICBA also supports making permanent the temporary full coverage of transaction accounts. Both of these programs are vital confidence-building measures in our communities.

ICBA applauds the chairman for including a provision to give the banking industry more time to recapitalize the FDIC Deposit Insurance Fund, an idea the ICBA has strongly advocated.

Even with these improvements, glaring inequities remain. The "too-big-to-fail" institutions have a deposit insurance product that is far better than traditional FDIC insurance, 100 percent coverage for all liabilities. Congress should direct the FDIC to assess special premiums on these banks that are so interconnected with the financial system that the government will not allow them to fail.

Unfortunately, short-term crisis management last fall led to the creation of even larger institutions. To prevent a recurrence, Congress should break up the systemic risk institutions or require them to divest sufficient assets so they no longer pose a significant risk to our economy.

Mr. Chairman, ICBA again commends you and your colleagues for working swiftly to address the pressing issues of the TARP and deposit insurance. We appreciate the opportunity and look forward to working with you on the many services you will be dealing with.

[The prepared statement of Ms. Blankenship can be found on page 90 of the appendix.]

Mr. KANJORSKI. Thank you, Ms. Blankenship.

And now, we will hear from Mr. Robson.

STATEMENT OF JOE R. ROBSON, 2008 CHAIRMAN-ELECT OF THE BOARD, NATIONAL ASSOCIATION OF HOME BUILDERS (NAHB)

Mr. ROBSON. Yes. I thank you for the opportunity to testify today.

The National Association of Home Builders was a strong supporter of EESA and the underlying TARP program. Unfortunately, while the stated intent of the legislation was expanding the flow of credit to consumers and businesses on competitive terms, the home building industry continues to experience severe credit problems. Additionally, the TARP program does not adequately respond to the Nation's foreclosure crisis, which must be addressed to keep people in their homes, stabilize home prices, and promote recovery of the economy.

NAHB supports the foreclosure mitigation proposal put forward by the FDIC and supports the use of TARP funds to address such mitigation efforts. The plan is a creative approach to loan modification. It contains features including risk sharing with current mortgage holders and enhanced compensation for servicers that will facilitate a systematic process to rework the terms on troubled loans. NAHB believes this approach can produce a significant reduction in impending foreclosures.

NAHB finds it disturbing that banks that have received TARP funds have not used the resources to expand credit liquidity. For the home building industry, the dramatic deterioration in credit availability has severely impacted the acquisition, development, and construction credit market. Home builders are having extreme difficulty in obtaining credit for viable projects. Builders with out-

standing construction and development loans are experiencing intense pressures as the result of requirements for significant additional equity, denials on loan extensions, and demands for immediate repayment. In short, the credit window has slammed shut for builders all over the country.

NAHB urges the committee to encourage regulators and lenders to give leeway to residential construction borrowers who have loans in good standing by providing flexibility on reappraisals and forbearance on loans to give builders time to complete their projects.

NAHB believes that lending institutions receiving TARP funds should be accountable for the use of those funds. NAHB applauds the chairman for including provisions for reporting, monitoring, and accountability within H.R. 384. Such scrutiny should focus on assessing how TARP funds are used to support lending, as well as how resources are employed to support efforts to work with existing borrowers to work out loans and avoid foreclosures.

The FDIC has just issued a letter to financial institutions it oversees to require documentation of the use of TARP funds. NAHB urges the other banking regulators to take similar steps to incorporate monitoring of TARP fund use in their supervisory systems.

Policy efforts must also address the issue of housing demand. Falling home values are at the core of the economic crisis, driven by a record high supply of existing homes. Congress must pass temporary and targeted incentives to encourage Americans to buy homes if we are to stabilize the home prices, home values, and market overall.

To bring consumers back to the market, reduce inventories of unsold homes, and stabilize home values, NAHB is advocating for a temporary program to strengthen housing demand and promote economic recovery. An enhanced home buyer tax credit, coupled with a mortgage rate buydown, will help restore consumer confidence and stimulate demand for homes by creating a sudden incentive for home purchases.

NAHB appreciates the provision in H.R. 384 directing the Treasury Department to develop a program to make interest rates more affordable for home buyers. NAHB believes the plan should go further by including a specific rate target. We believe that temporary and targeted lower rates are needed to produce a significant change in home buyer sentiment and stimulate home buying demand sufficient to reduce unsold inventories.

The credit market freeze, the declines in home prices, the surge in foreclosures, and the reduction in the home building activity are historic in scope, and time for action is now. We appreciate your efforts in addressing the shortcomings of TARP. Then you again for this opportunity.

[The prepared statement of Mr. Robson can be found on page 168 of the appendix.]

Mr. KANJORSKI. Thank you very much, Mr. Robson.

Mr. Charles McMillan.

STATEMENT OF CHARLES McMILLAN, CIPS, GRI, 2009 PRESIDENT, NATIONAL ASSOCIATION OF REALTORS (NAR)

Mr. MCMILLAN. Thank you, Mr. Chairman.

I am Charles McMillan, president of the National Association of Realtors and director of realty relations and broker of record for Coldwell Banker Residential Brokerage, Dallas-Fort Worth.

There is no question today that our Nation is facing an economic crisis, and housing is at the core. Realtors support the TARP Reform and Accountability Act. H.R. 384 reinforces NAR's keys to recovery and would help stimulate housing investment, mitigate foreclosures, help current homeowners, and address the problems with liquidity in the commercial mortgage market.

I am here today to testify on behalf of more than 1.2 million members of the National Association of Realtors on the ground who are involved in all aspects of the real estate industry regarding priorities that we believe should be addressed when deploying the additional funds for the Troubled Asset Relief Program.

First, we agree that low mortgage rates are key to reducing the supply of inventory and stemming further price declines. In November, the Federal Reserve announced that it would purchase debt and mortgage-backed securities from Fannie Mae and Freddie Mac. That helped to reduce mortgage rates by more than 60 basis points. It was a step in the right direction, but we can do more. Realtors also support the idea of a mortgage buydown, as well as other efforts to help reduce rates, including additional purchases of mortgage-backed securities.

Second, we believe ensuring consumers can get or modify a home loan is key to our economic recovery. H.R. 384 would help in several ways. It requires that a significant portion of the second $350 billion in TARP funds be used for foreclosure mitigation. It would protect servicers who engage in loan modifications from liability as long as they act in accordance with the Homeowner Emergency Relief Act. And it would improve the HOPE for Homeowners Program by eliminating the 3 percent upfront premium, reducing the annual premium, and raising the maximum loan to value for many borrowers.

We support these measures. However, we believe regulators also must work with financial institutions to improve the short sale process, remove unreasonable underwriting guidelines, and insist that credit reporting agencies correct errors promptly.

Third, Realtors believe a healthy commercial real estate market also is key to our economic recovery, and we thank Chairman Frank for including commercial provisions in your bill. We support efforts to clarify Treasury's authority to provide support for commercial real estate loans and mortgage-backed securities. Another option would be to use the Federal Reserve's Term Asset-Backed Securities Loan Facility to provide capital for new high-investment-grade commercial loans.

In addition to the provisions I have mentioned, we ask that Congress consider additional incentives to bring buyers back into the market and reduce inventory. One of the easiest ways is by making the $7,500 first-time home buyer tax credit available to all buyers and eliminate the repayment requirement.

We also ask that the 2008 FHA and GSE mortgage loan limits be made permanent. As of January the first, the loan limits in high-cost areas fell. Regulators also have recalculated the median home prices for all counties nationwide, which has further reduced

the loan limits in many markets. Many borrowers are facing higher mortgage rates and are simply unable to secure funding. We are concerned, on a related note, about recent increases in lender fees imposed by Fannie Mae, and we ask that Congress seek an explanation for these higher costs.

In closing, Realtors agree that by refocusing TARP on housing finance and by creating additional incentives for potential home buyers we can put our Nation's economy on the path to recovery. We thank Chairman Frank for introducing H.R. 384 to help unlock the housing market and for including provisions to address credit problems in commercial real estate. The National Association of Realtors and our members stand ready to work with Congress and a new Administration on these proposals, and I welcome any questions. Thank you so much for the privilege to testify.

[The prepared statement of Mr. McMillan can be found on page 152 of the appendix.]

Mr. KANJORSKI. Thank you very much, Mr. McMillan.

And now, we will hear from Mr. Michael Calhoun.

STATEMENT OF MICHAEL CALHOUN, PRESIDENT AND CHIEF OPERATING OFFICER, CENTER FOR RESPONSIBLE LENDING (CRL)

Mr. CALHOUN. Thank you, Mr. Chairman.

I am Mike Calhoun of the Center for Responsible Lending.

Time is running out to stem the flood of foreclosures and protect Americans from an even deeper financial meltdown. I will commend to all of you the recent report from Credit Suisse that came out last month. It predicts that over the next 4 years, 8 to 10 million American households will lose their homes to foreclosures. That is one out of six of all households in the country that presently have a mortgage. Again, one out of six families are projected to lose their homes to foreclosure over the next 4 years.

These devastating foreclosures continue to increase, despite the existing efforts. Congress intended when it passed the original TARP authorization that there would be substantial new efforts to address these foreclosures, but, unfortunately, they have not been forthcoming. The challenge is that we are caught in a Gordian knot created by the existing securitization and servicing structure. Mortgages were fragmented into small interests, and then the critical servicing of these loans, which includes decisions on foreclosures and loan modifications, were placed into the hands of an independent party who is financially penalized if they make loan modifications. So, not surprisingly, we are not getting the results that we would like.

Several recommendations for the TARP funds.

First, a significant portion of the remaining funds must be committed to directly preventing foreclosures, at least $100 billion. I would note that means that less than 14 percent of the total TARP funds would be used for addressing the core problem of the housing market, these foreclosures, and that problem is driving the overall financial crisis in our economy.

Second, these funds must be used effectively and efficiently, as they are using precious tax dollars. But if there is a lesson we have learned over the last year and a half, it is that there is no perfect

solution. Just as we do not fail to attack cancer because of undesirable side effects, we must also realize that the huge economic damage of continuing foreclosures far exceeds the cost of new efforts to address these foreclosures.

Third, experience over the last year and a half also teaches us that considerable flexibility is needed with Treasury still in the use of the TARP funds. For example, as it has been noted, the difficulties of the HOPE for Homeowners Program when we had prescriptive structure. So the plans should include the FDIC program that has been mentioned today, but there are other ideas that should be considered as well, some of those mentioned by John Taylor today. In addition, purchasing service rights to gain control over the modification of mortgages, purchasing second liens that currently block many of the modifications, as almost half of these troubled loans have second mortgages held by different parties that hold the first mortgage. And there should be compensation for servicers who perform mortgage modifications, as now they have to do this at their own expense.

Finally, payments in exchange for deferred debt should also be explored. At the same time that this flexibility is provided, the case has been made well today that increased accountability, goals and transparency, as demanded in the pending legislation, are long overdue.

Next, we must remove legal and accounting barriers that continue to block these foreclosures. These include the prohibitions in many of the pooling servicing agreements on modifications, the FAS accounting rules that prevent sales of loans out of pools to make them eligible for modifications, and, as mentioned, exposure to investor lawsuits.

I will mention in particular an idea advanced by Professor Michael Barr, and that is to use REMIC rules as the leverage to get these desirable results. All pooling and servicing agreements require that they comply with the REMIC rules. And that means that if going forward—the REMIC rules provide tax status on these pools—if going forward continued tax advantage for the pools was conditioned on removing these barriers, we think they would rapidly decrease.

The final point is that I would again urge the bankruptcy reform that would permit judges to make limited modifications, which would save up to 800,000 families from foreclosure at no cost to taxpayers.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Calhoun can be found on page 119 of the appendix.]

Mr. KANJORSKI. Thank you very much.

And now, we will finally hear from Dean Chris Mayer. Dean?

STATEMENT OF CHRISTOPHER J. MAYER, SENIOR VICE DEAN AND PAUL MILSTEIN PROFESSOR OF REAL ESTATE, COLUMBIA BUSINESS SCHOOL

Mr. MAYER. All right. Thank you.

I am Christopher Mayer, Paul Milstein Professor of Real Estate at Columbia Business School.

We are witnessing an unprecedented housing and foreclosure crisis. House prices are in a near free fall. More than 2.2 million foreclosures were started last year, representing 3 percent of all owner-occupied houses. And the problem will get worse without prompt action. Over 4 million Americans are at least 60 days late on their mortgages.

We must act now. I am here to describe a two-pronged approach to this crisis.

First, Columbia Business School Professor Glenn Hubbard and I propose that the government arrange for the GSEs to issue new mortgages at a rate that is 1.6 percent above the 10-year Treasury bond. With Treasury rates at 2.4 percent, this would immediately lower conforming mortgage rates to as low as 4 percent.

I want to be clear. This is not a subsidized rate but what the mortgage rate would be if credit markets were functioning normally. These mortgages would be profitable for taxpayers. House prices have already fallen at or below where fundamentals suggest and may decline an additional 10 percent or more without action. Our plan would stimulate as many as 2 million new home purchases, helping to absorb the inventory of vacant houses and putting a floor on house prices.

Lower mortgage rates would also allow as many as 34 million Americans to refinance their mortgages, saving an average of $425 per month, or $174 billion per year every year. This is a permanent reduction in homeowners' mortgage payments and will stimulate higher consumption growth than any one-time tax reduction.

Next, Columbia professors Edward Morrison, Tomasz Piskorski, and I have developed a new proposal which was distributed with my written commentary to prevent needless foreclosures.

Recent research shows that banks that manage their own portfolios are about a third less likely to pursue foreclosures than servicers of securitized mortgages. Why do securitizers opt for foreclosure? First, it is costly to modify a mortgage, and they aren't reimbursed. Second, the servicer faces great litigation risk whenever it modifies a loan. Third, some securitizations even forbid modifications.

This is an important problem. Although securitized mortgages represent only 15 percent of outstanding loans, they account for about half of all foreclosure starts.

We propose that servicers be paid an incentive fee equaling 10 percent of mortgage payments, for up to $60 per month. This program aligns incentives between servicers and investors and makes modification the cost-effective and preferred solution. If a mortgage is ongoing, the servicer receives a monthly fee. If it goes to foreclosure, there is no fee.

Second, the Federal Government should eliminate restrictions on modification in existing securitization agreements along the lines of section 205 in this proposal. Explicit contractual restrictions should be deleted. Ambiguous provisions that should be clarified via a safe harbor that insulates reasonable good-faith modification from litigation if the increase returns to investors as a group. We propose compensatory payments to the small number of investors whose interests might be harmed. But the cost of that is less than $2 billion in total.

Our proposal benefits homeowners as much as servicers and investors. A homeowner is a prime candidate for loan modification when her income is sufficient to make payments that over time exceed the foreclosure value of your home, just as envisioned in proposed bankruptcy reforms.

But bankruptcy reform, which is getting a lot of attention, is dangerous. Cram-downs raise the cost of future borrowing. If just 1 in 12 existing homeowners decided to stop paying and pursued bankruptcy, we would have double the current delinquency rate and a catastrophe.

This is not unprecedented. It has happened before with credit cards.

In addition, servicers might actually prefer bankruptcy to loan modification, because typical securitization agreements reimburse servicers for expenses in any legal proceeding, be they a foreclosure or a bankruptcy, but the servicer is not paid if they modify the loan. Bankruptcy reform could result in millions of needless and damaging Chapter 13 filings, delayed resolution of the current crisis for years, and two-thirds of all bankruptcy plans ultimately fail.

The FDIC proposal is a big step forward but has its own drawbacks. It encourages servicers to modify as many loans as possible, reducing ultimate payments to investors, but does not condition the incentive payment on successful modification. Additionally, the mortgage guarantee provision could cost taxpayers $70 billion and is unnecessary under our plan, which would encourage a similar number of modifications for a fraction of that price.

The proposals I discuss today would address the current crisis at lower cost and more effectively than other programs. Losses for bad loans would remain with private investors, rather than taxpayers.

With prompt action, I believe we can finally begin to plan for a housing recovery. Thank you.

[The prepared statement of Professor Mayer can be found on page 142 of the appendix.]

Mr. KANJORSKI. Thank you very much, Dean.

I am going to pass on my questions, and I will recognize Mr. Moore.

Mr. MOORE OF KANSAS. Thank you.

I would ask Ms. Murguia, in the Congressional Oversight Panel's second report issued on January 9th, the Panel said they wanted more information about what standards the Treasury uses to select which institutions are to receive TARP money. Since they are not here to explain the standards that they may use, what standards do you believe should be used to ensure the remaining TARP funds are spent fairly and responsibly?

Ms. MURGUIA. Thank you, Congressman Moore. Thanks for your leadership on this.

I think the legislation laid out by Chairman Frank here includes some of the key incentives that we need to see or the key targets, and that is requiring simply to implement a systemic loan modification system. We need to require that for any of our folks who are engaging with Treasury. Anybody who wants to receive these funds has to demonstrate that they are willing to come up with that and to show other ways in which they are increasing lending and putting capital out to those who need that access. And, for us,

the key benchmark is a systemic loan modification. We need to see that in any piece of legislation.

There are other incentives, and you have heard from other folks here about financial incentives that could be added to that, but we can't require on voluntary programs any more folks to come forward. That simply isn't good enough. We have had programs like HOPE for Homeowners and FHA Secure that relied on folks to do it voluntarily, and they just haven't been effective. We need something systemic, and it needs to be a clear incentive for folks to engage in this.

Mr. MOORE OF KANSAS. Thank you very much. Thank you, Mr. Chairman.

Mr. KANJORSKI. Thank you, Mr. Moore.

Mr. Posey?

Mr. POSEY. Thank you, Mr. Chairman.

Three very brief questions. First, for the Dean, by what mechanism do you suggest that Congress practically implement lowering mortgage interest rates to around 4 percent, as you recommended?

Mr. MAYER. I think this would have been an interesting question to have asked Mr. Kohn when he was here earlier.

Essentially, what we are doing now is relying on the Federal Reserve to print money and use that to purchase long-term mortgage-backed securities. That isn't really an economically viable solution, and it puts the U.S. Government at greater risk. What we should be doing instead is issuing Treasuries to offset mortgages. Mortgages are longer duration assets, and we can issue Treasuries to support those assets. That is a much more viable solution. It is much more efficient, and it doesn't rely on broken credit markets, which are currently setting mortgage rates that are just too high.

Mr. POSEY. Okay. Thank you.

And, for Mr. Yingling, in your testimony you cite that during the current recession, bank lending has actually expanded 12 percent for business loans and 9 percent for consumer loans. In this case, what do you think accounts for the constriction in credit markets?

Mr. YINGLING. I think it is important to get some facts on the table, because I think there is understandably a great deal of misunderstanding, particularly among the public and the media about this.

We definitely have a credit crisis. But people extrapolate from that and think that means banks aren't lending, like banks provide all the credit. Banks in recent years have provided in the traditional way about one-third of credit. Two-thirds is outside the banking industry.

In our testimony, we have some very interesting charts, because they show what has happened to the nonbank part. And it is like a cliff. In the last 6 months or so—or year or so, the nonbank lending has gone down almost 90 degrees; and the nonbank credit markets are totally broken. It is interesting that the bank credit actually in 2008 expanded, as you said; and this is highly unusual.

We have a chart in there that shows during a recession—and we now know we have been in a recession all during 2008—bank lending generally goes down because the demand goes down. So I am not saying there aren't issues relating to bank lending, but I think the critical point is traditional FDIC-insured banks are in a posi-

tion to lend, and in fact they not only have to continue lending, they have to make up some of this gap from nonbank lending. That is why we really need to focus on FDIC-insured traditional banks, and we would agree with the provisions in the bill that talk about methods to measure that so we know what banks are doing.

Mr. POSEY. Thank you.

Mr. Chairman, do I have time for one more question?

Mr. KANJORSKI. I am sorry?

Mr. POSEY. Do I have time for one more question?

Mr. KANJORSKI. You can have it.

Mr. POSEY. Thank you, Mr. Chairman.

This is for Ms. Blankenship. I have been concerned for some time about the delays in the Treasury's deployment of funds to small community banks, including S corporations and mutuals. Your members are at a disadvantage because of the Treasury's inability to roll out guidelines. Can you tell me what your discussion with the Treasury has been and what, if any, rationale Treasury has provided for such a lengthy delay?

Ms. BLANKENSHIP. It has been a source of frustration, I will tell you that, for many community banks. And you are right. Roughly one-third of community banks, even as it stands today, have no access to TARP funds. And they are highly frustrated.

In our discussions—and we have been working with Treasury over the last several months and made suggestions. The response is that because of the structure of Subchapter S and the inability of their tax structure to be allowed to issue preferred stock. But there are other ways around that. You could do phantom stock. Or there are other ways. We could simply allow Subchapter S banks to issue preferred stock.

And the mutuals have their own issues as well. I am continuing to get letters from members and in particular one Subchapter S bank in Florida that was well capitalized. And she said, I have made my application, and it has been sitting for months, and I am highly frustrated that the big banks got their money initially. You need to understand that, when there is a mandate for lending, the community banks have nothing to do with this money but lend. That is all we can do to leverage it and make it. And we make 77 percent of farm loans and 40 percent of all small real estate commercial loans. We can't turn around and invest it. We don't have investments overseas. We invest it back on Main Street. So that is why it is so vitally important to give this remaining one-third of all banks access to this. Because those banks on Main Street are vitally important in our communities.

Mr. POSEY. I agree. And frustration is a very kind word.

I thank you, Mr. Chairman. I yield back.

Mr. KANJORSKI. Thank you very much.

Mr. Cleaver.

Mr. CLEAVER. Thank you, Mr. Chairman.

Ms. Murguia, thank you for being here. I was looking through your testimony, and on the second page you have a quote: "For the Hispanic community, we expect the height of the crisis will likely come in 2009 and 2010, when interest rates are scheduled to adjust on loans common among Hispanic borrowers."

This would suggest what the NAACP suggested, which is that Hispanic borrowers were targeted for subprime loans. Do you have either empirical evidence or anecdotal evidence that this is in fact what has happened in the Hispanic community as well? Because we hear a lot in here about how we blame the victim. You should not have allowed us to rip you off.

Ms. MURGUIA. Sure. Absolutely. And, actually, I was here I think a year ago testifying before this committee and talking about the nature of predatory lending, offering lots of statistics and stories about how in our community—and our organization has a network of at least 15—excuse me, 50 homeownership counseling sites through our network of affiliates, community-based organizations which work directly through families, trying to get them good information so that they can prevent being subjected to this exploitation. And what we have found, of course, the best evidence is that when these folks have access to good education, when they have been prepared to know how to understand the system and navigate that system, guess what, none of those families are in homes that are in trouble with loans that are in trouble. But when we don't have the ability to get to those families and protect them and get them the information that they need and with people that they trust, then, obviously, we have real problems.

And what we saw and what we are seeing now is that many of those subprime loans, many of the servicers that were targeting folks out there clearly targeted those who were most vulnerable. And a lot of those folks were out there.

Of course, you always have a small fraction of folks who maybe should have known better. By and large, we understand that can happen. But, by and large, we are talking about a number of people who were not given the right information. The landscape just was not fair for them in terms of the folks who work with them.

When they are working outside of those community-based organizations, they are just very vulnerable. And we have seen that happen through our own network and seen story after story where that has been the case. And, of course, now that is being proven out through the statistics that we are seeing here today. And we are going to see 2009 and in 2010 this higher peak of percentage of those loans that will go into foreclosure among the Latino community.

And, obviously, it is important for us to say we can step in, we can still intervene and help protect some of these families from losing those homes. But it is going to require this bold effort by Congress to move on legislation like this so that we can have an intervention and so that we can have this systemic ability to have modifications tied to what families can really afford. If we can do that, the FDIC model, the mod in a box, we can get some progress on helping folks save those loans and helping financial institutions not inherit properties they have no knowledge of what to do with and no real recourse for what to do with them.

So, obviously, we see that as a real problem. We think this legislation that Chairman Frank is offering will help us move in the right direction. But the key, Congressman Cleaver, is accountability. We have had all this money go out the door. And even if we just put some quarterly reporting here we would be able to tell

you how families could be or were being served. Right now, nobody can talk about that, because they can't point to any evidence that Treasury has been able to come up with. So accountability really matters, especially now.

Thank you.

Mr. CLEAVER. That segues into a question for Mr. Calhoun.

In your testimony you mentioned that considerable flexibility should be allowed for the Treasury. We just went through that. We just went through considerable and, I must add, stupid flexibility for Treasury. Nobody can speak for Congress, but I can almost assure you that if flexibility is built into any legislation for Treasury it ain't going anywhere. I know it is bad English, but it is good politics.

Mr. CALHOUN. When I talk about flexibility, I am talking about how they carry out the foreclosure prevention program. But the legislation I think is actually well designed, and requires that by March 15 there be a specific foreclosure prevention program that also has to be approved by the TARP oversight board and failure to do that cuts off all of the TARP funds. So I applaud that approach in the legislation. So I agree with you, the past experiment worked very poorly.

Mr. CLEAVER. Thank you, Mr. Chairman.

Mr. KANJORSKI. Mr. Lance.

Mr. LANCE. Thank you, Chairman Kanjorski.

My questions are directed at Professor Mayer. Mr. Calhoun said, as I understand it, roughly one in six mortgages may be in foreclosure, those who have mortgages. Those are dramatic numbers. You stated in your testimony that foreclosures will increase unless we do something quickly, and I think Congress will do something quickly. But you also say it is important to protect taxpayers. As I understand your written testimony, you believe that section 204 can be improved and not as much money necessary as has currently been anticipated. Could you explain that in a little greater detail?

Mr. MAYER. Yes. Probably the most expensive provision, and I think the FDIC estimates of the mortgage guarantees are about $25 billion. I think one could easily look at what existing loan modification programs have done and easily come up with estimates that are much higher than that.

So the question is if we are going to spend what I would guess is $50 billion to $70 billion or more on mortgage guarantees, you would really like to know that is going to be effective.

To our view, the barrier for servicers is not about the Federal Government guaranteeing mortgages, the barrier for servicers are really twofold. First, they are not compensated to modify loans properly, and they are not incented to do that. And the second is that they have very complicated pooling and servicing agreements.

So under our proposal we break down both of those barriers. We explicitly call for change in contracts where necessary to make clear that servicers' duty is to improve returns for all investors.

Mr. LANCE. And that can be done constitutionally?

Mr. MAYER. That can be done constitutionally, and this is co-authored with a professor at Columbia Law School who has clerked on the Supreme Court, Professor Edward Morrison.

And the second part of this is we believe that there are better ways to incent servicers. So instead of paying $1,000 for a modification, we should pay you less money up front but more money every month as the borrower makes payments. So the modification has to be successful.

Mr. LANCE. Thank you. Then going on regarding your litigation safe harbor suggestion, the legal standard of servicers' reasonable good faith belief, I have a concern that might be interpreted differently among the various Federal circuits, and if you would comment on that and how we might be able to resolve that issue.

Mr. MAYER. Not being an attorney, I will defer to working with my co-author and other people on this. This has been vetted by constitutional scholars at various other law schools as well as including at least one sitting Federal judge.

Mr. LANCE. I do have the burden of being an attorney, and I would appreciate any written information you have through the Chair.

I yield the balance of my time.

Mr. CALHOUN. There is some suggestion, and some of it is incorporated in the existing legislation, of setting up a standard net present value test and then if the servicer complied with that net present value test so that it showed that the projected recovery to the investors was higher with the modification than with the foreclosure, then that would provide a more definite test. I share the burden and your same concern.

Mr. LANCE. Thank you, Mr. Chairman.

Mr. KANJORSKI. Thank you, Mr. Lance. Mr. Perlmutter from Colorado.

Mr. PERLMUTTER. Thank you, Mr. Chairman.

I am going to start with Mr. Yingling. You and I have been at several of these hearings starting in September, November, and now. Mr. Calhoun, in answering one of Mr. Cleaver's questions, said that TARP has not performed well, or "poorly," I think was your term. We have heard credit crisis, liquidity crisis, housing crisis, foreclosure crisis. Have we done anything by TARP from September until now? Have we improved the situation as we saw it and we were presented with information in September of this year?

Mr. YINGLING. In some ways, yes. But there are really terrible problems left.

We have a chart in my testimony that looks at the spread between LIBOR and Treasury, and I don't want to get too technical. But back at that period, the international lending markets were a disaster. It shows how that spread had spiked up to historic levels and so banks around the world wouldn't lend to each other. That has come down. I think it is clear there is more confidence in the financial markets. So we have accomplished something.

Mr. PERLMUTTER. I think at the time the big concern was banks were not lending to one another. That was the testimony that we had, that this was like the panic of 1907 when banks refused to do business with each other because they didn't know which bank would be left standing. Have we improved that situation?

Mr. YINGLING. Yes, we have improved that situation.

Mr. PERLMUTTER. I have taken a lot of heat for voting for this bill, and I want to know whether we have made some progress somewhere.

My second question, when we have had these hearings, we talked about stabilizing the markets, restoring confidence, and stimulating the economy. A lot of what I am hearing, Mr. Robson, from the Realtors, we want to stabilize real estate prices so we can start building again. So many people rely on the value of their homes as really their whole net worth. I have heard from Dean Mayer and I know that the Realtors are supporting kind of a refinancing buydown so we can start buying and selling houses. In the bill that we have before us, it doesn't really give us any particulars, but do you see with Dean Mayer's proposal or some other proposal how we can get the real estate market moving again at a 4, 4½, 5 percent lending rate?

Mr. Robson, I will turn to you first.

Mr. ROBSON. I am not sure if 4, 4½ percent is enough. We are advocating 2.99 for a short period of time, maybe go up to 3.99 percent. It is really more of a shock to the system. Certainly, mortgage mitigation is important. You have to keep the excess inventory from building up. But you also have to have some sort of stimulus to encourage buyers to get back in the market because they are staying away. They are afraid. It is the biggest investment that most people are going to make, and they are going to be very cautious in doing it today.

Mr. MCMILLAN. I did not flippantly make the comment that I was representing Realtors and representatives of consumers on the ground. I think one of the things that we need is more realism in the workout. We speak of loan mitigation and we speak of recidivism amongst those who were mitigated. One of the things that is not addressed is there has not been realism. When we talk about loan modification, when the lender acquiesces to reduce the existing mortgage by 10 percent when the market shows that this property has clearly fallen 30 to 40 percent, they are just prolonging failure.

The other thing that I see when we talk about mitigation of mortgages, we are only speaking of workout. We are not advocating that a homeowner keep their home at any expense. But the circumstances show that the homeowner is not in a position, perhaps they have lost their job, then we are looking at realism with respect to the short sale. And the short sale will permit the property to be purchased by an able and willing borrower today, many of which we bring to the table, with proper credit credentials and offering a reasonable price with respect to today's market, and that is sabotaged by delaying tactics and others that eventually permit the property to go straight to foreclosure.

Mr. PERLMUTTER. Thank you.

Mr. KANJORSKI. The gentleman from Illinois, Mr. Manzullo.

Mr. MANZULLO. Mr. Chairman, may I ask if there is anybody left in the room from the Federal Reserve or the FDIC? Anybody here from those organizations? Raise your hands.

I think that is the problem; they are gone. They don't understand that really there is a consensus here that you have to get people to start buying houses again. Pouring money to bail out crappy

loans, that is not going to do any good. That is why I encouraged them to read Ms. Blankenship's testimony. No one is talking about the zealous over-regulators that seemingly have a mission to destroy community banks. Ms. Blankenship, what is going on there?

Ms. BLANKENSHIP. What we are hearing from our bankers in the field is that in many cases you have examiners coming in and they have a knee-jerk reaction, if you will, from this crisis. I believe our system is broken in one respect in that you should have regulation according to risk. The banks that actually got us into the bailout, if you will, got the money first.

Mr. MANZULLO. The guys who caused the problem or the people who caused the problem got the money.

Ms. BLANKENSHIP. Right. We are sitting on Main Street, and yet we have to deal with over reaction by the examiners, reputational risk, lack of confidence by our own customer base, and so we have had to spend all this time and resources reeducating our customers while our business model is a basic business model and my banking business model has nothing in common with Bank of America.

Mr. MANZULLO. When you were here a couple of months ago with your fellow colleague from Texas, who is the head of the Automobile Dealers Association, and we talked about the fact that money has been out there, has your bank ever had a crunch on lending money to people who want to buy automobiles?

Ms. BLANKENSHIP. No, but we have had decreased demand because we had competitors, the GMAC and some of the other nonbank lenders, even the credit unions, who were able to offer substantially lower rates. The money is there to lend.

Mr. MANZULLO. Somebody created the myth—no, it is not a myth when it gets to guys who are building subdivisions and on that level. But when we talked to—what is name of the lady who is 300 miles away from you, which is across the street in Texas, but she said that at her Ford dealership, and as I talk to people across the country, people come in and say, I didn't think I was going to be able to buy this car, and people are saying that probably with homes, and the people who got it right here are those who say the only way out of this mess is to empower those people who are still working to buy homes. That is the only thing that is going to work. Everything else is patchwork. You can have all of the remedies you want for mortgage mitigation, etc., but if people are not working, everybody is wasting their time and those poor folks will end up losing their homes anyway.

Another example, I have a 150-year-old building in downtown Oregon, Illinois, population 3,500. I just got two tenants after it being empty for almost 2 years. When I sell it, if I resell it, there is a huge recapture tax. If I didn't have to pay that recapture tax, I would take that right off the property and lower it a tremendous amount of money. But my problem is, where are the people in government who think according to free market and common sense principles? Anybody? Mr. Taylor, you want to use eminent domain. That is about as far from free market as possible, but I will give you a chance to answer the question.

Mr. TAYLOR. I just want to say, it is your free market that brought us to this situation. It was a market that was free to cheat

and free to corrupt, it was all of those things. It is the lack of regulation. It is not overregulation that got us here.

Mr. MANZULLO. We know that.

Mr. TAYLOR. I agree with you, jobs are part of the answer. But we need to understand if we allow another 8 to 10 million foreclosures to occur, I can assure you that many of the homeowners in your district right now who are working will lose their job.

Mr. MANZULLO. But if you restart the automobile industry, it is so easy because you will be the direct beneficiaries of that. When people go back to work in the automobile industry, it goes all of the way up the line. It is trickle up. That is how it works.

Thank you.

Mr. KANJORSKI. Mr. McMillan?

Mr. MCMILLAN. Mr. Chairman, I wanted to address his commercial challenge because we represent commercial real estate as well, and we have many anecdotal stories from our commercial practitioners, many of them owners of high-quality commercial assets themselves, and have been with lenders for many years. Many of them have 50 percent equity and their loan is about up and the lenders are refusing to give them money.

One of the things that we propose is the use of the Federal Reserve's Term Asset-Backed Securities Loan Facility to provide capital for those new high investment commercial grade loans.

Mr. KANJORSKI. Thank you. Mr. Ellison.

Mr. ELLISON. Thank you, Mr. Chairman.

Mr. McMillan, I am going to pick up right where you left off. Many of my people in Minneapolis say the next shoe to drop is the commercial real estate market. Do you agree with that?

Mr. MCMILLAN. Absolutely. That is our next crisis and that crisis, sir, is more imminent than we know.

Mr. ELLISON. How did the commercial borrowers get into this mess? The general wisdom in the residential market is there is a proliferation of exotic mortgages, 2/28s, 3/27s, all of that stuff. How did you guys get into all this stuff?

Mr. MCMILLAN. Sir, that is an excellent question. The analysis by our folks show that the majority of businesses are fueled by small businesses, and those are the tenants in these commercial buildings. As these small tenants themselves experience difficulty in financing, the vacancy rates begin to go higher. And we have seen vacancy rates in many commercial markets move from traditionally 3 percent to 10 percent, which we know is problematic when we begin to do our due diligence with respect to analyzing commercial purchases.

Mr. ELLISON. One of the points I have tried to make to people is if you do the business of selling mortgages and you go into the market 3 and 4 times in the morning and 3 or 4 times in the afternoon, you are at an advantage with anybody, whether they be a residential purchaser or a commercial purchaser. Therefore, we need the regulation Mr. Taylor is talking about because we have a significant imbalance.

Moving on, we have heard that we have a demand-side problem here, that unemployment income is a real issue. Mr. Calhoun, can you talk to me about this phenomenon of the FICO scores that are

very high being the only ones who can actually borrow money these days? Do you agree with that and what do we do about it?

Mr. CALHOUN. I think everybody at the table would agree there is essentially no private label lending, that all of the mortgage lending that is occurring today is government guaranteed through FHA, VA, or Fannie or Freddie. They have generally imposed higher FICO score standards.

We need to expand back through both FHA and the GSEs, more access to those lower FICO scores.

Part of the problem is again we have talked about mixed messages. There has been, if you will, an overreaction of credit. Credit was too loose and needed to contract some, but there has been a substantial overreaction and the markets need to be loosened up, and the TARP funds—I want to make sure that my comments were understood before—the TARP funds have stabilized credit markets and eased credit in some significant ways. Their greatest failing is they have done little or close to nothing in terms of foreclosure prevention, which not only keeps families in their homes but it prevents a flood of inventory on the market. In markets like California, 40 to 50 percent of the real estate transactions are foreclosures and REOs and they are crowding out the home builders, who can't add any inventory to that overflooded market.

Mr. ELLISON. Mr. Taylor wants to discuss the FICO score issue, and I might want a house, might need a house, but if I have a 600 score, not a 700 score, I can't get a loan.

Mr. TAYLOR. There is no reason that a healthy competitive banking system, this system represented by Mr. Yingling, can't meet the needs of low- and moderate-income and blue-collar working class people. In fact, they did quite effectively up until 2003, when we had a steady growth in homeownership rates among low-income people and among minorities. There were huge jumps. In 1993 and 1994, a 50 percent increase in new homeowners in African-American and Latino communities. Tremendous success, all prime lending. In fact, if you look at the high-cost lending that did occur, this predatory, toxic, usurious, free market stuff that was allowed to occur unregulated, less than 10 percent was to the first-time home buyer. Less than 10 percent to a new homeowner. Half was refinance, the other half was people expanding their house.

Mr. ELLISON. That is an important observation. I have been singing that song myself.

Let me say, part of the new TARP bill, the chairman's bill, says there will be a safe harbor for servicers who will modify loans. This safe harbor is something you all support, I assume. Can you talk about the importance of this provision? And also if you might, how we need to get investors in this conversation if we are going to do anything more than just voluntary modifications: What are the investors going to do?

Mr. KANJORSKI. Mr. Ellison, you have run out of time. Does somebody want to answer?

Mr. TAYLOR. All these questions always end with how are we going to get the investors involved, and that is the problem. With servicers, their primary obligation is to maximize profits for the investors, for the trustees. That is their job. So, yes, we support that safe harbor because that will give them the security of being able

to make some modifications, but they are still going to make modifications where many are going to end up redefaulting because they are not going to get the investor to go along at the level that needs to occur.

I wish some Member of Congress would look at the eminent domain idea because none of you strike me as having taken the time to have done that. Look at what that offers because that gets at all of the investor problems. That gets at all of the voluntary issues, and it brings that mortgage down to a level where we don't even need a 50 percent guarantee and we could have the free market refinance these loans and taking the loss that has already been suffered on Wall Street. Take a look at that.

Mr. MAYER. Our proposal does precisely that in a legal way without the mortgage guarantees, I would sort of reiterate that, and it does so in a legal and constitutional way without having investors step in and impair modifications. So I would encourage consideration of that view.

Mr. KANJORSKI. Thank you.

Eminent domain is primarily State law, not Federal law. Each State has a different process through which you exercise eminent domain. So what you are suggesting is that we preempt State law and nationalize it. I won't argue that may be where we are headed, but you really want to think seriously before we usurp all real estate law at the Federal level.

Mr. TAYLOR. I am talking about a national problem. If you want to wait for the States to pass legislation to try to do something, good luck. But the Federal Government has the authority; there is no question about it.

Mr. KANJORSKI. Mr. Foster.

Mr. FOSTER. Mr. Robson, I should say I am a little pessimistic about the near-term prospects of restarting the home construction industry when there is a big overhang. We are basically overbuilt.

I was fascinated by your comment in your written testimony that there is no overhang in multi-family homes. If that is true, that means that is where there is hope that we could incentivize something that might restart some construction.

Mr. ROBSON. That would be correct except nobody can get financing.

Mr. FOSTER. Can you get some documentation for this zero overhang in the multi-family homes?

Mr. ROBSON. It is just the vacancy rates. When people are foreclosed on, they have to go somewhere. That is the bottom line. There is always an offset between excess inventory in single family versus multi-family. The problem is there is very, very little multi-family being built now because they can't get financing.

Mr. FOSTER. Professor Mayer, I think this represents as good an example as I have seen of a semi-voluntary mortgage modification plan. Have you or someone scored the effect on the balance sheets of the big financial players, the taxpayers and so on, of each of these things to the best of your ability?

Mr. MAYER. There is no way to effectively do it because you don't know who owns what securities. We have put forward very detailed cost estimates as to what this would cost various groups, including taxpayers. Our estimate for taxpayers is that the total cost of the

servicer incentives is about $9 billion. The cost of making aggrieved investors whole is very modest at $1.7 billion. So the total cost to taxpayers of our program is $10.7 billion. We estimate it reduces at least a million foreclosures. But I will say essentially the proposal is very similar to the FDIC except that it provides higher powered incentives for people to modify loans than is true under the FDIC, and we see no need for the incredibly expensive mortgage guarantees where taxpayers were taking on half the losses because mortgage guarantees aren't the problem, and so why should we spend that kind of money on something where it is unnecessary to achieve something that we are trying to get.

Mr. FOSTER. In your testimony, you indicated that you felt housing prices had already fallen below what their fundamentals would suggest, and you have a link on your written testimony that appears to be broken, at least on my hard copy. I would appreciate getting that information because that again is fascinating, if true.

Mr. Yingling, first, I have to commend you on the numbers and the graphs. You are right, the graphs on page 9 and following are tremendously interesting. And since they say they are from the Fed, maybe we can believe them.

The one labeled "Bank Lending Continues To Grow" and shows that bank lending has been essentially constant or so slowly growing during all of this period, which is very different than what we are hearing anecdotally. Is the mix of loan types changing? If we are seeing a lot of the loans that are increasing are preestablished credit lines that are finally being exercised, and in order to cancel that you are actually squeezing on other small businesses, and so on, because this really seems like it is inconsistent with what I am hearing from my constituents who come to my office every week complaining that the banks are cutting them out in ways that they didn't use to.

Mr. YINGLING. These graphs could add 55 footnotes to explain all of it. I think there is a little bit of the element you just talked about. There is some drawing down credit lines. But let me have sent to you the details on all of it.

But I think the fundamental fact is still true, that it is amazing that bank lending, traditional bank lending, has held up because if you look at the other graph that talks about during recessions, it almost always goes in the tank as loan demand goes down.

I think it is true there are loans available and, sure, in individual instances credit lines have been tightened. But there is a gross misperception that lending is not available from banks.

Mr. FOSTER. Do you have a breakdown of the different types?

Mr. YINGLING. We can provide all that. We will give you a complete breakdown.

Mr. FOSTER. Thank you.

Mr. KANJORSKI. Mr. Driehaus.

Mr. DRIEHAUS. As we are about to be called over to vote, I guess I would like to focus on one aspect of this crisis that I don't think gets nearly enough attention. Mr. McMillan, you talked about being real and looking at the reality of this situation. It seems to me that TARP has to some extent thawed the credit crisis and, thanks to the efforts of Chairman Frank, we are going to see an increase in foreclosure mitigation.

But the communities I represent have been paying the price of this foreclosure crisis for years. And a $7,500 tax credit is just not going to do the job in terms of incentivizing people to go in and purchase homes. It is barely going to cover the cost of the copper pipe that was stripped out of the home in the first place.

We have a crisis of huge proportion in these low- and moderate-income neighborhoods. My fear is that this legislation, the TARP legislation, isn't going nearly far enough to help those neighborhoods recover. I waited for this panel because so many of you represent the folks on the ground, the folks in those neighborhoods.

So while I don't expect you to give me the answers right now, and we actually all have to run out of here to vote, I would encourage all of you to think about that, whether this addresses that part of the problem, those communities like Cincinnati and other older cities that are struggling over the enormity of the costs associated with the foreclosure crisis and how we are going to help them recreate the market because a $7,500 tax credit just doesn't do it.

I would encourage you to forward your responses in writing to myself and the committee. That may begin this conversation.

Mr. KANJORSKI. Thank you very much. Mr. Maffei.

Mr. MAFFEI. I want to thank the panel for staying so late. Given my position on this august committee, I have a feeling I will be thanking panels a lot for being here.

I just want to follow up on something Mr. Foster was questioning about. Mr. Yingling, about your charts, because I think you put this as simple as I have heard it yet, which is that banks are continuing to lend and in fact are lending at a higher rate but the secondary market is so completely dried up. My constituents, like Mr. Foster's, are experiencing this as banks lending less. They are experiencing freezing in their home equity lines of credit. They can't get car loans and they can't get student loans in some cases, and it is the bank that is telling them no even if it may be the secondary market. Can you explain why that is or how we can describe that better?

Secondly, does title IV of the chairman's bill address that at all when it gives additional authority to the Treasury Department for purchasing asset-backed securities that would help with loans for autos and student loans?

Mr. YINGLING. The answer to the last question is yes. Part of it is just education. The media goes out and says bank lending is down, and it confuses people. Mr. Manzullo had an interesting comment. And I had an occasion just this week where an Ohio banker told me that an automobile dealership in his small town closed down and the automobile dealer said, it is because I can't get credit for my auto loans. And then the reporter came to the banker and said, why aren't you lending for auto loans? The answer was that he was lending. It was the captive finance company of that automobile company that couldn't get loans out. So I think a lot of it is education.

The secondary market is really a huge problem in student loans and credit card loans and auto loans. People don't realize that half the funding of credit card loans has historically come from the secondary market. So we need two prongs. We need to support banks

around the country so they can pick up some of the slack here, and we need to undertake methods to unfreeze the secondary market.

Mr. MAFFEI. My district is, according to Forbes magazine, the second best. This is Syracuse, New York, the second best real estate market in the country, not because our property values are going up but our property values are not going down and yet people are getting their home equity loans stopped essentially in their tracks.

Mr. YINGLING. In our testimony, there are numerous government policies that move in the opposite direction. It is amazing to see the conflicting messages that banks get. Our accounting policies are a prime example of it.

Mr. MAFFEI. One last question, and then I will go vote and allow the chairman to dismiss you.

Would some of these smaller loans, would that be helped by easing up, and I am assuming I know your answer to this, but easing up for the community banks? Are they more likely to offer those kinds of loans, is that part of the problem, bank lending continues to grow but is more on the bigger bank side than the smaller banks?

Mr. YINGLING. I think it is all banks. But certainly, community banks are a major source. Mr. Taylor talked about the fact you go back a little ways in history and you would find that banks did a lot more of it and they did it better. We talked about the foreclosure crisis and we talked about the ability to work out loans if you actually made the loan. So I think there is a strong reason to focus on the traditional FDIC-insured banks as the basis for getting us out of this mess.

Mr. MAFFEI. Ms. Blankenship, do you have anything to add to that?

Ms. BLANKENSHIP. Yes. As I stated earlier, we have to be able to put those loans on our balance sheet. And I haven't seen the data, but I would believe the community banks have increased their lending simply because our balance sheets—really that is the biggest part of our assets, our balance sheet. Unlike some of the larger regional or the super large banks, they have investments and off balance sheet assets, but we only have liquid assets and primarily loans. That's how our model works. We have to make those loans.

Mr. MAFFEI. So if more TARP funds became available?

Ms. BLANKENSHIP. Yes.

Mr. MAFFEI. If you have any data on that, please send it to us. Thank you, Mr. Chairman.

Mr. KANJORSKI. Just 30 seconds to Mrs. Maloney.

Mrs. MALONEY. First, I would like to thank the panelists and be associated with the comments of my colleagues on the need for TARP money and focus on government programs to help Americans stay in their homes and help stabilize the markets, help our economy, and help individual families.

I am pleased to see, Mr. Yingling, that more credit is getting out into the communities, but that certainly is not what we are hearing. The stories I hear from my constituents are that commercial lending they once had access to is no longer there, that the lines of credit for businesses with good balance sheets that have been

around for decades providing services, they are having their lines of credit cut and that the lending is not there. So what is the shift that is the problem? If banks are putting more money out there, then other sources of lending must be cutting back. We do know about the problem with the cars that my colleagues mentioned, but then we just put TARP money out there for GMAC to start loaning specifically for cars. What we hear from the economists who come before us is that we have to get this economy moving and the small loans going out there to be moving forward.

I would say that in our TARP efforts, we have stabilized the financial markets considerably. There were many forced marriages, mergers, acquisitions that were in response to economic crisis, and that was the purpose of them. But we are now hearing that the financial institutions are now asking for a second TARP program.

Now this second TARP program, what are you hearing that this should be used for? Since the institutions are stabilized, is it to buy the toxic assets which we have not done in the past, or in what specific way do you think this additional access to capital should be used? And first and foremost, even though your statistics are great that more lending is out from financial institutions than ever before, that is not the story we are hearing from Main Street and our districts. We are hearing from legitimate, respected businessmen and women that they do not have access to capital. If banks are lending more, where is the cutback that they don't have it? Yet, they tell me that they used to get it from their bank and now they can't get it from their bank.

Thank you for your efforts to help stabilize our economy and move us forward in a positive way.

Mr. KANJORSKI. Thank you, Mrs. Maloney. Who do you have that question directed to?

Mrs. MALONEY. Mr. Yingling.

Mr. YINGLING. I will be brief.

I don't want to say that there aren't terrible problems still in the credit markets. We think if we get the rest of the CPP money, that is the part of the program that goes to banks that was originally talked about so that the community banks and others get it, that ought to be enough, and that the focus going forward needs to be on other programs and those programs with the stimulus and the TARP ought to be on these other areas that people talked about: foreclosure prevention, on getting the secondary markets opened up, and getting the housing started, and that we need a broad approach to lending that covers all of these types of things.

Mr. KANJORSKI. Thank you very much, Mr. Yingling. Thank you, Mrs. Maloney.

Mr. Scott, 15 seconds.

Mr. SCOTT. With this economic crisis really challenging even some of our strongest financial service companies, can you tell this committee what role the Federal Home Loan Banks have played for your industry and what your recommendation for them going forward would be? I think it is important to get the Federal Home Loan Banks' perspective?

Ms. BLANKENSHIP. For many decades, Federal Home Loan Banks have played an important role for the community banks in particular because they provide a source of liquidity for us, a source

of funding at a time when the funding is becoming more and more challenging for community banks. We have to have the ability to gather those funds so that we can turn those funds around and loan them back and invest in our communities. So we need the government to understand that and we need Congress to help ensure that we can still have access to those Federal Home Loan Banks because without that we have to fall back on borrowing from other banks or other sources of maybe higher cost of funds, which in turn makes the loans higher.

Mr. SCOTT. Do you have any specific recommendations going forward?

Mr. YINGLING. We will provide those for the record.

Mr. KANJORSKI. I want to thank the panel. I am sorry I didn't get a chance to ask questions. Thank you all for being here and giving of your time here today. The committee fully appreciates it.

This meeting stands adjourned.

[Whereupon, at 6:44 p.m., the meeting was adjourned.]

A P P E N D I X

January 13, 2009

AL GREEN
Member of Congress

Congressman Al Green Opening Statement at Meeting on
"The Priorities for the Next Administration:
Use of TARP Funds under EESA"

Chairman Frank, Ranking Member Bachus, Chairman Kanjorski, Ranking Member Pryce, thank you for holding this important meeting. It is critically important that we develop a proposal that efficiently and effectively addresses the housing market crisis because .

The "TARP Reform and Accountability Act" contains the provisions of the LaTourette-Green Amendment, introduced in the 111th Congress as H.R. 387, the "TARP Accountability Act of 2009." This bill requires that financial institutions that have benefited from TARP funds report how much the TARP funds have increased their new lending or lowered their decrease in new lending. If they are unable to specifically document how much of the lending increase is attributable to TARP funds, they must report their total increase in new lending. The House adopted the amendment by a 403-0 vote on December 10, 2008.

As we contemplate how the next $350 milllion of the EESA funds will be appropriated, we must make sure that the enormous amount of taxpayer dollars infused into large financial institutions will be accounted for and that greater transparency will be required. Again, thank you for holding this hearing and I look forward to discussing how we can ensure a fiscally responsible solution to addressing the housing market crisis.

LYNN JENKINS
2D DISTRICT, KANSAS

130 CANNON HOUSE OFFICE BUILDING
(202) 225-6601

Congress of the United States
House of Representatives
Washington, DC 20515–1602

January 13, 2009

Mr. Chairman:

Today, I speak in opposition to a provision in bill HR 384, the Troubled Reform and Accountability Act, which requires corporations receiving TARP assistance to divest themselves of privately owned or leased aircraft.

General Aviation is crucial to the economic stability of Kansas and our entire nation. At a time when the economy is facing deep losses, this provision would be a severe blow to an industry that provides millions of aviation manufacturing jobs. There's no doubt the consequences would be felt permanently and deeply not only in Kansas, but across the country.

Efforts that are directed toward irresponsible CEOs should not destroy the manufacturing jobs that average Americans rely on to pay the bills and feed their families. General aviation contributes more than $150 billion to the U.S. economy annually and employs more than 1.2 million people. It's also worth noting aviation is one of the few domestic manufacturing industries that maintain a positive trade balance for the United States.

I urge you and the members of this committee to think long and hard about the far-reaching and harmful consequences of this provision. This Congress has been charged by the American people to see that our economy recovers and to prevent even more jobs from being lost. Thank you.

Lynn Jenkins

Lynn Jenkins, CPA
Member of Congress

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FAX 316-946-2220

January 9, 2009

Honorable Lynn Jenkins
U.S. House of Representatives
Washington, DC 20515-1602

Dear Representative Jenkins:

I am writing to ask you to contact Chairman Dodd of the Senate Banking Committee, Chairman Frank of House Financial Services Committee, and President-Elect Obama's economic team to urge them to oppose efforts in Congress to punish corporations that own or lease business aircraft. This is a matter of utmost urgency.

As you recall, the Auto Loan Financing bill that passed the House in December required corporations receiving government assistance to divest any business aircraft they owned or leased. The Bush Administration later incorporated the same measure in its loan package after the bill died in the Senate, and I fear that there are efforts underway to replicate the provision for banks and financial firms that own or lease aircraft. While I understand that Congress and the Administration have been reacting to the criticism the CEO's of GM, Ford, and Chrysler encountered when they flew business aircraft to Washington, the fact is that these provisions, if replicated, will lead to fewer aircraft orders, cost jobs, and tarnish the image of the general aviation industry.

You know as well as anyone how important general aviation is to the national economy and to the State of Kansas, and that general aviation manufacturers are already suffering from a weak economy. The last thing we need is for Congress to pursue an effort that may feel good but that will ultimately weaken an important domestic manufacturing industry. Chairman Dodd, Chairman Frank, and the President-Elect's economic team need to hear from leaders like you about how important general aviation manufacturing is for the U.S. economy. Targeting general aviation is an unacceptable and counterproductive response to our nation's economic situation which will cost us good, high-paying jobs in Kansas and throughout the United States.

I thank you for your continued support of general aviation and for considering this urgent request.

Sincerely,

David M. Coleal
Vice President and General Manager
Learjet

Cc: Kansas Congressional Delegation

January 13, 2009

Jack J. Pelton
Chairman, President & CEO

The Honorable Lynn Jenkins
United States House of Representatives
Washington, DC 20515

Dear Congresswoman Jenkins:

On behalf of Cessna Aircraft Company, and the thousands of Kansans who are employed at our facilities in Wichita and Independence, I want to express our appreciation for your strong opposition to a provision especially harmful to general aviation that has been included in HR 384, the Troubled Assets Relief Program (TARP) reauthorization bill. This legislation has been referred to the House Financial Services Committee of which you are a member.

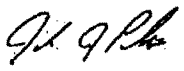
As you know, this particular provision would require TARP participants to divest themselves of any general aviation aircraft currently owned, and to terminate any existing leases of general aviation aircraft. It would be disastrous to the general aviation industry, which is of vital importance to Kansas and the nation. We know that this provision would set a very bad precedent, and that its ultimate effects would be highly counterproductive – fewer aircraft orders, severe reductions in high quality manufacturing jobs, and harm to the valued presence of general aviation in the national and world economies. We can least afford this now, especially in light of the severe challenges already being faced by general aviation resulting from the economic downturn over the past several months, which have already caused significant layoffs at many of our companies, including Cessna.

Overall, general aviation contributes more than $150 billion per year to the national economy and employs 1,265,000 people in highly skilled, well paying jobs throughout the manufacturing and supply chain communities. Last year, our industry delivered almost 3,300 aircraft, with a total value of almost $12 billion, in the United States and around the world. Over 38% of these aircraft were exported to other nations, leading to a trade surplus for our industry.

Cessna Aircraft Company One Cessna Boulevard, Wichita, Kansas 67215-1400, 316.517.0049, Fax 316 517.6430
Mailing Address: P.O. Box 7706, Wichita, Kansas 67277-7706

Thank you for your support of the general aviation industry and for your opposition to this provision of the TARP legislation. We look forward to continuing to work with you in Congress on other matters of high importance to our industry, to our employees, and to the people of Kansas and the nation.

Sincerely,



Jack J. Pelton

Hawker Beechcraft

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Hawker Beechcraft Corporation
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Wichita, Kansas
67206 USA

January 9, 2009

The Honorable Kathleen Sebelius
Governor
State of Kansas
Capitol, 300 SW 10th Avenue, Suite 2125
Topeka, KS 66612-1590

Dear Governor Sebelius,

I am writing to ask for your help with an important business matter that affects jobs in Kansas. Hawker Beechcraft, along with all of the other general aviation manufacturers, needs your assistance urging key leaders to oppose efforts in Congress that punish corporations who own or lease business aircraft. We ask that you contact Chairman Dodd of the Senate Banking Committee, Chairman Frank of the House Financial Services Committee, and President-Elect Obama's economic team, as this is a matter of utmost importance to our business.

As you recall, December's Auto Loan Financing bill that passed in the House required corporations receiving government assistance to divest any business aircraft they owned or leased. The Bush Administration later incorporated the same measure in its loan package after the bill died in the Senate, and I fear that there are efforts underway to replicate the provision for banks and financial firms that own or lease aircraft. I understand that Congress and the Administration are reacting to the criticism the automotive industry CEOs encountered when they flew business aircraft to Washington. The fact is that these provisions tarnish the image of the general aviation industry and, if replicated, will lead to fewer aircraft orders and additional lost jobs in Kansas.

You know as well as anyone how important general aviation is to the State of Kansas. Our company is already suffering from one of the most challenging economic environments in our history and the last thing we need is for Congress to pursue an effort that will significantly weaken our business. Chairman Dodd, Chairman Frank, and the President-Elect's economic team need to hear from leaders like you about the importance of general aviation manufacturing to the U.S. economy. Targeting general aviation is an unacceptable and counterproductive response to our nation's economic situation. It will cost us good, high-paying jobs in Kansas and throughout the United States.

I thank you for your continued support of general aviation and for considering this urgent request.

Sincerely,

Thanks!!

James E. Schuster
Chairman and CEO

cc: Kansas Congressional Delegation

Testimony of

Cynthia Blankenship
Vice Chairman/COO, Bank of the West

On behalf of the
Independent Community Bankers of America

Before the

Congress of the United States
House of Representatives
Committee on Financial Services

Hearing on

"Priorities for the Next Administration: Use of TARP Funds Under EESA"

January 13, 2009
Washington, DC

Chairman Frank, Ranking Member Bachus, Members of the Committee, my name is Cynthia Blankenship and I am the Chief Operating Officer and Vice Chairman of Bank of the West in Grapevine, Texas, and the Chairman of the Independent Community Bankers of America[1]. Bank of the West is a state-chartered bank with $250 million in assets and is part of a two-bank holding company. I am pleased to represent community bankers and ICBA's 5,000 members at this important hearing on "Priorities for the Next Administration: Use of TARP Funds Under EESA."

Introduction & Summary

Today's hearing is focused on the use of Troubled Asset Relief Program's Capital Purchase Program and other provisions under the Emergency Economic Stabilization Act of 2008. The TARP is a key element of the nation's economic recovery plan. My testimony addresses the following issues:

- Treasury's delay in providing CPP funds to community banks;
- The increasingly difficult examination and accounting environment community banks are facing;
- Our comments on the foreclosure mitigation process; and
- Deposit insurance issues Congress must address in 2009.

We believe each of these issues will have a direct impact on the prospects for a strong recovery.

It is vital to note at the outset that community banks had no role in creating the current problems we face. They did not engage in irresponsible subprime lending and have remained strongly capitalized. Therefore, our members are well-positioned to drive economic recovery in their communities.

That is why we urge Congress to direct the Treasury to quickly provide funds for Subchapter S and mutual institutions, which have not been eligible for funds under the existing terms of the CPP. While the vast majority of community banks generally have enough capital to serve their current customers, additional capital from the CPP for interested banks would help them serve additional consumers and businesses.

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[1] *The Independent Community Bankers of America represents nearly 5,000 community banks of all sizes and charter types throughout the United States and is dedicated exclusively to representing the interests of the community banking industry and the communities and customers we serve. ICBA aggregates the power of its members to provide a voice for community banking interests in Washington, resources to enhance community bank education and marketability, and profitability options to help community banks compete in an ever-changing marketplace.*

With nearly 5,000 members, representing more than 18,000 locations nationwide and employing over 268,000 Americans, ICBA members hold more than $908 billion in assets, $726 billion in deposits, and more than $619 billion in loans to consumers, small businesses and the agricultural community. For more information, visit ICBA's website at www.icba.org.

We also recommend that the bank regulatory agencies adopt a more flexible and reasonable examination policy, particularly with respect to real estate lending, so that community banks can meet their communities' credit needs. To get at the heart of the current crisis, ICBA believes current foreclosure mitigation programs such as Hope for Homeowners, the voluntary FHA programs and the FDIC's proposed plan can be made more workable. The Chairman's proposed changes to Hope for Homeowners and proposal to use TARP funds for foreclosure mitigation should significantly enhance the government's foreclosure mitigation efforts. Finally, Congress and the FDIC should address expiring deposit insurance coverage and glaring inequities in the deposit insurance system so community banks will have continued access to local deposits, which are the main source of lendable funds.

We applaud the Chairman for addressing many of these issues by introducing the TARP Reform and Accountability Act of 2009 (H.R. 384), and ICBA urges its swift passage. The bill contains many provisions important to community banks. The bill requires the Secretary of the Treasury to promptly allow access to the CPP by Subchapter S banks and mutual FDIC-insured banks, and to do so on terms comparable to those applicable to the largest banks that have already received capital infusions under the TARP. ICBA applauds the Chairman for including a provision to give the banking industry more time to recapitalize the FDIC Deposit Insurance Fund – an idea the ICBA has strongly advocated. The bill makes permanent the increase in deposit insurance coverage from $100,000 to $250,000. And as the ICBA recently advocated in a comment letter to the FDIC, the bill makes clear bank holding companies with significant non-bank subsidiaries will pay their fair share of any deficit in the FDIC Temporary Liquidity Guarantee Program.

Limited Availability of Community Banks to TARP/CPP Must be Addressed

There are more than 8,000 community banks nationwide, and they are well positioned to extend lending to their communities using capital from the Capital Purchase Program. Including interested banks in the Capital Purchase Program will stimulate additional lending in local communities throughout the country.

However, ICBA has had significant concerns with the pace of implementation of the Troubled Asset Relief Program's CPP. ICBA members are growing increasingly concerned that only $60 billion is left uncommitted from the $250 billion Capital Purchase Program and still more than 3,000 financial institutions cannot qualify for the CPP. Half of the CPP's $250 billion was quickly provided to just nine of nation's largest banks. Notably, an additional $40 billion was granted to insurer American International Group from the general TARP funds.

Large institutions, such as credit card company American Express and auto lender GMAC, have also converted to bank holding companies so they too may access TARP funds. This follows the rapid conversion of the gigantic investment firms such as Goldman Sachs and Morgan Stanley into bank holding companies

after being battered in the markets. All the while thousands of traditional community banks stand ready willing and interested in TARP CPP access to help boost lending but they have been largely shut out.

The Treasury's term sheets released so far do not work for Subchapter S banks and mutual institutions because of statutory constraints and organizational structures peculiar to each of these types of institutions. ICBA and others provided Treasury concrete suggestion to overcome the obstacles to term sheets for these smaller banks. We were pleased Treasury issued a term sheet for certain privately held banks, but have been disappointed that Subchapter S and mutual banks are still waiting on workable CPP terms to access the program. These institutions play critical roles in their communities, particularly in small towns and in the New England states where they are the predominant local and small business lenders.

ICBA is pleased H.R. 384 directly addresses these concerns. It explicitly directs the Treasury "to promptly make funds available for smaller community institutions." It is entirely feasible to craft workable terms for Subchapter S and mutual banks so they can access CPP funds under similar economic terms as the big publicly traded banks. We urge Treasury to act quickly to include all community banks in the CPP.

We are pleased that the Chairman's draft would not apply most of the new conditions for the receipt of TARP capital to Subchapter S and mutual banks, which, through no fault of their own, have been unable to apply for TARP capital infusions. H.R. 384 recognizes that applying such conditions retroactively would have placed an unfair burden on community banks.

Allowing all community banks to participate in the TARP CPP and help boost lending to families and small businesses. For every dollar in new capital a community bank can raise it will help facilitate an additional seven to ten dollars of lending in their communities. The cost of this CPP capital is not inexpensive for community banks, at some 7.5% tax effective rate in the first five years with additional warrant-related costs on top. So community banks using this capital will put it to good use by doing what they do best – lend on Main Street.

Banks nationwide interested in expanding lending through the Capital Purchase Program are rightly concerned about a provision in the CPP agreement that will allow the Treasury to retroactively change any of the contract terms of the established Securities Purchase Agreement should there be a change to a federal statute. ICBA suggests this provision be modified to say that only future changes to federal law that apply to all financial institutions, not those changes directed solely at institutions participating in the CPP program, could be incorporated into the agreement retroactively. This would ameliorate the concern of community banks that significant terms of the agreement could be changed retroactively.

TARP Funds & Consolidation

Many in the community banking sector have become concerned that TARP capital infusions can be used to fuel unnecessary consolidation within the industry. We are pleased that the Chairman has included a provision in his bill that addresses the use of TARP funds for the acquisition of healthy community banks. The bill would require any acquisition of another depository institution by an institution receiving TARP funds be conditioned on a finding by Treasury, in consultation with the relevant bank regulatory agencies, 1) that the acquisition reduces the risk to taxpayers or, 2) that the transaction could have been accomplished without funds provided under the TARP.

Commercial Real Estate

On a technical matter, we note that section 403 of the bill, relating to commercial real estate loans, clarifies the TARP authority to purchase commercial real estate loans, including those in asset backed securities. We recommend that the statutory language explicitly provide clarification that whole real estate loans can be purchased under the TARP, since community banks are more likely to hold commercial real estate assets in that form.

Difficult Exam and Accounting Environment is Exacerbating the Credit Crunch and Impeding Economic Recovery

Examinations

Economic recovery will be delayed if banks are discouraged from making good loans to consumers and businesses. ICBA is hearing from community bankers across the country about overzealous and unduly overreaching examiners who are, in some cases, second guessing bankers and professional independent appraisers and demanding overly aggressive write-downs and reclassifications of viable commercial real estate loans and other assets. This will lead to a contraction in credit as community bankers avoid making good loans for fear of examiner criticism, write-downs, and the resulting loss of income and capital.

Therefore, ICBA commended the banking agencies last fall for issuing their Interagency Statement on Meeting the Needs of Creditworthy Borrowers. It is very important that all banking organizations and their regulators work together to ensure that the needs of creditworthy borrowers are met. Given the fact that most community banks are well capitalized and have appropriate dividend, compensation, and loss mitigation policies, ICBA believes that the community banking industry generally will have few problems complying with the guidance set forth in the Interagency Statement. As you know, community banks play a significant role in meeting the credit needs of households and small business and stand ready to work with the regulators to continue to meet that objective.

However, for the Interagency Statement to have its intended effect regarding lending, the agencies must address the current examination environment. We have had many reports from community bankers of examiners requiring write-downs or classification of performing loans due to the value of collateral irrespective of the income or cash flow of the borrowers; placing loans on non-accrual even though the borrower is current on payments; discounting entirely the value of guarantors; criticizing long-standing practices and processes that have not been criticized before; and substituting their judgment for that of the appraiser.

While we expect examiners will be more thorough and careful with their examinations during a credit downturn, based on what we have heard from our members, we believe that in many cases examiners have gone too far. Unfortunately, excessively tough exams that result in potentially unnecessary loss of earnings and capital can have a dramatic and adverse impact on the ability of community banks to lend, impairing their ability to support economic growth. Since community banks are the prime engine behind small business lending, any contraction of lending would further exacerbate the current economic downturn and impede attempts by the regulators to keep loans flowing to creditworthy borrowers to help foster an economic recovery.

Community banks are ready to meet the objectives stated in the Interagency Statement of lending to creditworthy households and businesses, but they cannot meet those objectives without a change in the current examination environment. In addition to the issuance of the Interagency Statement, we urge the bank regulatory agencies to adopt a more flexible and reasonable examination policy particularly with respect to real estate lending so that community banks can meet the credit needs of their communities.

Accounting

Congress should direct regulators to temporarily suspend the misapplication of mark-to-market and "Other Than Temporary Impairment" (OTTI) concepts to financial institutions during these extraordinary abnormal market circumstances. These requirements must be suspended until the financial markets return to more normal operations to prevent further destruction of capital and lendable funds in the economy. Congress gave the SEC the power to suspend mark-to-market accounting to avoid this race to the bottom. More needs to be done to ensure a proper understanding of what fair value is and is not, and to ensure that it is being properly applied so that there is less likelihood for different interpretations among statement preparers, auditing firms, analysts, examiners and ultimately the markets. The SEC and FASB should reconsider accounting for impairments, including the current restrictions on the ability to record increases in value when market prices recover and the development of additional guidance for determining the fair value of investments in inactive markets where market prices are not readily available.

Foreclosure Mitigation Steps

Community banks are truly invested in long-term relationships with their customers and their communities. When community banks service mortgages, they have a strong interest in maintaining those relationships, and not just guarding the interests of investors. Community banks' involvement in finding solutions for consumers extends beyond their own customers as community banks have offered refinancing to troubled borrowers with loans from other institutions as well.

Community banks played no role in causing the current crisis because, by and large, they did not engage in the subprime lending practices at the heart of the current crisis. As a result, community banks are not currently experiencing unusual levels of mortgage defaults. And, ICBA members are still making mortgage loans. Community bank mortgage originations have remained steady throughout 2008 year. ICBA Mortgage Corporation helped 1,000 community banks write approximately 40,000 mortgages totaling $6.2 billion. Assuming that ICBA Mortgage Corporation's market share of the community bank market is five percent, we estimate community banks have originated approximately 800,000 mortgage loans for an aggregate principal amount of approximately $125 billion for 2008.

But we agree that minimizing foreclosures is an important part of the effort to stabilize the U.S. economy. Foreclosure is often a very lengthy, costly and destructive process that puts downward pressure on the price of nearby homes.

Community banks that service their own mortgages monitor payment activity for changes that might signal a borrower could have difficulty paying the mortgage. If that occurs, they contact the borrower quickly to avoid potential problems. Community banks do not rush to foreclosure, which has significant negative consequences for both borrowers and lenders.

Community banks will continue to work with individual borrowers to find the best solution to keep the borrowers in their homes, including through a loan modification under the Hope for Homeowners Program or under any new government programs that would support mortgage modification.

The pending bill will make significant improvements to the Hope for Homeowners Program and will provide $50 billion of TARP funds to bolster the government's foreclosure mitigation efforts. We have some additional concerns and suggestions for foreclosure mitigation.

Hope for Homeowners and FDIC Program

Loan to Value Determination -- Any program depends on a credible valuation of the property. The agencies in charge of loan modification support programs

should work with the lending community to establish a procedure to determine the value of a property, and once the value of a home is determined, there should be an agreement by the banking regulators that they won't second guess the value of the collateral in a subsequent bank examination, at least for a reasonable period of time.

Regulatory and Accounting Forbearance – When a lender modifies a mortgage, it must recognize a loss on the original loan. There should be a relaxation of accounting standards for the recognition of the losses, and the banking regulators should relax regulatory capital standards vis-à-vis these losses.

FDIC Program[2]

More Generous Loss Sharing in High Foreclosure Areas – The FDIC loss sharing begins to phase out at 100% LTV and disappears at 150% LTV. For areas with high foreclosure rates, the loss sharing should be more generous above 100% LTV. Home values are particularly depressed in those areas and there could be many more modifications above 100% LTV.

Borrower Eligibility for Significant Changes in Condition -- The FDIC proposal only makes eligible loans that are 60 days past due. We understand that some contracts between investors and servicers prevent the servicer from working with borrowers who are current. Nevertheless, the FDIC program should be flexible enough to allow a borrower who has lost a job or has other significant changes in condition to qualify for a modified mortgage before he or she becomes delinquent. At the very least, this feature should be available for servicers and lenders who are not constrained by contract from pursuing a modification before default.

Congress Should Address Deposit Insurance Issues for 2009

The Emergency Economic Stabilization Act temporarily increased deposit insurance coverage from $100,000 to $250,000 (coincidentally, the level for certain retirement accounts). Separately, the FDIC Temporary Liquidity Guaranty Program temporarily provides full coverage for transaction accounts.

This additional coverage has helped many community banks serve their communities and compete with banks that are too big to fail. We recommend that Congress enact legislation to make these increases permanent. It should also consider a corresponding increase in retirement account coverage. Now, more than ever, it is essential that middle class Americans have a safe place for their retirement dollars.

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[2] The FDIC's proposed program is designed to make mortgages more affordable to homeowners through interest rate reduction, amortization term extension, and/or principal forbearance.

Community banks fully recognize that the banking industry must pay for this additional coverage. Indeed, we note that all the funds that the FDIC provided during this crisis have been paid in advance by the banking industry. We urge that Congress provide the FDIC additional time to recapitalize the Deposit Insurance Fund to the full 1.25 percent reserve ratio beyond the current 5-year time horizon. An extension would take into account the extraordinary losses the DIF has incurred, and the cost of the additional coverage levels that we have endorsed. Unless the industry has additional time to restore the reserve ratio, the FDIC will be forced to charge high deposit insurance premiums and remove funds from communities at a time when they need as much capital as possible to support local lending. We commend the Chairman's approach of increasing the period for recapitalization of the DIF from five years to eight years.

We would like to bring to the Committee's attention one issue that may take Congressional action to address. The FDIC used its systemic risk authority to establish the TLGP. The net costs of any activity under the systemic risk authority must eventually be borne by all FDIC-insured banks and thrifts through an assessment based on the institutions' assets minus equity. The statute does not expressly authorize the FDIC to assess non-bank and non-thrift affiliates, including holding companies. The Debt Guarantee Program has been extended to holding companies because much of the bank debt is issued at the holding company level. However, should a special assessment be needed to make up for any deficit in the TLGP, the FDIC cannot levy an assessment against the non-bank assets of a holding company. We applaud the Chairman and the FDIC for their support of a provision in the bill that would allow the FDIC to ensure holding companies with significant non-bank assets pay their fair share of any deficit in the TLGP.

Premiums on Too-Big-to-Fail Banks; Break-Up of Systemic Risk Institutions

Congress should also direct the FDIC to assess special premiums on banks that are so large or interconnected with the financial system that the government will not allow them to fail. These too-big-to-fail institutions have a deposit insurance product that is better than traditional FDIC coverage – 100 percent coverage for all liabilities. They should pay for it through a systemic risk premium.

Even if Congress enacts this reform, ICBA remains deeply concerned about the continued concentration of banking assets in the U.S. Today, the four largest banking companies control more than 40% of the nation's deposits and more than 50% of the assets held by U.S. banks, posing an enormous systemic risk not only to the FDIC Bank Insurance Fund but also to our historically diversified economic system. We do not believe it is in the public interest to have four institutions controlling most of the assets of the banking industry. Our nation just went through an agonizing series of bankruptcies, bank failures, forced mergers, and recapitalizations of some of the nation's largest banking and investment

houses costing American taxpayers hundreds of billions and resulting in the government becoming a major stockholder of many of our financial institutions. Our nation cannot afford to go through that again.

Unfortunately, short-term crisis management last fall led to the creation of even larger institutions. To prevent a recurrence of this crisis, Congress should break up the systemic risk institutions or require them to divest sufficient assets so they no longer pose such a significant risk to our economy. It is not enough to block further mergers; the largest institutions need to be broken into more manageable firms. Too-big or too-interconnected-to-fail then could be eliminated from the American lexicon.

Conclusion

ICBA appreciates this opportunity to testify on these critical issues. We look forward to working with this Committee and Congress on these and other steps that will help us emerge from this current crisis and improve our financial system for the long run.

EMBARGOED UNTIL DELIVERY

STATEMENT OF

JOHN F. BOVENZI
DEPUTY TO THE CHAIRMAN AND CHIEF OPERATING OFFICER
FEDERAL DEPOSIT INSURANCE CORPORATION

on

PRIORITIES FOR THE NEXT ADMINISTRATION: USE OF TARP FUNDS UNDER THE EMERGENCY ECONOMIC STABILIZATION ACT OF 2008

COMMITTEE ON FINANCIAL SERVICES
U.S. HOUSE OF REPRESENTATIVES

January 13, 2009
Room 2128, Rayburn House Office Building

Chairman Frank, Ranking Member Bachus and members of the Committee, I appreciate the opportunity to testify on behalf of the Federal Deposit Insurance Corporation (FDIC) regarding the use of funds under the Emergency Economic Stabilization Act of 2008 (EESA). The incoming Administration will face a number of serious economic challenges and the effective and efficient use of the funds provided by Congress under EESA will be an essential element for maintaining stability in the financial markets and returning them to more normal operations. In addition, EESA provides statutory authority and funding that could be effective in reducing unnecessary foreclosures which have contributed substantially to our current economic problems.

On November 18, Chairman Bair testified before this Committee on efforts to stabilize the nation's financial markets and to reduce foreclosures. While some additional steps have been taken, credit remains tight and more needs to be done for homeowners in distress. Credit markets have not been functioning normally, contributing to a rising level of distress in the economy. In addition, high levels of foreclosures are contributing to downward pressure on home prices. Troubled assets continue to mount at insured commercial banks and savings institutions, placing a growing burden on industry earnings. As reported in the third quarter 2008 *FDIC Quarterly Banking Profile*, expenses for credit losses topped $50 billion for the second consecutive quarter. Third quarter income totaled only $1.7 billion, a decline of $27 billion (94 percent) from the third quarter of 2007. Almost one in four institutions (24.1 percent) reported a net loss for the quarter. However, as discussed further below, programs implemented by the

Federal Reserve Board (FRB), the FDIC, and the U.S. Treasury Department to boost liquidity appear to be making a positive impact.

Returning the economy to a condition where it can support normal economic activity and future economic growth will require a number of strategies, including providing access to additional funds under the Troubled Asset Relief Program (TARP). We understand that many Members of Congress have concerns about the past use of TARP funds. The FDIC does not serve on the TARP Oversight Board and has no statutory role in the administration of its programs. However, we will support Treasury's request for the release of the second $350 billion. We believe that these funds -- with appropriate transparency and accountability -- could provide important and necessary support to prevent additional contractions in lending, assist financial institutions in providing credit to creditworthy borrowers and provide incentives to avoid unnecessary foreclosures.

My testimony will discuss the FDIC's efforts to provide additional liquidity to insured institutions through our Temporary Liquidity Guarantee Program (TLGP), as well as our participation in the Capital Purchase Program implemented by the Treasury Department under EESA. Though the TLGP is funded through industry assessments and does not rely on TARP funding, it is an important component of combined interagency efforts to combat the financial crisis. I also will discuss the continuing need for a program to provide a means for financial institutions to sell troubled assets to free up additional balance sheet capability to engage in prudent lending. We believe a program

is needed that is capable of managing these assets until the economy and the banking industry are stabilized, and that institutions of all sizes should be allowed to participate if they otherwise qualify. In addition, I will reiterate the need for more robust mortgage loan modification efforts, such as those previously proposed and implemented under the auspices of the FDIC. Finally, I will discuss measures that financial institutions should take to ensure that TARP/EESA funds are used responsibly and effectively.

Efforts to Improve the Liquidity and Capital at Insured Depository Institutions

Temporary Liquidity Guarantee Program

The FDIC Board of Directors adopted the TLGP on October 13, 2008 in response to credit market disruptions, particularly in the interbank lending market. The FDIC's action in establishing the TLGP is unprecedented and necessitated by the crisis in our credit markets, which has been fed by a rising aversion to risk and serious concerns about the effects this will have on the real economy. The FDIC's action was authorized under the systemic risk exception of the FDIC Improvement Act of 1991 and followed similar actions by the international community. If the FDIC had not acted, guarantees for bank debt and increases in deposit insurance by foreign governments would have created a competitive disadvantage for U.S. banks. Along with Treasury's actions to inject more capital into the banking system, the combined coordinated measures to free up credit markets have had a stabilizing effect on bank funding.

The TLGP is designed to help stabilize the funding structure of financial institutions and expand their funding base to support the extension of new credit. The TLGP has two components: 1) a program to guarantee senior unsecured debt of insured depository institutions and most depository institution holding companies, and 2) a program to guarantee noninterest bearing transaction deposit accounts in excess of deposit insurance limits. It is important to note that the TLGP does not rely on taxpayer funding or the Deposit Insurance Fund. Instead, both aspects of the program will be paid for by direct user fees. With regard to the debt guarantee program, premiums are charged on a sliding scale depending on the length of the debt maturity. For the deposit insurance guarantee, a 10 basis point surcharge is applied to deposits in non-interest bearing transaction deposit accounts not otherwise covered by the existing deposit insurance limit of $250,000. This surcharge will be collected at the same time that the participating bank pays its existing risk-based deposit insurance premium paid on those deposits.

The FDIC is charging significant fees to offset its new risk exposure and minimize the likelihood that there will be any losses associated with the program. However, if losses should occur, they would be covered through a special systemic risk assessment. Unfortunately, under current law, the FDIC has authority to assess only insured depository institutions, even though the benefits of the TLGP accrue more broadly to bank holding companies. As a consequence, the FDIC is seeking authority from the new Congress to broaden its systemic risk special assessment authority to include depository institution holding companies, as appropriate to the benefits they

receive and we are pleased that Chairman Frank included such a provision in his recently proposed legislation on EESA.

The TLGP has a high level of participation; over 6,700 banks and thrifts have opted in to the deposit guarantee program, and over 6,900 bank and thrifts and their holding companies have opted in to the debt guarantee program. The program also has improved access to funding and lowered banks' borrowing costs. As of December 30, participating entities reported about $258 billion in guaranteed debt issued, with about $222 billion of this still outstanding. Data show that FDIC-guaranteed debt is trading at considerably lower spreads than non-guaranteed debt issued by the same companies. Since the inception of the TLGP program and the other interagency measures announced in mid-October, interbank lending rates have declined. For example, the LIBOR – Treasury (TED) spread declined from 464 basis points on October 10 to 120 basis points on January 9.

Capital Purchase Program

As a part of EESA, the Treasury Department developed a Capital Purchase Program (CPP) which allows certain financial companies to apply for capital augmentation of up to three percent of risk weighted assets. The ongoing financial crisis has disrupted a number of the channels through which market-based financing is normally provided to U.S. businesses and households. Private asset-backed securitization remains virtually shut down, and the commercial paper market is now heavily dependent

on credit facilities created by the Federal Reserve. In this environment, banks will need to provide a greater share of credit intermediation than in the past to support normal levels of economic activity. By contrast, a significant reduction in bank lending would be expected to have strong, negative procyclical effects on the U.S. economy that would worsen the problems of the financial sector.

Before the recent capital infusions, banks appeared to be on course to significantly reduce their supply of new credit as a response to an unusually severe combination of credit distress and financial market turmoil. Standard banking practice during previous periods of severe credit distress has been to conserve capital by curtailing lending. In the present episode, lending standards were likely to be tightened further due to higher funding costs resulting from overall financial market uncertainty. There was ample evidence in the Federal Reserve's *Senior Loan Officer Survey* in October that bank lending standards were being tightened to a degree that is unprecedented in recent history.[1]

Government intervention was needed to interrupt this self-reinforcing cycle of credit losses and reduced lending. The Treasury Department implemented the CPP as a means of countering the procyclical economic effects of financial sector de-leveraging. The federal bank regulators expect banks to actively seek ways to use this assistance by making sound loans to household and business borrowers. The FDIC recognizes that banks will need to make adjustments to their operations, even cutting back in certain

[1] Federal Reserve Board, *Senior Loan Officer Opinion Survey on Bank Lending Practices*, October 2008, http://www.federalreserve.gov/boarddocs/snloansurvey/200811/

areas, to cope with recent adverse credit trends. However, the goal of providing government support is to ensure that such cut-backs and adjustments are made mostly in areas such as dividend policy and management compensation, rather than in the volume of prudent bank lending. These considerations are consistent with the precept that the highest and best use by banks of CPP capital in the present crisis is to support prudent lending activity. As discussed in more detail below, ongoing supervisory assessments of bank earnings and capital will take into account how available capital is deployed to generate income through responsible lending.

Thus far, a number of the largest banking companies in the U.S. have taken advantage of the CPP, significantly bolstering their capital base during a period of economic and financial stress. In addition, over 1,200 community financial institutions have applied to this program. In participating in the CPP program, as well as in launching the TLGP, it was the FDIC's express understanding that $250 billion would be made available for bank capital investments and that all eligible institutions, large and small, stock and mutual, would be able to participate. We strongly encourage both the Treasury Department and the Congress to make sure adequate funding is available for community bank participation in the CPP program.

It is critically important that community banks (commonly defined as those under $1 billion in total assets) are given every opportunity to participate in this program. Although, as a group, community banks have performed somewhat better than their larger competitors, they have not fully escaped recent economic problems. Community

banks control eleven percent of industry total assets; however, their importance is especially evident in small towns and rural communities. Of the 9,800 banking offices located in communities with populations under 10,000, 67 percent are offices of community banks. In these markets, the local bank is often the essential provider of banking services and credit. Their contribution to small business and agriculture lending is especially important and disproportionate to their size. As of June 30, 2008, bank lending by community banks accounted for 29 percent of small commercial and industrial loans, 40 percent of small commercial real estate loans, 77 percent of small agricultural production loans, and 75 percent of small farm land loans.[2] Although the viability of community banks as a sector continues to be strong, the CPP offers an opportunity for individual institutions to strengthen their balance sheets and continue providing banking services and credit to their communities.

We also believe it is important for the CPP to be implemented in a manner that encourages and rewards private capital investments to be made alongside TARP capital. Private capital investments serve as a powerful vote of confidence in the viability of a financial institution over the long term and that viability is enhanced by programs that match private funds with TARP capital.

[2] Small commercial and industrial loans and small commercial real estate loans are in amounts under $1 million. Small agricultural production loans and small farm land loans are in amounts under $500,000.

Addressing the Problems of Troubled Assets

The FDIC believes that the original intent of the TARP -- to remove problem assets from the balance sheets of banks and related entities -- continues to be vitally important. Such a program is necessary to expand banks' balance sheet capacity to undertake new lending as well as to attract private equity investment. As the receiver for failed banks, the FDIC has considerable experience with the challenges inherent in handling troubled assets. The management of troubled assets is difficult and costly. The development of a program to assist institutions in addressing their inventories of troubled assets should be a key component of TARP funds going forward.

The FDIC encourages development of a troubled asset program that meets three main principles:

Accountability -- The program should follow a standardized approach that establishes a fair and transparent program upfront for dealing with troubled assets to alleviate market uncertainty. Participating entities should be required to develop compensation programs that truly reward long term performance and rely on definable metrics. It is essential that any such program carry conditions and expectations to support credit availability and the viability of the banking industry for years to come.

Transparency -- Participants in the program should be required at the outset to show how participation would expand prudent lending activity. Specifically, they should provide the government with a plan for using the funds to facilitate new lending, with definable metrics for measuring performance.

Viability -- Participants should be required to demonstrate the capacity to raise additional private capital in significant proportion to the relief provided. In order to be eligible, participating entities should have to demonstrate that the transaction would ensure their viability over the long term and an important test of viability

would be their ability to raise private common equity capital alongside their sale of assets into this structure.

Even with the various forms of government assistance that have been provided by the regulators and through EESA, troubled asset relief will still be necessary to enable financial institutions to address their inventories of troubled assets so that they can return to more normal lending activity. This program should be made available to banks of all sizes, rather than just large financial institutions, to address financial stresses that may be occurring at the regional and local levels. In the current market conditions, uncertainty about the potential losses embedded in the balance sheets of financial institutions is constricting lending between institutions and dissuading investors from providing the new capital essential to a recovery. In addition, government acquisition of troubled residential mortgages would facilitate action to restructure these loans and improve the performance of housing-related assets, providing the foundation both for a greater flow of credit and the investment of new capital into the financial system. However, because of the sheer volume of troubled mortgages, as well as the large number which are locked in securitization trusts, it also is vital to institute a specific program aimed at foreclosure prevention.

Efforts to Reduce Unnecessary Foreclosures

Minimizing foreclosures continues to be essential to the broader effort to stabilize global financial markets and the U.S. economy. There were an estimated 1.5 million U.S. foreclosures in 2007, and another 1.2 million in the first half alone of 2008. The

continuing trend of unnecessary foreclosures imposes costs not only on borrowers and lenders, but also on entire communities and the economy as a whole. Foreclosures may result in vacant homes that may invite crime and create an appearance of market distress, diminishing the market value of other nearby properties. Foreclosures add inventory and create distressed sale prices which place downward pressure on surrounding home values. In addition, the direct costs of foreclosure include legal fees, brokers' fees, property management fees, and other holding costs that are avoided in workout scenarios. These costs can total between 20 and 40 percent of the market value of the property.[3]

The FDIC has strongly encouraged loan holders and servicers to adopt systematic approaches to loan modifications that result in affordable loans that are sustainable over the long term. Unnecessary foreclosures perpetuate the cycle of financial distress and risk aversion, thus raising the very real possibility that home prices could overcorrect on the downside.

Beyond their positive impact on foreclosures, there is a strong business case for loan modifications. Loan restructurings are a time-tested tool for mitigating losses when loans become delinquent. The FDIC has long used loan modifications to improve the value of troubled loans we inherit from failed banks. Not surprisingly, our experience demonstrates that performing loans are worth much more than delinquent loans we sell back into the private sector.

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[3] Capone, Jr., C. A., *Providing Alternatives to Mortgage Foreclosure: A Report to Congress*, Washington, D.C.: United States Department of Housing and Urban Development, 1996.

If, through restructuring, a borrower is able to continue making payments, this will provide more value to the lender than a foreclosed property. This is especially the case when the housing market has declined precipitously. In today's market, a foreclosure sale will usually net far less than the outstanding balance of the loan. Not only have home prices declined, but foreclosure costs currently run 20 to 40 percent of the property's value. For instance, modifying a 30-year loan with a 7 percent interest rate to 5.5 percent for the balance of the loan term would reduce the net present value of the loan by only 10 percent. By comparison, in today's market a foreclosure sale would likely impose losses of at least 25 percent, if not significantly more. Therefore, loan modifications that convert troubled loans into loans that are sustainable over the long term not only prevent unnecessary foreclosures, but make good business sense.

Foreclosure Mitigation Under EESA

EESA provides broad authority to the Secretary of the Treasury to take action to ameliorate the growing distress in our credit and financial markets, as well as the broader economy. EESA specifically provides the Secretary with the authority to use loan guarantees and credit enhancements to facilitate loan modifications to prevent avoidable foreclosures. We believe that it is essential to utilize this authority to accelerate the pace of loan modifications in order to halt and reverse the rising tide of foreclosures that is imperiling the economy.

Mortgage loan modifications have been an area of intense interest and discussion for more than a year now. Meanwhile, despite the many programs introduced to address the problem, it continues to get worse. During the second quarter of 2008, we saw mortgage loans becoming 60 days or more past due at a rate of more than 700,000 per quarter -- net of past due loans that returned to current status. No one can dispute that this remains the fundamental source of uncertainty for our financial markets and the key sector of weakness for our economy. We must decisively address the mortgage problem as part of our wider strategy to restore confidence and stability to our economy.

In previous testimony, Chairman Bair has outlined an FDIC proposal for the creation of a guarantee program based on the FDIC's practical experience in modifying mortgages at IndyMac Federal Bank in California. We believe this program could prevent as many as 1.5 million avoidable foreclosures. Generally, the FDIC has proposed that the government establish standards for loan modifications and provide for a defined sharing of losses on any default by modified mortgages meeting those standards. By doing so, unaffordable loans could be converted into loans that are sustainable over the long term. This proposal is authorized by the EESA and may be implemented under the existing authority provided to the Secretary under that statute.

Redefaults are a significant concern for investors with regard to loan restructurings. One recent report[4] suggested that between 35 and 42 percent of modified mortgages subsequently become more than 60 days delinquent. However, this report did not track the quality of the modifications, defining the term broadly to include any

[4] OCC and OTS Mortgage Metrics Report, Third Quarter 2008.

change in contract terms. Other reports suggest much lower redefault rates where the borrower's payment is reduced. One study found redefault rates of 15 percent where modifications reduce interest payments.[5]

Deteriorating economic conditions will certainly cause redefault rates to increase. It should be noted, however, that even with high redefault rates, loan modifications still make business sense in many cases. This is because the value preserved through a loan restructuring is generally much greater than the incremental loss from waiting a period of months before the servicer forecloses or otherwise resolves the defaulting mortgage. For instance, as conservator of IndyMac Federal Savings Bank, the FDIC has used a systematic approach to loan modifications to restructure thousands of unaffordable loans into more sustainable payments. Even assuming a redefault rate of 40 percent, the net present value of loans that we have modified exceeds foreclosure value by an average of $50,000, with aggregate savings of over $400 million. In fact, we believe redefault rates will be much lower, but even at higher rates, systematic loan modifications make good business sense.

Over the next two years, an estimated 4 to 5 million mortgage loans will enter foreclosure if nothing is done. In addition to reducing the number of foreclosures, we believe that a loss sharing program would reduce the overhang of excess vacant homes that is driving down U.S. home prices. Such an approach makes good business sense, keeps modified mortgages within existing securitization transactions, does not require

[5] Credit Suisse, Fixed Income Research Report, Subprime Loan Modifications Update, Oct. 1, 2008.

approval by second lienholders, ensures that lenders and investors retain some risk of loss, and protects servicers from the putative risks of litigation by providing a clear economic benefit from the modifications.

While the proposed FDIC program would require a cash outlay in the event of default, we must consider the returns this guarantee would deliver in terms of our housing markets and, by extension, the economic well-being of our communities. While we support the various initiatives taken to date, if we are to achieve stability in our credit and financial markets we cannot simply provide funds to market participants. We must address the root cause of the financial crisis – too many unaffordable mortgages creating too many delinquencies and foreclosures. The time is overdue for us to invest in our homes and communities by adopting a program that will prudently achieve large-scale loan modifications to minimize the impact of foreclosures on households, lenders and local housing markets.

Financial Institution Accountability for Use of EESA Funds

On November 12, 2008 the FDIC issued an *Interagency Statement on Meeting the Needs of Creditworthy Borrowers* to all FDIC supervised institutions. To support this objective, consistent with safety and soundness principles and existing supervisory standards, each individual banking organization was urged to ensure the adequacy of its capital base, engage in appropriate loss mitigation strategies and foreclosure prevention,

and reassess the incentive implications of its compensation policies. In communicating this guidance to its supervised institutions, the FDIC encouraged them to:

- lend prudently and responsibly to creditworthy borrowers;
- work with borrowers to preserve homeownership and avoid preventable foreclosures;
- adjust dividend policies to preserve capital and lending capacity; and
- employ compensation structures that encourage prudent lending.

The FDIC emphasized that adherence to these standards would be reflected in examination ratings both for safety and soundness and compliance criteria.

To meet these objectives, it is crucial that banking organizations track the use of the funds made available through federal programs and provide appropriate information about the use of these funds. This week, the FDIC issued another Financial Institution Letter advising insured institutions that they should track their use of capital injections, liquidity support, and/or financing guarantees obtained through recent financial stability programs as part of a process for determining how these federal programs have improved the stability of the institution and contributed to lending to the community. Equally important to this process is providing this information to investors and the public. As a result, this Financial Institution Letter advises insured institutions to include information about their use of the funds in public reports, such as shareholder reports and financial statements.

Internally at the FDIC, we are preparing guidance to our bank examiners for evaluating participating banks' compliance with EESA, the CPP securities purchase agreements, and success in implementing the goals of the November 12 interagency statement. Importantly, this examiner guidance will focus on banks' use of TARP CPP funds and how their capital subscription was used to promote lending and encourage foreclosure prevention efforts. The banking agencies will measure and assess participating institutions' success in deploying TARP capital and other financial support from various federal initiatives to ensure that funds are used in a manner consistent with the intent of Congress and participants are held accountable.

FDIC examiners will be reviewing the expectations that we have established in the recent Financial Institution Letter for banks participating in the CPP, including:

- Establishment of a monitoring process for the use of TARP proceeds to determine the primary uses by the institution of received funds;
- Increased lending efforts in the institution's market since receiving a TARP CPP subscription;
- Down-streaming subscription proceeds to the insured depository institution (if a holding company structure is in place) to ensure that TARP funds can be intermediated into loans and bank capital is augmented;
- Engagement in mortgage loan modification or foreclosure prevention efforts that rely on systematic, proactive approaches that enhance the net present value of individual mortgage loans versus foreclosure;
- Utilization of executive compensation programs that exemplify good corporate governance and conform with EESA and other requirements; and
- Implementation of the goals of the November 12 interagency statement to meet the needs of creditworthy borrowers in the institution's market area.

During examinations, our supervisory staff will be reviewing banks' efforts in these areas and will make comments as appropriate in FDIC Reports of Examination. Our examiners will also be considering these issues when they assign CAMELS composite component ratings.

Conclusion

As we mentioned at the onset of this statement, the incoming Administration will face a number of serious economic challenges that will require a variety of approaches to successfully restore confidence in the financial system. TARP funds authorized by EESA will provide essential funding for capital stability for institutions and to provide incentives to avoid unnecessary foreclosures. The FDIC encourages Congress to authorize the additional $350 billion under TARP to continue these efforts. In addition, TARP funds could be used to develop strategies for the management of distressed assets that are burdening bank balance sheets. However, it is essential for institutions to account for how federal funds are being utilized. Examination staff is focusing its efforts on this issue to ensure that funds are used effectively. The FDIC looks forward to working with Congress in achieving these goals.

I will be pleased to answer any questions the Committee might have.

Testimony of Michael Calhoun, Center for Responsible Lending
Before the U.S. House of Representatives Committee on Financial Services

"Priorities for the Next Administration: Use of TARP Funds under EESA"

January 13, 2009

Good morning Chairman Frank, Ranking Member Bachus, and members of the Committee. Thank you for inviting me to testify on the use of TARP funds under the Emergency Economic Stabilization Act of 2008 and on H.R. 384, the TARP Reform and Accountability Act of 2009.

I serve as President of the Center for Responsible Lending (CRL), a nonprofit, non-partisan research and policy organization dedicated to protecting homeownership and family wealth by working to eliminate abusive financial practices. CRL is an affiliate of Self-Help, a nonprofit community development financial institution that consists of a credit union and a non-profit loan fund. For close to thirty years, Self-Help has focused on creating ownership opportunities for low-wealth families, primarily through financing home loans to low-income and minority families who otherwise might not have been able to get affordable home loans. In total, Self-Help has provided over $5 billion of financing to 55,000 low-wealth families, small businesses and nonprofit organizations in North Carolina and across America. Self-Help's lending record includes an extensive secondary market program, which encourages other lenders to make sustainable loans to borrowers with blemished credit.

With the constant barrage of statistics and staggering dollar figures that have become commonplace during this financial crisis, it is easy to become numb to the depth and scope of the financial pain American families are experiencing today. However, the numbers paint a picture we cannot ignore. Our most recent report on subprime mortgages shows that over 1.5 million homes have already been lost to foreclosure, and another two million families with subprime loans are currently delinquent and in danger of losing their homes in the near future.[1] Projected foreclosures on all types of mortgages during the next five years are 8.1 million at a minimum, which equates to 1 in 9 households or 1 in 6 households with mortgages.[2] On subprime mortgages alone, the spillover costs are massive. At least 40 million homes—households where, for the most part, people have paid their mortgages on time every month—are suffering a decrease in their property values that amounts to $352 billion.[3] These losses, in turn, are impacting nearly every aspect of American communities, from police and fire protection to community resources for education.

While the causes of this crisis are many,[4] so far solutions are few. Voluntary efforts by servicers and lenders have not been able to get ahead of the curve, and many of the modifications made so far have not resulted in sustainable loans for a variety of reasons discussed below. To date, the federal government has not created a systematic, large-scale way to stop those foreclosures that can reasonably be prevented.

We believe that the Troubled Asset Relief Program (TARP) is the key to leveraging systematic approaches to modifying mortgages to sustainable levels. H.R. 384 takes this approach as well. Whether through legislation or agency action, we strongly encourage the Treasury Department to

move in the direction that the legislation suggests. Using TARP to promote modifications and changing the law to permit judicial modification of primary residence mortgages are the two most important ways to help families stay in their homes and reduce their debt burden.

Helping families will stop the decline in neighborhood property values and will have a stimulative effect on the economy: we need consumer spending power we need to pull us out of this downward economic cycle. What's more, foreclosure prevention will strengthen the financial system as a whole. Financial institutions will not survive if their loan-related portfolios continue to fail, given that many banks have leveraged bets on the performance of these loans beyond investments in the securities backed by the loans themselves through credit default swap commitments or collateralized debt obligation investments.

In my testimony today, I will focus on five key points.

I. Voluntary, loan-by-loan modification efforts are not effectively stemming the tide of foreclosures. Modifications being made are unsustainable and many structural, legal, and financial obstacles exist to making modifications at all.

II. Streamlined, broad-based modification efforts are necessary to get ahead of the foreclosure curve. The Treasury can and should facilitate such an effort through TARP.

III. Treasury and Congress can also deploy other powerful tools to remove the current obstacles that block desirable loan modifications.

IV. Judicial loan modifications are needed to provide a crucial backstop in situations where servicers cannot modify a loan through the streamlined system and will provide a strong incentive for servicers and investors to make these programs work.

V. Vigilant oversight of the TARP program is crucial to provide accountability and to ensure that the program t is meeting its objectives.

I. Current voluntary modification efforts have failed to stem the tide of foreclosures.

Despite the loss mitigation encouragement by HOPE NOW, the federal banking agencies, and state agencies, voluntary efforts undertaken thus far by lenders, servicers and investors have not been sufficient to stem the tide of foreclosures. Moreover, servicers still face significant obstacles in making modifications.

A. The number of modifications is inadequate to stem the tide of foreclosures and the type of modifications being made is unsustainable.

Seriously delinquent loans are at a record high for both subprime and prime loans.[5] All available data consistently indicate that continuing foreclosures far outpace total loss mitigation efforts and that only a small share of loss mitigation efforts result in true loan modifications that are likely to result in sustainable loans.

In October, Credit Suisse reported that only 3.5 percent of delinquent subprime loans received modifications in August 2008.[6] Similarly, the most recent report from the State Foreclosure Working Group of Attorneys General and Banking Commissioners, which covers 13 servicers, 57% of the subprime market, and 4.6 million subprime loans, confirms that progress in stopping foreclosures is "profoundly disappointing."[7] Their data indicate that nearly eight out of ten seriously delinquent homeowners are not on track for any loss mitigation outcome, up from seven out of ten from their last report.[8] Even the homeowners who receive some kind of loss mitigation are increasingly losing their house through a short sale or deed-in-lieu rather than keeping the home through a loan modification or workout.[9]

What's more, when modifications and other workouts are made, they are frequently temporary or unsustainable, leading to re-default and placing homeowners and financial institutions in an even worse economic position than when they started. According to an analysis by Valparaiso Professor of Law Alan White, a national expert on foreclosure policy, of more than 3.5 million subprime and alt-A mortgages (all securitized), only 35% of modifications in the November 2008 report reduced monthly payments below the initial payment, while 20% left the payment the same and 45% increased the monthly payment.[10] Similarly, data through September 2008 indicate that the large majority of HOPE NOW efforts rely on repayment plans,[11] which typically require financially burdened households to add previously unpaid debt to their current mortgage payments.

In view of the foregoing, the recent report by the Office of the Comptroller of the Currency (OCC) regarding high loan modification redefault rates is unsurprising.[12] What is surprising is that the OCC seems to suggest that these redefault rates prove that loan modifications are useless in preventing foreclosures. To the contrary, what this report demonstrates is what we already suspected, which is that the modifications being made are not sustainable, affordable modifications. It does not take a statistician to predict that if a homeowner in default is given a higher rather than a lower monthly payment, there is a high probability of redefault.

Studies tracking the results obtained by different types of modifications show that certain types of modifications are much more successful than other types. According to a recent Lehman Brothers analysis, rate reduction modifications result in a more significant improvement in performance than principal and interest capitalizations that add past-due amounts onto the balance of the loan.[13] Credit Suisse reports that when interest rates or principal are reduced, the re-default rate is less than half of those for these other modifications.[14] And the OCC report suggests that modifications of mortgages held by a lender, rather than ones pooled into a mortgage-backed security, have been defaulting at lower rates, and this data further supports the notion that sustainable modifications can be made if obstacles to doing so can be overcome.[15]

B. Numerous legal and structural obstacles stand in the way of modifications.

A recent Federal Reserve Staff Working Paper identifies a number of obstacles that limit the scale of modifications.[16] These obstacles help explain why voluntary loss mitigation cannot keep up with demand.

- *Investor Concerns:* Servicers may shy away from modifications for fear of investor lawsuits.[17] While some Pooling and Servicing Agreements (PSAs) provide adequate authority to modify loans, these modifications may cause disproportionate harm to certain tranches of securities over other classes. Other PSAs include serious impediments to modifying securitized loans. For example, some limit the number or percentage of loans in a pool that can be modified.[18]

- *Second Liens:* Additional liens on a property pose a structural obstacle that is often impossible for servicers of the first lien to overcome. Between one-third and one-half of the homes purchased in 2006 with subprime mortgages have second mortgages,[19] and many more homeowners have open home equity lines of credit secured by their home. The holder of the first mortgage will not generally want to provide modifications that would simply free up homeowner resources to make payments on a formerly worthless junior lien, nor to modify a loan where there is a second mortgage in default. But as Credit Suisse reports, "it is often difficult, if not impossible, to force a second-lien holder to take the pain prior to a first-lien holder when it comes to modifications," thereby dooming the effort.[20]

- *Servicer Incentives:* The way servicers are compensated by lenders creates a market-distorting bias for moving forward with foreclosure rather than engaging in foreclosure prevention. Servicers are often not paid for modifications, but are reimbursed for foreclosure costs.[21] The Federal Reserve concludes, "Loan loss mitigation is labor intensive and thus raises servicing costs, which in turn make it more likely that a servicer would forego loss mitigation and pursue foreclosure even if the investor would be better off if foreclosure were avoided."[22]

- *Limited Servicer Staff and Technology:* With few but welcome recent exceptions, servicers have continued to process loan modifications in a labor-intensive, case-by-case review. While they have added staff and enhanced systems, the lack of transparent, standardized formulas has limited the number of modifications that have been produced.[23] Even when a servicer has a uniform methodology, that lack of transparency in the inputs to its net present value analysis, such as its selection of an appropriate discount rate, prevents borrowers and the public from properly evaluating modification decisions.

II. **The Treasury should use the Troubled Asset Relief Program (TARP) to leverage a systematic modification approach that will result in much larger numbers of sustainable modifications.**

As noted above, the most pressing public policy goal today is to help homeowners to stay in their homes and, by extension, to support their neighbors' property values and the financial system as a whole. Yet as administered by Treasury, TARP has to date utterly ignored the problem of excessive foreclosures, in the face of clear Congressional intent otherwise. We believe it is crucial for the Treasury to use its TARP authority to prevent many of these foreclosures and thereby to restore stability to the housing market and to ease access to credit.

The core approach of H.R. 384 is modeled on the streamlined and systematic approach to loan modifications that the FDIC has been using for restructuring IndyMac Federal Bank's mortgage loans and that will continue after the FDIC sells IndyMac. Similar approaches have now been adopted as part of a recent settlement between Bank of America and state Attorney Generals regarding unfair and deceptive lending practices by Countrywide, by Citigroup, and by JP Morgan Chase/Washington Mutual. While these modification programs face some obstacles, including difficulty getting all homeowners to respond and the inability so far to modify sufficient numbers of loans held in private label securities, they represent a step in the right direction and can serve as a basis for modifying loans through the TARP program.

As we see it, the Treasury will need to adopt different strategies for three different categories of loans:

- **Loans in Private Label Securities:** Treasury should adopt FDIC's proposed loan modification guarantee program and provide guarantees to modifications from servicers with streamlined affordable modification protocols based on the FDIC/IndyMac model. An appropriately structured model that subsidized borrower interest payments could also be considered.

- **Loans Held By Fannie Mae and Freddie Mac:** As the conservator for the GSEs, the Federal Housing Finance Agency should direct them to facilitate modifications to the greatest extent possible. The recent November 11 announcement is a positive step for these loans.

- **Loans Held in Portfolio by Banks and Thrifts:** Treasury should require banks and thrifts that participate in Treasury's equity investment or asset purchase program to adopt these streamlined loan modification protocols.

A. Creating a loan modification guarantee program through TARP would create an efficient subsidy for modifications of loans held in private-label securities.

As noted above, FDIC has pioneered a promising approach to streamlined modifications in its operations at IndyMac Bank, which it is applying to IndyMac loans held in portfolio and to those it services for private mortgage-backed securities investors, where possible. As H.R. 384 proposes, TARP could substantially expand this promising approach and effectively address the existing obstacles to modifications, particularly the obstacles posed by private securitization.

The FDIC/IndyMac model compares the net present value of modifying the loan to foreclosing and losing money reselling the house. As long the modification provides a greater return than foreclosing, the loan can be modified. All loans are converted to fixed rate loans at the Freddie Mac Survey interest rate at the time of the modification, which is currently 5 percent. The model establishes a clear affordability target: a 38 percent debt-to-income ratio (DTI) for total housing payments for the IndyMac first mortgage (including mortgage principal, interest, taxes and insurance).

To reach the affordability target based on the income information they have (subject to income verification before being finalized), the model uses a three-step approach:

- Servicers first reduce interest rates for five years, potentially to as low as 3%, to meet the DTI target. Thereafter the rate rises by 1% per year until it reaches a market rate, which is defined as the Freddie Mac survey rate.

- If this rate reduction is not enough to reach the target DTI, the servicer would increase the loan term to a maximum of 40 years from date of origination.

- If the loan still isn't affordable, then a portion of principal would be deferred until the loan becomes due or pays off early, with no interest accruing, or forgiven entirely. Monthly payments would be calculated on the lower balance, which would make the loan more affordable.

The FDIC has also introduced some important procedural initiatives to try to increase response rates. Where they have income information, they establish a pre-approved modification offer which they send to the borrower via certified mail. To accept, the borrower can return the offer in an enclosed pre-paid envelope, with a signature, a lower payment and current income verification documentation. Where FDIC does not have borrower income information, they have used mail, phone calls and payments to counselors to try to contact borrowers. Although there is still limited data available, the FDIC /IndyMac model is increasing modifications substantially for homeowners who take advantage of the program.

Implementing the new loan modification guarantee program modeled on the FDIC IndyMac modification program as outlined in H.R. 384 would act as a strong financial incentive for servicers and investors to agree to modify loans to newly established affordability standards. Under such a program, servicers who modified loans to meet certain standards would share the losses that result from future re-defaults of these modified loans.

The program would result in sustainable and affordable home loans for families facing foreclosure because it focuses on debt-to-income ratios and caps final interest rates at a pre-determined, prime rate. In addition, the FDIC model aligns incentives among investors and homeowners to the benefit of stabilizing home values: investors want to see modifications succeed because they share in future losses and the loan must perform for a minimum period before the guarantee kicks in. Further, since the guarantee can cover the cost of a re-modification or disposition short of foreclosure, there are substantial incentives for servicers to forego foreclosure.

Affordability Standards: Because federal resources would be insuring future performance risk, it would be important to establish strong affordability standards for the initial modifications. Although IndyMac is using a 38% housing DTI standard without any federal guarantee, when the taxpayers are funding guarantees, we believe that the initial affordability should be set at 31% of income for total housing costs.

Several additional standards should be required as well. First, the guarantee payments should not be available until the loan has a proven record of six months payments without delinquency after initial modification. Second, the guarantee should be limited to those loans where initial payments are reduced by at least ten percent to ensure that scarce federal guarantees are used only for loans that provide significant relief to borrowers and have a high likelihood of avoiding future re-defaults. Finally, the guarantees should remain in place for at least eight years, which covers the initial affordability period of five years plus the transition to the permanent rate.

Efficient Use of Taxpayer Resources: One of the most important aspects of this proposal is that the return on the government's investment would be substantial. For example, an investment of $24.4 billion would enable this program to assist up to 2.2 million borrowers at risk of foreclosures.[24] Structured as a guarantee program, federal costs would only be incurred when modified loans default. These losses would be shared equally with the investors. By using government funds as risk capital rather than liquidity, and leaving the loans within private securities, the government can leverage its funding significantly.

Loan Modifications Even When a Second Lien Exists. The best outcome for loans that have second liens – often with no value based on current market prices – is to have them paid off with very sharp discounts.[25] However, FDIC's IndyMac and model allows modifications to go forward even with second liens attached in the event that FDIC is unable to negotiate with the holders of the second mortgage to give up its lien interest, and the new loan guarantee program should also take this approach. Leaving the second liens in place is not optimal, but may be a necessary evil since 50% of subprime and Alt A loans currently have piggyback seconds, and these borrowers should not face certain foreclosure just because their out-of-the-money second mortgage investors refuse to release their interests. Many second mortgages will not foreclose, because after the house is sold in foreclosure and foreclosure expenses are taken into account, there would be no funds left to pay the second.

Incentive payments to servicers would increase the number of loans modified. As a counterweight to the reality that most servicing contracts compensate servicers more for foreclosure than modification, a payment to servicers of approximately $1,000 for each modification that meets the identified affordability standards would tilt the playing field toward modification. Just as Treasury pays investment advisors and other contractors under TARP to structure its equity investments or asset purchases, this program would pay the servicers who will do the work necessary to modify the mortgages under this program.

The combination of modification guarantees and paying servicers for affordable modifications would address many of the existing obstacles to broader scale modifications.

- *Investor Concerns:* A government guarantee to share the costs of future re-defaults has significant implications for the basic decision about whether a modification generates better returns for investors than foreclosing. Servicers would accept the government guarantee when the net present value to investors is greater to modify under the program than to foreclose, and the guarantee against re-default is likely to tip the scales strongly toward modifying. When the net present value (NPV) comparison results in this clear positive outcome, the fears about investor lawsuits would be substantially alleviated.

- *Second Liens:* As described above, permitting modifications even if second liens existed will maximize the number of loans that can be modified in a streamlined fashion. When the ban on judicial modifications is legislatively lifted, as is discussed in Section V below, the ability to settle or write off second liens will be increased. It would work best in combination with a Treasury program to purchase second mortgages cheaply, as described below.

- *Servicer Incentives:* Paying servicers directly for delivering affordable and sustainable modifications would address the servicer incentive problem. A direct payment should mitigate current incentives for them to opt for foreclosures rather than modifications.

- *Servicer Staffing and Technology:* Adopting a systematic approach based on the FDIC model simplifies and streamlines the work of servicers, limiting staff time per case. The modification analysis can be performed by a simple model and requires much less staff time or expertise than the current labor-intensive process, which requires subjective scrutiny of family debts and budgets. The FDIC was able to implement its new approach to modifications within weeks of taking over IndyMac Bank. Further, the use of a worksheet like the FDIC's makes the NPV calculation transparent.

B. Treasury and FHFA should prescribe more aggressive modifications for loans held or guaranteed by Fannie Mae and Freddie Mac.

In November, the GSEs announced a program to provide streamlined modifications for loans they own or that have been placed in Fannie Mae or Freddie Mac mortgage-backed securities that they guarantee. While the program is still new, this announcement is an important step forward for conforming loans, which represent over half of all mortgages in the country.[26]

While they were private companies, Fannie and Freddie hesitated to purchase out of securities loans that they had guaranteed because accounting standards required the GSEs to mark the loan down to its current market value.[27] While it is understandable that a private company under financial stress would hesitate in this manner, accounting-only losses should not drive substantive policy, particularly when modifying loans will result in lower final losses, which are now backed directly by U.S. taxpayers. We therefore commend FHFA and the GSEs for no longer making the distinction between loans on their portfolio and securitized loans for modifications.

However, we understand that the streamlined refinance program is not available for borrowers unless they are in default, which continues to serve as an obstacle to modification. Such stipulations have prevented many servicers from initiating timely and cost-effective modifications for borrowers who are likely to default in the future, and they create the perverse incentive of having borrowers miss payments and enter default to qualify for modifications. However, we also understand that the Trust Agreement has been modified to permit early workouts outside of the streamlined process even before a borrower becomes delinquent. We urge widespread usage of this option for borrowers for whom default is reasonably foreseeable, without requiring them to actually default first. In addition, Fannie Mae's streamlined modification program applies for loans sold to the GSE without recourse by the seller. In order to induce lenders to modify loans

that do not fit into this category, Fannie Mae should implement policies to allow the purchase of performing mortgages after they have been modified.

Finally, since the loans held or guaranteed by the GSEs produce at most just 20% of current foreclosures, our other recommendations are critical to address the other 80% of at risk loans, particularly those subprime and Alt A loans that are held in private label securities.

C. TARP should require participating banks and thrifts to establish systematic loan modification programs for the loans held in their portfolios.

The remaining at-risk loans, approximately 10%, are held directly by banks and thrifts in their portfolios. There are fewer obstacles from banks modifying these loans than if they were sold, but some obstacles remain from having these loans modified to avoid foreclosures. Most notably, banks may be reluctant to do so because such modifications will require marking down their balance sheets and weakening their capital positions, the same problem faced by Fannie and Freddie.

TARP's equity injection program provides a significant lever for requiring participating banks and thrifts to adopt a systematic loan modification program for their loans held in portfolio. Since the banks would just be recognizing losses they would soon bear anyway, and minimizing losses at that, Treasury should make receipt of equity from the TARP program contingent upon the adoption of a similar loan modification program. The fact that the government is providing equity that can absorb accounting losses should remove this objection. The Treasury Department conditioned Citigroup's second injection of funding on the implementation of a streamlined loan modification program along the lines of the FDIC program, and this requirement should be extended to all participants. When an institution has been required to create a streamlined loan modification program of this nature, foreclosure will only be permitted in those situations where the protocol does not produce a loan modification or where the homeowner has defaulted on such a loan modification.

III. <u>There are also other powerful tools that can increase modifications by removing the current obstacles that block desirable modifications.</u>

In addition to creating a streamlined modification program, there are several supplemental approaches that can be taken to maximize sustainable loan modifications.

A. Use TARP to purchase second mortgages so that they can be consolidated with the first mortgages and restructured.

As noted above, second mortgages are one of the greatest obstacles to modifications because a first mortgage holder will not generally voluntarily reduce interest or principal only to increase return for a second mortgage holder or cure its loan if the borrower is still in default on a second. Yet because most second liens are underwater, Treasury could likely purchase them very inexpensively.

To be most effective, purchases should be concentrated on second mortgages where the owner of the first mortgage is known and a modification effort is already being made, and/or Treasury could establish a fund to purchase second mortgages that can then be accessed by servicers who run into the problem of a second mortgage when trying to modify a first mortgage whose owner is already known. (For securitized second mortgages, there would need to be a change in REMIC rules, as discussed below, to enable their purchase.)

Although H.R. 384 contemplates a program under which the government could loan homeowners the money to pay off second liens, direct purchases may be the best outcome for homeowners if they can be made cheaply enough.

B. Provide servicers with a safe harbor from investor lawsuits when they modify loans.

One obstacle to servicers in modifying loans is that they fear lawsuits by investors harmed by their decision; any modification will favor some investors and disfavor others. H.R. 384 addresses this obstacle by creating a safe harbor for servicers attempting to do the right thing. The legislation provides that servicers can modify mortgages regardless of any limitations contained in a PSA and also that servicers are not required to repurchase loans out of pools to make such modifications. We support this approach and agree that fee-shifting provisions will support the goals of this legislation.

C. Change rules governing trusts so that the government can purchase whole loans out of securities.

The biggest problem TARP faces with respect to loan modifications is that 80% of recent subprime and Alt-A loans are securitized, and if the government purchases securities, the government will own just a partial interest in the cash flow generated by loans, giving it no greater rights to modify loans than other owners scattered around the globe. If the government could buy whole loans, it would have the discretion to do modifications similar to what FDIC has done with IndyMac's portfolio or Fannie Mae and Freddie Mac just announced. However, trusts are designed to be passive entities and are not permitted to sell whole loans, even though they have some flexibility to modify the loans or accept a refinance for less than the principal balance.

Congress should pass legislation clarifying that participation in a government-sponsored whole loan purchase program would be permitted under Real Estate Mortgage Investment Conduit (REMIC) tax rules in order to provide Treasury with a further option to address the foreclosure crisis if the other suggestions are not sufficient. Congress should provide that continued REMIC status (and future tax benefits) is contingent on PSAs being modified to permit (but not require) participation in the loan sale process. Finally, Congress, the SEC or Financial Accounting Standards Board would need to ensure that accounting standards change to permit these sales. Clearly, having whole loans that servicers for whatever reason are unable to modify, that will cause needless foreclosures, and that Treasury cannot purchase even though it could restructure the loans to make them affordable to the borrowers and maximize the return to the government, is not socially optimal. There should be no objection to freeing servicers to modify or sell these assets at the direction of a Treasury program.[28] These changes should also permit private parties to purchase whole loans out of securities under a program that Treasury describes to increase

modifications, which would increase the value of mortgage related securities and decrease the leveraged losses to financial institutions.

Once Treasury purchased loans at a substantial discount and modified them to an affordable level, it could resecuritize the mortgages into pools guaranteed by the government. This guarantee would make the securities marketable and allow the government to revolve its funding into new purchases, increasing its impact. In addition, this change should be implemented to provide Treasury the ability to cheaply buy second mortgages, which are proving a significant obstacle to modifications.

D. Buy servicing rights of existing loans to facilitate modifications.

Another way that TARP funds could be used is that Treasury could purchase servicing rights where the PSAs provide the servicer with sufficient flexibility to modify. Servicing rights are very inexpensive, and should not cost more than about 1% of the outstanding balance; government funding could therefore be leveraged 100 to one to modify loans. Moreover, they are an eligible "troubled asset" under TARP. Once the government holds the servicing rights, it would be in a strong position—through a contract with a competent private subservicer—to aggressively modify loans within the limitations of the pooling and servicing agreements.

Having the government as servicer would provide a number of advantages over private servicers. First, the government would be highly motivated to modify loans when the net present value of modifying exceeds foreclosing. Second, it would be far more difficult for investors to challenge the federal government's use of the pooling and service agreement authority than if a private servicer did the modifications. Finally, government would have fewer financial constraints in paying for staff than highly strapped servicers to process modifications, if necessary.

One issue is that sometimes the net interest margin security (NIMS) insurer needs to agree to modifications beyond certain level, such as 5% of the loans. In these cases, the government might need to buy this insurance policy; while it would certainly be inexpensive, it would require taking on some limited liability for NIMS losses that would need to be calculated.

E. Treasury should set specific goals for sustainable modifications with detailed reporting to increase transparency.

Right now, because loan servicers have no obligation to provide specific information on their servicing activities, it is difficult to monitor progress and assess servicing performance. For example, the data from HOPE NOW are aggregate data and not identified either by servicer or loan. This lack of data creates difficulty in ascertaining what is and is not working.

To improve analysis of modifications and to provide an incentive to servicers, Treasury should identify modification activity by individual servicer. Most helpful would be a database like that required by the Home Mortgage Disclosure Act (HMDA), with loan-level data made available to the public.

In addition, Treasury should require servicers to make public their modification protocols, as well as the inputs to the NPV analyses that they undertake when deciding whether to modify versus whether to foreclose. Because of falling house values, proper use of these models should be leading to orders of magnitude more voluntary modifications than are occurring. Transparency should address this issue and prevent servicers from skewing the results by using unrealistically high discount rates or other inaccurate inputs.

F. Ensure income tax burdens do not undermine sustainability of loan modifications.

When a servicer provides a homeowner with a loan modification containing a principal writedown or, in certain circumstances, a significant interest rate reduction, the IRS considers the homeowner to have received taxable cancellation of indebtedness income unless the mortgage debt is "qualified" under the terms of the Mortgage Forgiveness Debt Relief Act of 2007 or the homeowner is insolvent. In many instances, especially where the difference between the original loan amount and the current value of the house is large, the prospect of tax liability could discourage homeowners from seeking a modification, or, if such a modification is obtained, the resulting tax liability could cause the homeowner to redefault on the loan. To prevent this perverse result, Congress should amend the Mortgage Forgiveness Debt Relief Act of 2007 in two ways: (1) lenders should not be required to file a Form 1099 with the IRS when cancelling any mortgage-related debt; and (2) the definition of "qualified mortgage debt" should be extended to include all home equity debt.

IV. TARP must have effective oversight to ensure accountability and to check that it is meeting its objectives.

Although the passage of TARP was necessary to protect the U.S. financial system, the fact remains that this legislation gives the Treasury Department unprecedented authority to use enormous sums of taxpayer money with very few strings attached. More disturbingly, Treasury has provided only a bare minimum of detail to Congress and to the nation regarding how the TARP money has been spent so far. The lack of transparency is mystifying and suggests at best a disregard for the very taxpayers funding the program, let alone for the members of Congress who voted for the program.

Under those circumstances, it is crucial that Congress provide effective oversight of the TARP program. Oversight provides accountability for the use of the funds, which protects both the taxpayers and the Treasury Department. What's more, proper oversight can ensure that the program is meeting its stated goals, and if those goals are not being met, Congress can work with the Treasury Department to make any needed changes. The changes in size and authority of the Financial Stability Oversight Board proposed by H.R. 384 are the types of tools which are required.

V. Congress should lift the ban on judicial loan modifications, which would prevent hundreds of thousands of foreclosures without costing the taxpayer at all.

It is important also to provide a backstop to protect those homeowners whose lenders cannot or will not agree to voluntarily modify their loans, either through the TARP initiative or otherwise.

The best and only solution in these cases – provided the homeowner could sustain a market rate mortgage – is to lift the ban on judicial modifications, and allow a bankruptcy court to implement an economically rational solution that otherwise would be lost.

Right now, judicial modification of loans in bankruptcy court is available for owners of commercial real estate and yachts, as well as subprime lenders like New Century and investment banks like Lehman Bros., yet it is denied to families whose most important asset is the home they live in. In fact, current law makes a mortgage on a primary residence *the only debt* that bankruptcy courts are *not* permitted to modify in Chapter 13 payment plans. Eliminating this exception would immediately help stem the tide of foreclosures *at zero cost to the U.S. taxpayer.* [29] Mark Zandi, founder and chief economist of Moody's Economy.com, testified last week in support of this measure, estimating that it could save 800,000 homes from foreclosure.[30]

The urgent need for a solution, and the manifest failure of the many proposed solutions attempted to date, have led several prominent industry leaders to reverse their former opposition and now urge that Congress lift the ban on judicial modification of primary residence mortgages. Just last week, Citigroup reached an agreement with Congressional leaders to support court supervised loan modifications in bankruptcy as set out in S 61 and HR 200, provide that the legislation is amended to accomplish three things: (1) to limit relief to cover only existing loans (not loans made in the future); (2) to require borrowers to certify that they have attempted to work out an acceptable solution with the lender or servicer; and (3) to provide for the forfeiture of lender claims only where the lender has violated certain provisions of the Truth in Lending Act.

There are already a number of other limitations in the bill. Relief is available only to homeowners who would otherwise lose the home in foreclosure and who have sufficient means to sustain a market rate mortgage. The downside to lenders is circumscribed: interest rates must be set at commercially reasonable, market rates; the loan term may not exceed 40 years; and the principal balance may not be reduced below the value of the property. The judge must be satisfied of the homeowner's good faith in seeking relief. Finally, as with all Chapter 13 bankruptcy cases, the homeowner must subject herself to the supervision of the bankruptcy court for a three to five year period, during which time she can make no expenditures beyond limited allowable living expenses, and incur no credit card or other debt, without court supervision.

These provisions will ensure adequate protection for lenders, servicers and investors, while providing the forceful solution needed to lift the housing market out of its present crisis. Making this change will have the further benefit of encouraging servicers to participate in the TARP and other voluntary modification initiatives. To be clear, CRL does not want to see hundreds of thousands of homeowners actually file for bankruptcy. It is far preferable for most of these homeowners to receive a sustainable loan modification through a streamlined or individualized program. But if bankruptcy judges could make these modifications, it will help encourage additional voluntary modifications as everyone in the system would know the alternative.[31] Investors would have no reason to sue over a modification if the same or more costly modification could be made by a judge. Bankruptcy judges, who are extremely skilled at debt workouts, could help develop modification templates that could be used by servicers outside of the bankruptcy court context.[32]

Finally, there is clear precedent for this relief. Congress implemented a similar measure in response to the farm crisis of the 1980s when an economic downturn and depressed land values were pushing family farmers into foreclosure. Congress enacted the Family Farmer Bankruptcy Act of 1986, for the specific and express purpose of permitting bankruptcy judges to modify mortgages on family farms, permitting adjustment of interest rates and the reduction of principal to fair market value, in order to help distressed farmers avoid foreclosure, including on their primary residence. Chapter 12 proved effective in helping farmers through the crisis. In fact, after being extended several times, the Act was made a permanent part of the Bankruptcy Code, with bipartisan support, in 2005.

Conclusion

Today's financial crisis is a monument to destructive lending practices—bad lending that never before had been practiced on such a large scale and with so little oversight. These practices have now undermined not only just the entire US economic, but the world economy as well. There is no single solution to the challenges facing us today, but any effective policies must seek to maximize the number of families who stay in their homes. In particular, Treasury should use its TARP authority to prevent foreclosures and Congress should lift the ban on judicial restructuring of loans on primary residences.

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[1] Center for Responsible Lending, *Continued Decay and Shaky Repairs: The State of Subprime Loans Today* (Jan. 8, 2009) p. 2 [hereinafter "*Continued Decay*"]. http://www.responsiblelending.org/issues/mortgage/research/continued-decay-and-shaky-repairs-the-state-of-subprime-loans-today.html

[2] Credit Suisse Fixed Income Research, *Foreclosure Update: Over 8 Million Foreclosures Expected* (Dec. 4, 2008), p.1.

[3] *Continued Decay* p. 3.

[4] On October 16, 2008, Eric Stein, senior vice president of the Center for Responsible Lending, testified before the Senate Banking Committee regarding the causes of the crisis. While more details can be found in his testimony, it is clear that dangerous lending greatly inflated the housing bubble, and the resulting foreclosures of patently unsustainable mortgages are magnifying the damage of the bubble's collapse. Testimony is available at http://www.responsiblelending.org/pdfs/senate-testimony-10-16-08-hearing-stein-final.pdf

[5] *See* HOPE NOW Data for all periods, *available at* http://www.hopenow.com/upload/data/files/July%202008%20Industry%20Extrapolations.pdf.

[6] Credit Suisse Fixed Income Research, *Subprime Loan Modifications Update*, October 1, 2008, p.2, *available at* http://www.credit-suisse.com/researchandanalytics [hereinafter "Credit Suisse Update"].

[7] State Foreclosure Prevention Working Group, *Analysis of Subprime Servicing Performance*, Sept. 2008, at 2, *available at* http://www.mass.gov/Cago/docs/press/2008_09_29_foreclosure_report_attachment1.pdf.

[8] Id. at 6.

[9] Id. at 7-9.

[10] Alan White, *Deleveraging American Homeowners: December 18, 2008 Update to August 2008 Report*, Valparaiso University School of Law (December 2008), p. 2.

[11] *HOPE NOW Loss Mitigation National Data July 07 to September 08*, p. 9 HOPE NOW Alliance (October 2008) *available at* http://www.hopenow.com/upload/data/files/HOPE%20NOW%20Loss%20Mitigation%20National%20Data%20July%2007%20to%20September%2008.pdf

[12] *See* OCC and OTS Mortgage Metrics Report (Third Quarter 2008), *available at* http://occ.gov/ftp/release/2008-150a.pdf [hereinafter "OCC Report"]. One of the many concerns about this report is that meaningful, sustainable loan modification efforts did not become active until the third and fourth quarters of 2008, long after the OCC's was collected including the streamlined modification programs being used by the FDIC for IndyMac Federal Bank and by Fannie Mae and Freddie Mac.

[13] Lehman Bros. U.S. Securitized Products Fixed Income Research, *The Loan Modification Story So Far* (Sept. 11, 2008) p. 2.

[14] Credit Suisse Update, p.1.

[15] OCC Report, pp. 5-6. We hope that the OCC will release disaggregated data, which we anticipate would show that when modifications reduce monthly payments and are made in accordance with the homeowner's ability to pay, these modifications are much less likely to redefault than modifications that do not reduce or even raise monthly payments.

[16] The Incentives of Mortgage Servicers: Myths and Realities, Larry Cordell, Karen Dynan, Andreas Lehnert, Nellie Liang and Eileen Mauskopf, Federal Reserve Staff Working Paper, Finance and Economics Discussion Series, 2008-46.

17 *See* Bajaj, Vikas and Meier, Barry, *Some Hedge Funds Argue Against Proposals to Modify Mortgages*, New York Times, October 23, 2008.

[18] *See* Credit Suisse, *The Day After Tomorrow: Payment Shock and Loan Modifications*, Apr. 5, 2007 (noting specific examples of PSAs with various modification restrictions, including 5% by balance, 5% by loan count, limits on frequency, and limits on interest rate).

[19] Credit Suisse, *Mortgage Liquidity du Jour: Underestimated No More*, March 12, 2007 at 5.

[20] Credit Suisse Update, p. 8.

[21] *See* Testimony of Eric Stein Center for Responsible Lending, Before the U.S. Senate Committee on Banking, Housing and Urban Affairs, October 16, 2008, at fn 30, *available at:* http://www.responsiblelending.org/pdfs/senate-testimony-10-16-08-hearing-stein-final.pdf .

[22] Larry Cordell, Karen Dynan, Andreas Lehnert, Nellie Liang and Eileen Mauskopf , *The Incentives of Mortgage Servicers: Myths and Realities* (Federal Reserve Staff Working Paper, Finance and Economics Discussion Series, 2008-46), p. 15 [hereinafter "*Myths and Realities*"].

[23] Id. at 3, 9, 23.

[24] These projections can be found at http://www.fdic.gov/consumers/loans/loanmod/

[25] As noted below, the Treasury could also buy second liens at a fraction of their cost.

[26] For example, it's unclear how the "borrower hardship" requirement will be implemented, or what level interest rates will be permitted to rise to if they have been reduced for five years.

[27] AICPA Statement of Position 03-03, Accounting for Certain Loans or Debt Securities Acquired in a Transfer (SOP 03-3).

[28] See Center For American Progress, Issue Brief: Overcoming Legal Barriers to the Bulk Sale of At-Risk Mortgages, April 2008, available at http://www.americanprogress.org/issues/2008/04/reimc_brief.html.

[29] For a detailed discussion of judicial loan modifications, *see* Statement of Eric Stein, Center for Responsible Lending, Before the U.S. Senate Judiciary Committee, Dec. 5, 2007, *available at* http://www.responsiblelending.org/pdfs/stein-statement-to-senate-judiciary-looming-foreclosure-crisis.pdf.

[30] Williamson, Elizabeth, and Simon, Ruth, *Plan to Cut Foreclosure Rate Clears Key Hurdle*, Wall Street Journal (Jan. 9, 2009), *available at* http://online.wsj.com/article/SB123144562914865337.html?mod=djemalertNEWS

[31] The same phenomenon *occurred* when Chapter 12 was passed to modify loans on family farms in the late 1980s.

[32] See statement by J. Rich Leonard, US Bankruptcy Judge, Eastern District of North Carolina, at http://www.responsiblelending.org/pdfs/leonard-letter.pdf

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Statement by

Donald L. Kohn

Vice Chairman

Board of Governors of the Federal Reserve System

before the

Committee on Financial Services

U.S. House of Representatives

January 13, 2009

Chairman Frank, Ranking Member Bachus, and other members of the Committee, I appreciate this opportunity to review some of the activities to date of the Treasury's Troubled Asset Relief Program, or TARP, and to discuss how additional funding could be used to strengthen our financial system and promote economic recovery.

A well-functioning, stable financial system is essential for healthy economic growth. Unfortunately, as you know, after the collapse of a credit boom that encompassed both mortgage lending and other major credit markets, the financial systems of the United States and of a number of other industrialized countries came under severe strain. Banks and other key financial institutions have seen their capital depleted and their balance sheets clogged with poorly performing and hard-to-value assets. Securitization markets have largely shut down, and credit spreads have widened dramatically on balance. Together with the ongoing contraction of the housing sector, the worsening of credit conditions weighed heavily on economic growth throughout 2008.

The financial crisis intensified considerably more in September and manifested in many countries that it had not yet touched, which led to grave concerns about the stability of the global financial system itself. The shocks to confidence and to the availability of credit that followed the intensification of the crisis last fall have contributed to a substantial further weakening in global economic activity. However, although the economic impact of the worsening crisis has been severe indeed, an international financial collapse--which seemed a real possibility in early October--would unquestionably have led to economic outcomes far worse even than those we are currently experiencing. The first and most urgent priority of policy was thus to avert such a collapse. The existence of the TARP allowed the Treasury to react quickly by announcing, on October 14, a plan to inject $250 billion in capital into U.S. financial institutions. Although the

Capital Purchase Program has been in place less than three months, many banks, both large and small, have applied for and received capital from this program. The Treasury's actions were complemented by the Federal Deposit Insurance Corporation's (FDIC) expansion of bank liability guarantees and by the Federal Reserve's measures to increase liquidity and support the functioning of key credit markets. Together, these actions helped to bolster confidence in our lending institutions, which enabled them to access funds and make loans. As contemplated by the enabling legislation, TARP funds have also been used on a targeted basis to prevent potentially disorderly failures of systemically critical financial institutions--failures that would have had highly adverse consequences for the system as a whole.

These actions, together with similar measures in other countries, have brought greater stability to our financial system. Moreover, injections of new capital are moderating the powerful pressures on the financial institutions that received the injections to deleverage by selling assets and pulling back from new lending. Stabilization and slowing the pace of deleveraging are critical first steps toward more-normal credit conditions. The federal banking regulators, pursuant to their joint November 12 statement, are working to help banks ensure that they are fully meeting the needs of creditworthy borrowers.[1] Bank lending to creditworthy borrowers is good for the economy, but it is also good for the profitability of banks and supports their safety and soundness. We have strongly encouraged our examiners to work constructively with banks as they perform the careful analysis needed to identify sound lending opportunities.

Regarding the future, the remaining TARP funds will play an essential role in further strengthening the financial system and restoring normal credit flows. An important use of these

[1] See Board of Governors of the Federal Reserve System, FDIC, Office of the Comptroller of the Currency, Office of Thrift Supervision (2009), "Interagency Statement on Meeting the Needs of Creditworthy Borrowers," joint press release, November 12, www.federalreserve.gov/newsevents/press/bcreg/20081112a.htm.

funds will be to step up efforts to avoid preventable foreclosures. Preventable foreclosures harm not only the affected borrowers and their communities but also, through their effects on the housing market, the broader economy and the financial system as well. Although a number of efforts are underway to address the problem of preventable foreclosures, more needs to be done.

Generally speaking, the most attractive approaches to reducing preventable foreclosures fall into two main categories. The first category features highly streamlined re-underwriting processes with the goal of modifying large numbers of troubled mortgages quickly. Based partly on its experience working with troubled borrowers at IndyMac Federal Bank, F.S.B., the FDIC has proposed a plan of this type. To encourage an aggressive approach to loan modification, the FDIC plan would provide partial insurance against the losses stemming from borrower redefaults on modified loans and would also pay servicers $1,000 for each loan they modify. An alternative program in this same category would have the government share the cost when the servicer reduces the borrower's monthly payment.

The second category of foreclosure prevention plans takes a less streamlined but more deliberate approach, with the goal of increasing the proportion of loan modifications that borrowers will be able to sustain over the longer term. The tradeoff is that the more deliberate approach would likely result in relatively fewer mortgages being modified. One example of a plan that puts greater emphasis on achieving sustainability would have the Treasury use TARP funds as working capital to buy delinquent mortgages from lenders and investors at steep discounts to their remaining balances, through negotiations or through reverse auctions. The acquired mortgages would then be re-underwritten and modified as appropriate to meet the criteria for refinancing into Hope for Homeowners (H4H) or other government programs.

Especially if the Congress moves forward on a plan of this type, it should examine the possibility of enhancing the H4H program to make it a more effective vehicle for this effort.

A second broad use of new TARP funding, besides foreclosure mitigation, would be to support programs to help restart key credit markets. The Treasury and the Federal Reserve recently announced such a program, the Term Asset-Backed Securities Loan Facility, which is designed to stimulate securitization activity in the market for asset-backed securities collateralized by a range of consumer and small business loans.[2] Under this program, which is expected to begin operation next month, the Federal Reserve will lend for up to three years on a nonrecourse basis against asset-backed securities. By providing this financing, the program should increase the availability of credit to households and small businesses. The Federal Reserve will be protected from credit losses by lending amounts less than the market value of the financed security--that is, by applying a "haircut"--and by the $20 billion of capital provided by the TARP. If the program is successful, the program could be increased in size or expanded in scope to provide financing for additional types of securities, such as commercial mortgage-backed securities, for which the markets are currently distressed.

Finally, I would expect the bulk of the remaining TARP funding to be devoted to strengthening financial institutions, thereby supporting the normalization of credit markets and the flow of new credit. Some of this support might take the form of additional capital injections, both to offset additional credit losses and to further expand lending capacity. Consideration should be given to whether it is feasible for some capital injections to be made on a matching

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[2] See Board of Governors of the Federal Reserve System (2008), "Federal Reserve Announces the Creation of the Term Asset-Backed Securities Loan Facility (TALF)," press release, November 25, www.federalreserve.gov/newsevents/press/monetary/20081125a.htm; and U.S. Department of the Treasury (2008), "Secretary Paulson Remarks on Consumer ABS Lending Facility," press release, November 25, www.treas.gov/press/releases/hp1293.htm.

basis with private capital raises, thereby providing a market test for those injections. In addition, prudence requires that funds be held in reserve as needed to address urgent contingencies, such as averting the disorderly failure of a systemically important financial institution.

A continuing barrier to private investment in financial institutions is the large quantity of troubled, hard-to-value assets that remain on institutions' balance sheets. The presence of these assets significantly increases uncertainty about the underlying value of these institutions and may inhibit private investment and new lending. The Treasury may thus wish to consider whether to supplement injections of capital with steps to reduce the uncertainty about the values of assets held by financial institutions. This objective could be accomplished in several ways, including by directly purchasing troubled assets, by setting up and capitalizing special banks that would purchase assets from financial institutions in exchange for cash and shares of capital in the special bank, or by making available to banks insurance that would pay off under very adverse conditions. Each approach could build on the infrastructure that the Treasury developed when it was planning to purchase troubled assets directly. Moreover, as I noted earlier, purchases that include residential mortgages could be combined with steps to restructure some mortgages as needed to avert preventable foreclosures.

As you know, the ultimate cost of the TARP program to the taxpayer is likely to be far less than the total amount allocated, because the funds are not simply spent but are used to acquire financial assets, such as preferred shares in banks. Even so, the public is understandably concerned about the cost of this program, particularly as most other industries experiencing distress are not receiving comparable assistance. History clearly shows, and recent experience confirms, that--because of the dependence of modern economies on the flow of credit--serious financial instability imposes disproportionately large costs on the broader economy. The

rationale for public investment in the financial industry is not, therefore, any special regard for managers, workers, or investors in that industry over others, but rather the need to prevent a further deterioration in financial conditions that would destroy jobs and incomes in all industries and regions. That said, the public is entitled to demand that policymakers take near-term, concrete actions to ensure that we do not face a similar crisis in the future. An important part of those actions should be to create a stronger supervisory and regulatory system in which gaps and unnecessary duplication in coverage are eliminated, lines of supervisory authority and responsibility are clear, and oversight powers are sufficient to curb excessive leverage and risk-taking, particularly in systemically critical institutions. The Federal Reserve stands ready to work closely with the Congress to achieve meaningful and effective regulatory reform.

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

TESTIMONY OF DR. CHRISTOPHER J. MAYER
BEFORE THE HOUSE COMMITTEE ON FINANCIAL SERVICES
HEARING: PRIORITIES FOR THE NEXT ADMINISTRATION: USE OF TARP FUNDS UNDER EESA
JANUARY 13, 2009

Good morning Chairman Frank, Ranking Member Bachus, and Members of the Committee. Thank you for inviting me to speak today. My name is Christopher J. Mayer. I am the Paul Milstein Professor of Real Estate and Senior Vice Dean at Columbia Business School. I have spent the last 16 years studying housing markets and credit while working at the Federal Reserve Bank of Boston and serving on the faculties of Columbia Business School, the University of Michigan Business School, and the Wharton School of the University of Pennsylvania. I am an expert in real estate and credit markets, so I cannot comment about the questions of taxpayer accountability of TARP funds or on restrictions for recipients of TARP funds. Instead I will focus my comments on the use TARP expenditures to facilitate economic recovery, reduce foreclosures, and help struggling homeowners.

Accelerating declines in the housing market and growing foreclosures are placing a serious strain on American households and economy. While it is crucial to deal with the broader economic crisis through a comprehensive stimulus package and tax cuts, the economy is unlikely to recover without addressing the housing crisis directly. More than two-thirds of all American households own their own home. Most homeowners have relatively modest stock holdings; the bulk of their wealth is tied up in their home. As house prices keep falling, these households suffer increasing wealth declines, making them more likely to further retrench and cut spending. We must do as much as we can to stem house price declines and prevent foreclosures, while at the same time also protecting the financial system. Further mortgage-related losses may cause additional bank failures, lead the credit markets to continue spiraling downward, and impose additional losses on taxpayers through the almost $6 trillion of outstanding debt and mortgage guarantees from Freddie Mac, Fannie Mae, and Ginnie Mae, loans to AIG, and other securities owned by the Federal Reserve and the Federal Government.

The problems in the housing market have been stunning and unprecedented. House prices have fallen about 18 percent in the last year according to Case and Shiller/S&P, likely the largest national decline in prices since the Great Depression. This has led to crisis of foreclosures, with 2.25 million foreclosures started last year (Federal Reserve)[1] and the forecast of 1.7 million foreclosures started in 2009 (Credit Suisse Foreclosure Update)[2]. Foreclosures contribute to a

[1] http://www.federalreserve.gov/newsevents/speech/bernanke20081204a.htm

[2] http://www.nhc.org/Credit Suisse Update 04 Dec 08.doc

further decline in house prices and deteriorating communities. Despite good intentions and appreciable effort, public policy to stem foreclosures has had limited success.

And the problem will likely get worse without prompt action. As of September 2008, there were more than 2.2 million vacant homes, 4 million vacant rental properties, and 4.5 million houses on the market, unsold. Without reducing this inventory, house prices will keep falling. The likelihood of growing foreclosures looks equally bleak. As of October 2008, sixty-day delinquency rates exceeded thirty-three percent among the 2.8 million outstanding securitized subprime loans and seventeen percent among the 2.2 million securitized alt-A loans. Even worse, many securitized option ARMs will hit negative amortization limits between 2009 and 2011, resulting in rising payments and higher default rates.

I am here to suggest a two-pronged approach to stabilizing the housing market and preventing foreclosures. First, I believe the federal government should immediately act to reduce mortgage rates and stabilize the mortgage market. Lower mortgage rates represent the single best way to reduce foreclosures by stabilizing house prices. Academic studies show that falling house prices are the single strongest contributor to the growth in foreclosures. Lower mortgage rates could attract new homebuyers to absorb inventory and allow as many as 25 million existing homeowners to refinance their mortgages, saving about $450 per month. This would provide a fiscal stimulus of $175 billion PER YEAR. This plan is not a substitute for the currently considered $775 billion stimulus, but unlike that program, the stimulus from lower mortgage rates would require no new federal appropriations. The government could simply arrange for lower rates by issuing US Treasury securities to fund new mortgages.

Nonetheless, even if we immediately stabilize the housing market, millions of homeowners will face the possibility of foreclosure in the coming years. Thus the second part of my testimony addresses a new proposal prepared with Edward Morrison and Tomasz Piskorski to reduce foreclosures through a combination of an incentive fee program to encourage servicers to avoid foreclosures and a legislative initiative to modify servicing agreements to clarify that servicers have the right to modify any loan where modification makes better economic sense than foreclosure. The cost of this proposal is incredibly modest compared to other proposals. We estimate that as many as one million foreclosures could be prevented at a cost of $10.7 billion that could be paid for by TARP funds.

Finally, I address some provisions of the recently published draft legislation (1/9/2009) entitled "TARP Reform and Accountability Act of 2009" from this Committee. In particular, I suggest specific improvements that could be made to this legislation. Nonetheless, I believe that this legislation represents an appreciable step forward and that such an approach represents a step to addressing the foreclosure crisis. As argued below, this legislation could accomplish much of what proponents have claimed would be true with mortgage "cramdowns," without the negative repercussions.

Stabilize the Mortgage Market and House Prices

I briefly describe a program to return mortgage markets to normal operations and stabilize house prices. Along with R. Glenn Hubbard, I have proposed that the government allow new mortgages to be issued at a rate that is 1.6 percent above the rate of the 10-year Treasury bond. With 10-year Treasury rates as low as 2.4 percent, this would immediately lower mortgage rates as low as 4 percent for conforming mortgages.

Lower mortgage rates would accomplish many things at once. Lower rates will stabilize house prices. A recent paper that I wrote with R. Glenn Hubbard suggests that house prices have already fallen at or below where fundamentals suggest, but are likely to continue to decline due to the mortgage market meltdown and the deteriorating economy.[3]

Lower mortgage rates also provide a strong fiscal stimulus, allowing as many as tens of millions of American households to refinance their mortgages, with a monthly savings of $425 that is not a temporary stimulus but permanently lower payments.[4] These lower mortgage payments could make the difference for millions of homeowners in allowing them to obtain affordable mortgages and avoid foreclosure. As well, lower rates would provide a fiscal stimulus that would total more than $174 billion per year and would almost surely induce an increase in consumption relative to a temporary tax stimulus.

Moreover, a low mortgage rate will raise housing demand significantly. We estimate that anywhere between 800,000 and 2.4 million additional owner occupants could enter the housing market in 2009.[5] These gains in new homeowners would help absorb the inventory of vacant houses, putting a floor on house price declines. TARP money might facilitate larger gains in new homeowners by helping finance low down payment mortgages through the Federal Housing Administration.

While lower mortgage rates do not require any additional government expenditure, TARP funds could provide additional help to homeowners struggling to pay off a mortgage on a house that is worth less than the mortgage. The federal government could also help facilitate many of the refinancings by offering to share some of the losses with lenders in return for taxpayers receiving a portion of the future appreciation of houses that participate in these new refinancings. These losses would be funded from the TARP. Our initial estimates were that a plan to share

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[3] See "House Prices, Interest Rates, and the Mortgage Market Meltdown" by Christopher Mayer and R. Glenn Hubbard available at http://www2.gsb.columbia.edu/faculty/cmayer/Papers/Mayer-Hubbard-BFP-10-2008-v7.pdf

[4] Calculations are available at http://www4.gsb.columbia.edu/null?&exclusive=filemgr.download&file_id=53340

[5] See calculations at www4.gsb.columbia.edu/realestate/research/mortgagemarket

losses 50-50 with lenders would cost the government $121 billion. It would allow millions of additional homeowners to refinance their mortgages to an affordable level. The government would recoup some of its expenditures by retaining a stake in the future appreciation of houses refinanced under this program.

Moreover, trillions of dollars of refinancings would retire a large number of the existing mortgage-backed securities. This would reduce uncertainty about the value of existing mortgage-backed securities. It would flood the market with additional liquidity that the private sector could deploy to other uses such as auto loans, credit cards, commercial mortgages and general business lending.

Reduce Foreclosures and Help Struggling Homeowners

Even if we stabilize the housing market, with the economic downturn, the resetting of mortgage rates, and the end of negative amortizing mortgages, millions of Americans will face the loss of their home in the coming years. It is essential for the government to take action to help prevent this crisis.

I discuss in more detail a proposal recently put forward with Edward Morrison and Tomasz Piskorski, both colleagues and professors at Columbia University. The proposal is attached to this testimony and provides more detail on the proposal, the cost-benefit calculations, and the supporting constitutional arguments.

We offer a new approach to foreclosure prevention that focuses on what has been the most intractable part of the foreclosure problem: the behavior of third-party servicers who manage portfolios of securitized portfolios. Why focus on servicers of securitized mortgages? Because securitized subprime, alt-A, and prime/jumbo loans accounted for more than one-half of foreclosure starts in 2008 despite representing about fifteen percent of all outstanding mortgages.[6] While the Fannie Mae, Freddie Mac, the FHA, and the largest private banks and portfolio lenders have announced their own aggressive programs to pursue mortgage modification, servicers of securitized mortgages lag behind.

Our approach to combating foreclosures builds on research by Tomasz Piskorski, Amit Seru, and Vikrant Vig[7] showing that portfolio lenders—lenders who service loans that they own—are significantly more successful in stemming foreclosures than third-party servicers, who

[6] According to the Mortgage Bankers Association, about 1.64 million loans started the foreclosure process as of the third quarter of 2008. Our own calculations from data obtained from Braddock Financial shows that about 900,000 securitized loans began the foreclosure process as of October, 2008.

[7] See "Securitization and Distressed Loan Renegotiation: Evidence from the Subprime Mortgage Crisis" by Tomasz Piskorski, Amit Seru, and Vikrant Vig available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1321646

service loans owned by other parties. The research shows that portfolio lenders achieve foreclosure rates that are nineteen to thirty-three percent lower than the rates experienced by third-party servicers. In fact, portfolio lenders are even more successful in reducing foreclosures for the highest quality loans, where current delinquency rates are rising the fastest (portfolio lenders achieve foreclosure rates thirty to fifty percent lower than third-party servicers). Third-party servicers, however, are often unable or unwilling to use the same tools as portfolio lenders are currently using.[8] Recent research documents the failures of servicers to successfully modify loans.[9]

Our proposal eliminates barriers that prevent third-party servicers from effectively managing the foreclosure crisis. Commentary and evidence suggests servicers face two appreciable barriers: 1) Servicing contracts makes little economic sense in the current crisis. No one anticipated the extent of the current crisis and servicers are poorly compensated as a result. As well, servicers have too few incentives to pursue loan modification instead of foreclosure, even when modification makes good economic sense for investors. Most securitization agreements compensate servicers for costs incurred during the foreclosure process, but not for expenses associated with loan modification. Even if modification is successful, it typically does not generate sufficient fees to cover the costs of modification. Consequently, servicers often choose to foreclose, even when modification makes good economic sense for borrower and investors. 2) Servicers face explicit and implicit legal barriers to modifying mortgages successfully. Some pooling and servicing agreements (PSAs) place explicit limits on loan modifications. In other cases, vague provisions in the PSAs, and the consequent threat of lawsuits, serve to limit servicers' ability to modify loans successfully.

We propose two steps to get around these barriers: 1) an Incentive Fee structure that increases payments to servicers and better aligns their incentives with investors, and 2) a Legislative Proposal that removes explicit barriers to modification in PSAs and that reduces the litigation exposure of servicers who do modify loans. Our proposal might prevent as many as one million foreclosures at a cost of no more than $10.7 billion that can be funded by TARP money. Other proposals do not address both barriers that servicers face. As well, our proposal would cost taxpayers considerably less money than other programs currently under consideration, with no requirement to provide costly loan guarantees. Losses for bad loans remain with private investors rather than taxpayers.

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[8] Of course, many other foreclosures come from FHA programs and Fannie Mae and Freddie Mac, where the government already has appreciable influence in guiding programs to reduce foreclosures.

[9] See "Rewriting Contracts, Wholesale: Data on Voluntary Mortgage Modifications from 2007 and 2008 Remittance Reports" by Alan White available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1259538 and a recent update available at http://www.hastingsgroup.com/Whiteupdate.pdf.

Incentive Fees: We believe that servicers need greater resources and stronger incentives to modify loans. We propose that servicers of privately securitized mortgages be paid a monthly Incentive Fee equal to ten percent of all mortgage payments made by borrowers, with a cap for each mortgage of $60 per month ($720 per year). The servicer would also receive a one-time payment equal to twelve times the previous month's Incentive Fee if the borrower prepays the mortgage, rewarding servicers that accept short sales. These payments would be in addition to the normal servicing fees as specified by the PSA. The program would be limited to any securitized mortgage that is below the conforming loan limit at the origination date. The Incentive Fees, which would equal about $9 billion, can be paid from money authorized under the US Treasury's TARP program. The Incentive Fees should remain in place for a period of three years, after which improvements in the economy will likely reduce the need for the incentive program.

Our Incentive Fee program would substantially encourage servicers to modify mortgages. Servicing fees would now more than cover the direct costs of modifications, estimated to be as much as $750 to $1,000.[10] Equally important, the Incentive Fee program better aligns servicers' interests with those of investors by giving them a percentage of all cash flow. By paying an Incentive Fee only when borrowers make payments, we reward successful modifications. A servicer whose loan modifications are unsuccessful and result in a quick re-default would collect few Incentive Fees.[11] Our proposal, therefore, rewards servicers for keeping future payments as high as possible without putting the homeowner in a position where he or she is likely to re-default soon after modification. This is exactly the tension that a portfolio lender deals with in its own loans. Of course, there will still be circumstances when costly foreclosure will be unavoidable, but the Incentive Fee will encourage servicers to look for other options.

Legislative Proposal: We propose specific, temporary legislation to eliminate legal barriers to loan modification in PSAs for all securitized loans. We believe that Congress has the authority, under the Commerce and Spending Clauses, to modify the terms of securitization contracts.

We propose two kinds of legislated changes to PSAs. First, Congress should enact legislation that eliminates explicit limits on modification, including both outright prohibitions and provisions that constrain the range of permissible modifications. The legislation should be temporary, lasting only three years. Second, Congress should create a "litigation safe harbor" that insulates servicers from costly litigation, provided they modify loans in a reasonable, good faith belief that they are acting in the best interests of investors as a group. The safe harbor is an affirmative defense, which servicers can assert in the event of litigation. Importantly, the defense

[10] See for example Barclays 2008 Global Securitization Annual.

[11] Evidence suggests that more than one half of loan modifications in the first quarter of 2008 re-defaulted within 6 months, so it is important only to reward servicers for pursuing successful loan modifications (OCC/OTS Report, 12/2008).

is based on evidence that the servicer held a reasonable, good faith belief in the benefit of modification, not on evidence that the modification was in fact successful or not. If investors bring suit, but a servicer successfully invokes the safe harbor, the investors will pay the servicer's actual legal costs, including attorney and expert-witness fees. Finally, our proposal therefore requires servicers to make public the details of any modification.

Our Legislative Proposal raises no meaningful constitutional concerns and has been vetted by leading constitutional scholars. The Proposal is a temporary program to moderate an avalanche of foreclosures during an economic crisis. It is more tailored and potentially less burdensome on investors than temporary legislation enacted during the Great Depression and upheld by the Supreme Court. Indeed, our program should benefit investors, because it fosters loan modification only when it increases returns—relative to foreclosure—to investors as a group.

Our Legislative Proposal addresses a number of flaws in existing PSAs, which were created when investors and underwriters did not envision a housing collapse of the magnitude we are now seeing. Although the proposed legislation will abrogate contractual rights of investors, it will also free servicers to undertake loan modifications that increase payments—relative to a foreclosure—to investors as a group. Thus, the bulk of investors will benefit from this legislation, despite the loss of contractual rights. Most PSAs do not explicitly limit modifications, but instead contain vague language that can paralyze servicers. With respect to these securitizations, our proposal can best be viewed as clarifying the interpretation of the PSAs.

Our Legislative Proposal is slightly more complicated for the minority of PSAs that contain explicit provisions barring modifications, limiting the types of available modification, or requiring that a servicer purchase any modified loans—at par value—from the securitization trust. Our proposal will abrogate provisions like these. It is important to note, however, that our legislation enables modification only when it increases overall investor value. To be sure, some junior tranche holders might be harmed. We believe that policymakers should provide compensation to these investors, who have suffered economic losses. Note, however, that compensation to junior-tranche investors will be necessary only when legislation abrogates contractual provisions that would have guaranteed, absent abrogation, cash flow rights to these investors. Our computations indicate that the total cost of this compensation would be no more than $1.7 billion.

A key feature of our proposal bears emphasis: it benefits homeowners as much as servicers and investors. A homeowner is a prime candidate for loan modification when her income is sufficient to make payments that, over time, exceed the foreclosure value of her home. Competing proposals do less for homeowners, do more harm to investors, or are more costly to taxpayers.

One oft-discussed alternative would allow a homeowner to file Chapter 13 bankruptcy and then write-down mortgage debt to current home value (so-called "strip down"). This proposal is deeply problematic. First, the risk of moral hazard is significant. Our current housing problems would be much worse if the fifty-two million homeowners that are now current on their mortgages believe that they can stop paying their mortgage and not risk losing their homes.

Bankruptcy reform also assumes that one kind of modification—strip down—is always appropriate. We know that, among lenders who successfully modify loans, a broad range of modifications are used. One, for example, leaves the original debt intact (no strip down) but obligates the homeowner to pay a lower interest rate on only a fraction of the debt (a five percent rate, for example, might be paid on eighty percent of the debt). Instead of permitting servicers to tailor modifications to the needs and abilities of homeowners, bankruptcy reform imposes a one-size-fits-all solution.

Proponents argue that bankruptcy reform would give borrowers a tool to fight back against servicers. Yet, the opposite might be the case. Servicers might prefer bankruptcy to loan modification for the same reason that they now prefer foreclosure: the typical securitization agreement reimburses servicers for expenses incurred in a bankruptcy, just as they now recover expenses incurred in a foreclosure. This could result in millions of Chapter 13 bankruptcy filings that harm consumer credit and delay resolution of the current crisis for years.

Finally, bankruptcy reform would make it harder for many people to own a home in the future. Lenders will be reluctant to extend credit to people who have struggled in the past and have tarnished credit records. Recent empirical research has proven this effect. Even if bankruptcy reform applies only to existing mortgages, lenders may worry that it will be extended to new mortgages in the future.

Another alternative is the FDIC proposal that would have the government pay servicers $1,000 every time they modify a loan, and have taxpayers share up to fifty percent of losses from post-modification default. This proposal is a big step forward, and shares features with ours, but it has important risks and drawbacks. For one, the mortgage guarantee imposes a potentially large burden on taxpayers instead of investors. It is difficult to estimate the cost of such a loan guarantee, but we should expect that servicers will "modify" as many loans as possible to access the guarantee as well as the $1,000 incentive payment. This proposal does not guarantee that the modification will ultimately be successful. Additionally, under the FDIC plan, servicers would still be face appreciable legal barriers to modifying large numbers of loans.

Commentary on H.R. 384: "TARP Reform and Accountability Act"[12]

[12] See: http://www.house.gov/apps/list/press/financialsvcs_dem/press0109093.shtml

This draft legislation has many merits and is a big step forward in addressing the current foreclosure crisis. I include a few comments.

The legislation requires an expenditure of between $40 and $100 billion to reduce foreclosures. While I heartily support the goal of reducing foreclosures, my proposals can accomplish this goal with much lower cost to taxpayers. In particular, Section 204 of the Act contains language allowing the Secretary to provide taxpayer-funded loss sharing or mortgage guarantees. Under the FDIC plan, such loss sharing would represent up to fifty percent of the newly modified loan. I believe that such mortgage guarantees or loss sharing is unnecessary. A well-funded payment plan for servicers to modify mortgages that better aligns servicers interests and a legal safe harbor will be enough to ensure that servicers modify a substantial number of mortgages. Both of these provisions are allowed under the Act.

Furthermore, the mortgage guarantees might well be extremely expensive to taxpayers, even as they are likely unnecessary to ensure mortgage modifications. The FDIC estimates from its own proposal likely substantially underestimates the cost of mortgage guarantees. The FDIC calculations assume that only one-third of mortgage modifications would fail, even if historical evidence suggests that more than two-thirds of modifications are unsuccessful. As well, the FDIC cost estimates assume that only one-half of mortgages will be modified, despite paying servicers to modify loans. It is my view that more mortgages would be modified and that the number of failures would also be higher. Thus the FDIC program could be very expensive, costing $70 billion or more, and mortgage guarantees are not needed to accomplish the Act's goals.

Second, I would encourage the addition of a provision ensuring that compensation is paid to aggrieved bondholders who are impacted by the safe harbor provisions for servicers (Section 205). While my proposal with Edward Morrison and Tomasz Piskorski argues that compensation might not be strictly necessary to meet constitutional requirements, I believe that the government should tread very carefully in changing explicit contract terms. It is important to uphold the principal that the government will not change explicit contract provisions without compensation. Our compensation proposal would affect a minority of pooling and servicing agreements. We estimate total expenditures of $1.7 billion, which is relatively small compared to other expenditures in this Act. This compensation will help ensure the efficient operation of capital markets in the future so that investors can have confidence in contracts that they sign.

Conclusion

I believe it is essential for the incoming Administration and Congress to address the housing crisis. Existing policies have not successfully fixed the mortgage or housing markets. Even aggressive Federal Reserve purchases of mortgage-backed securities issued by Fannie Mae and Freddie Mac have not succeeded in returning mortgage rates to their normal relationship to the 10-year US Treasury rate.House prices continue to spiral downward in much of the country.

Foreclosures are already taking place at an alarming rate and will only grow if we do not take immediate action.

Nonetheless, it is important to protect taxpayers. I have put forward two plans. One plan helps restore the normal functioning of the mortgage market at little cost to taxpayers. The second plan addresses the large growth in foreclosures in securitized mortgages. That plan relies on incentive payments and legislated changes in securitization agreements to induce servicers to undertake modifications that would benefit both homeowners and investors, without relying on changes to bankruptcy laws. The plan can prevent up to a million foreclosures at a modest cost to taxpayers of $10.7 billion.

I appreciate the opportunity to address you today and look forward to answering any questions that you might have.

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TESTIMONY OF

CHARLES McMILLAN, CIPS, GRI

2009 PRESIDENT OF THE

NATIONAL ASSOCIATION OF REALTORS®

BEFORE THE

U.S. HOUSE OF REPRESENTATIVES
COMMITTEE ON FINANCIAL SERVICES

HEARING REGARDING

"PRIORITIES FOR THE NEXT ADMINISTRATION: USE OF TARP FUNDS UNDER THE EESA."

JANUARY 13, 2009

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Introduction

Chairman Frank, Ranking Member Bachus, and Members of the Committee, thank you for inviting me to testify today regarding priorities that must be addressed by the next administration when deploying TARP funds authorized under the Emergency Economic Stabilization Act of 2008.

My name is Charles McMillan, and I am the 2009 President of the National Association of REALTORS®. I have been a REALTOR® for more than 20 years, and am Director of Realty Relations and Broker of Record for Coldwell Banker Residential Brokerage, Dallas-Fort Worth. Along with being a REALTOR®, I have been active in my community, serving as past chairman of the Community Development Council of Fort Worth, the Tarrant County Affordable Housing Task Force, the Housing Subcommittee of Fort Worth, and a past director of the United Way of Tarrant County and of the Fort Worth Chamber of Commerce.

I am here to testify on behalf of more than 1.2 million REALTORS® who are involved in residential and commercial real estate as brokers, sales people, property managers, appraisers, counselors, and others engaged in all aspects of the real estate industry. Members belong to one or more of some 1,400 local associations/boards and 54 state and territory associations of REALTORS®.

We thank the House Financial Services Committee for holding this hearing on an issue that is paramount to the recovery of the housing market and the U.S. economy.

Ensuring that TARP Funds Facilitate Economic Recovery

NAR strongly believes that the housing sector is at the core of our current economic crisis. Moreover, we believe that in order to move the country out crisis, Congress and the new administration must place significant emphasis on repairing and restoring confidence in this vital wealth building and commerce generating industry.

Achieving these objectives requires that the Troubled Asset Relief Program (TARP) be refocused towards its initial intention – thawing the credit crisis, which will jump start mortgage lending.

Due to the prolonged severity of the current crisis, aside from making funds available to consumers for home purchases, there are additional issues that are critical to stabilizing the housing market: (1) boosting homebuyer confidence, (2) reducing the current foreclosure rate (3) offering foreclosure relief, and (4) providing needed liquidity to commercial real estate

markets. As home values decrease in many markets, job losses escalate and the financial burden of American families continue to soar, homeowners seeking to refinance their mortgage or sell their primary residence are left with few alternatives and are "walking away" from their mortgage obligations. These actions increase housing inventory and further fuels a decrease in home values. If home prices continue to fall, default rates and re-default rates by borrowers whose mortgages have been modified will rise. Therefore, it is critical to include stimulus measures that bring buyers back to the market and reduce inventory in order to stabilize home prices.

To staunch this cycle, we strongly urge Congress to consider NAR's Housing Stimulus Plan.

Stimulating the Real Estate Market, Mitigating Foreclosures, and Helping Homeowners

NAR's Housing Stimulus plan includes provisions aimed at:

- Getting the Troubled Asset Relief Program (TARP) back on track by targeting funds for mortgage relief through efforts to lower mortgage interest rates,
- Eliminating the repayment feature of the first-time homebuyer tax credit, expanding it to all homebuyers, and extending the credit's effective date to December 31, 2009, Making the higher Economic Stimulus Act of 2008's FHA and GSE mortgage loan limits that applied in 2008 permanent, and
- Increasing liquidity in the commercial real estate loan market.

NAR strongly believes that focusing on these priorities is imperative to move our nation out of this economic crisis. One component that will provide a near immediate impact to the housing market, and the overall economy, is the effort to ensure that mortgage interest rates remain low, with the ultimate goal of having them within the normal 160 to 180 basis points spread over 10-year Treasury notes.

Maintaining Low Mortgage Interest Rates

An effort to reduce and maintain low mortgage interest rates, and more specifically, to have the rates mirror the normal spread above 10-year Treasury notes (160 - 180 basis points) seen in a stable economic climate, is one way the Federal government can quickly provide stimulus to the struggling housing market. In the recent past, the Director of the Federal Housing Finance Agency, James Lockhart, has made public statements acknowledging the link between lower rates in helping homeowners and home buyers. NAR estimates that a one percentage point decrease in mortgage interest rates would increase home sales by 500,000.

To date, several ideas have been discussed. One would be for TARP to fund the payment of points at the individual loan level to achieve a low interest rate. Another approach is for Fannie Mae and Freddie Mac to purchase mortgages at a below market interest rate but pay lenders the market rate. Fannie and Freddie could either take the loss directly or pool the loans and sell them to the Treasury Department at market rates.

Another idea involving the Federal Home Loan Bank System would broaden the impact of the concept. For example, the Federal Home Loan Banks could raise funds by selling a debt instrument to the Treasury Department at a below market rate and make the proceeds available as advances to member institutions that agree to make it available for mortgage loans with a specified below market mortgage interest rate. These lenders could hold the mortgages in portfolio. The added bonus of an initiative implemented by the Federal Home Loan Banks is the money could be extended to homeowners and homebuyers with financing needs in excess of the maximum existing GSE and FHA jumbo conforming loan limits - $625,500.

NAR believes that these types of initiatives will bring buyers back into the housing market, quickly reduce inventory, and thereby stabilize home prices. It is estimated that the supply of inventory would fall to about 7.5 months – a level consistent with no further home price declines. Moreover, the impact of this type of initiative would be felt almost immediately.

Federal action has already had some success in lowering interest rates. The Treasury Department is purchasing mortgage backed securities (MBSs) of the GSEs. In addition, on November 25, the Federal Reserve announced its decision to purchase GSE debt and MBSs. Just the announcement spurred a significant reduction in mortgage interest rates, an initial decrease of 61 basis points. During this period, many REALTORS® reported a significant increase of consumer interest in "for sale" properties. The revival of consumer interest due to a small decrease in mortgage interest rates confirms our suspicion that a significant reduction in mortgage interest rates, by any method, will bring a substantial number of consumers back to the housing market.

Additional NAR Housing Stimulus Plan Components

In addition to government action to reduce mortgage interest rates, NAR's housing stimulus plan also includes the following components:

Amend the Homebuyer Tax Credit

NAR supports making the $7500 first-time homebuyer tax credit available to all buyers and eliminating the repayment requirement, and extending its expiration date through the end of

December 2009. The credit's limited availability and repayment requirement severely restrict the credit's use and effectiveness. A tax credit that is available to all homebuyers, first-time or repeat / trade-up buyers will increase demand for the existing housing supply and kick-start the housing market.

Make the 2008 FHA, Fannie Mae and Freddie Mac Loan Limits Permanent

NAR believes that making the 2008 FHA and GSE loan limits permanent will expand mortgage affordability in a time when home sales and refinance activity are required to stabilize the housing market and move it towards recovery. Other sources of mortgage capital have dried up, increasing the importance of FHA and the GSEs.

As required by current law, the maximum limits were reduced at the end of 2008 from 125 percent of area median up to $729,750 to 115 percent of area median up to $625,500. In addition, the regulators have chosen to recalculate the median home prices for all counties, most of which went down. This recalculation, coupled with the change to the high cost area formula, has further reduced the loan limits in many markets, and greatly limited access to mortgage credit.

Lowering the loan limits for FHA and the GSE means borrowers are finding themselves facing higher mortgage interest rates and more adverse terms and conditions, or are unable to secure a mortgage because they are in an area that is now subject to lower GSE and FHA loan limits. These significant changes in loan limits will act to exacerbate the existing problems within the housing market.

Making the 2008 limits permanent will assure that a wide range of borrowers will have access to fair and affordable mortgages, including those residing in high cost areas.

Additional Measures to Ensure a Successful Housing Recovery

Implementation of these core priorities will only go so far if the federal government and the mortgage lending industry do not address additional fundamental operational issues that are beginning to impede the delivery of mortgage credit and increase foreclosures. To successfully facilitate a housing market recovery and effectively implement TARP, the following issues must be acted upon:

- The Treasury Department should provide additional TARP funds subject to agreement by the recipients to make additional loans for housing and other consumer purposes, establish foreclosure prevention programs, modify more mortgage loans to prevent foreclosures to the maximum extent possible, establish an efficient and effective short sales process, or a combination of these activities.

- All mortgage lenders, their servicers, the GSEs (Fannie Mae and Freddie Mac), and investors in mortgage assets should adopt and implement aggressive policies that result in more mortgage loan modifications to prevent as many foreclosures as possible. Where keeping the family in the home is not possible, these entities should facilitate short sales that will benefit all parties: owners, buyers, neighbors, communities, and lenders/servicers/GSEs/investors.

- Mortgage lenders and private mortgage insurers should (1) reexamine underwriting standards to determine whether they have over-corrected in response to abuses in the mortgage market, and (2) remove unnecessarily strict underwriting standards (such as (i) requiring excessively high credit scores that result in qualified borrowers being arbitrarily turned down for a loan, and (ii) coupling much tighter investor underwriting criteria with a lower cap on the number of financed properties an investor may own).

- Consumer reporting agencies (credit bureaus) should improve compliance with the Fair Credit Act, including prompt responses to consumers who seek to correct files and prompt correction of errors.

- Reform Hope For Homeowners. This program was designed to allow homeowners with troubled mortgages to refinance and get a new 30-year fixed FHA mortgage. However, due to its very restrictive provisions, this program has not be utilized. Reforms including providing great incentives for servicer/investor participation, expanding consumer eligibility, and lessening costs will make the program a much more effective tool for preventing foreclosure.

- FHASecure should be reinstated. HUD's FHASecure program successfully helped more than 450,000 families modify their mortgages and stay in their homes. However, this valuable program was allowed to sunset on December 31, 2008. The Hope for Homeowners program, which was expected to take the place of FHASecure, has not yet achieved the same levels of success. We urge HUD to reinstate FHASecure, so that homeowners have all the tools available to them to avoid foreclosure.

- As families consider buying a foreclosed home, they find that many properties need work in terms of rehabilitation or renovation. FHA's section 203(k) program is a valuable tool that allows homeowners to obtain one insured mortgage to rehabilitate a property in need of repair. However, this program is not available to investors, who may be interested in purchasing these homes and repairing them so they are ready for

sale or for conversion to rental units. If the program were made available to them, vacant, dilapidated homes will be renewed and provide safe, comfortable homes for families. Investors will be able to access credit that is unavailable because of the current economic crisis. Finally, neighborhoods will be stabilized and previously vacant homes will contribute to the local property tax base. We urge HUD to once again open the section 203(k) program to investors, with appropriate safeguards and oversight.

Current Actions Detrimental to the Housing Recovery

Increased GSE Fees

On December 29, 2008, Fannie Mae announced an increase in lender fees in Announcement 08-38. The higher fee structure imposes major new costs on home buyers and home owners seeking fair and affordable mortgage loans, and NAR questions whether it makes sense, from a policy standpoint, to increase these fees and is concerned about the lack of any explanation of or justification for the action.

In the past, Director Lockhart has expressed concern about the negative impact of higher fees being imposed by the government sponsored enterprises, Fannie Mae and Freddie Mac, to raise capital. Moreover, Secretary Paulson stated that the primary mission of the GSEs under the conservatorship would be to increase mortgage affordability. With that as background, we were completely surprised that Fannie Mae has decided to raise fees, especially so significantly. As we understand Fannie Mae's announcement, a borrower with a credit score of 670 making a 20% down payment for a condominium would have the fee increased from 150 basis points to 350 basis points—more than double.

A related concern is complete lack of justification or even explanation for the increases. This was a concern even before the conservatorship, but now that the GSEs are subject to government conservatorship, we think that they should be required to increase the transparency of their major policy decisions and explain the basis for their actions. NAR urges Congress to seek an explanation for this increase, and request that the GSE provide more transparency when changes like this are made.

Lack of Credit in the Commercial Market

Commercial real estate is threatened by a lack of credit being offered by nearly all lending outlets. Currently, there is not enough available capital in the current credit environment to refinance the massive amount of commercial real estate debt that will mature in 2009 and subsequent years.

A possible initiative that may be used to support commercial real estate's credit needs is the Term Asset-Backed Securities Loan Facility (TALF) established by the Federal Reserve. Utilization of this facility would provide a source of capital for newly originated secured and unsecured loans on commercial real estate properties that have a long-term credit rating in the highest investment-grade rating category (for example, AAA). Such a credit facility would help restore capacity and address the enormous credit shortfall facing commercial real estate.

It is imperative that action be taken to support the commercial real estate sector because it directly and indirectly generates economic activity equivalent to about 20 percent of gross domestic product. Real estate encompasses an estimated $20 trillion in owner-occupied housing and approximately $6 trillion in income-producing commercial property. Moreover, this sector supports more than 9 million jobs and generates millions of dollars in federal, regional and local tax revenue. Local governments, especially, depend on this revenue (approximately 70 cents of every local budget dollar) to pay for public services such as education, road construction, law enforcement and emergency planning and response.

Conclusion

As we enter a new year, and a new administration is about to take office, there remains a lot of work that Congress and the housing industry must complete in order for our nation to face down the continual turmoil in the housing market and the whole economy. We can only overcome this threat if we pursue avenues that will motivate the frightened and cautious housing consumer to enter the marketplace, and that will encourage the extension of credit to consumers and businesses.

NAR believes that refocusing TARP, as proposed in H.R. 384, on housing finance, in particular, initiatives aimed at lowering mortgage interest rates, offering relief to troubled homeowners, and providing liquidity to the commercial market will encourage potential real estate purchasers to enter the marketplace. Moreover, it will help families seeking to refinance in order to stay in their home find fair and affordable mortgages. Only then can the housing recovery begin, and only then can our nation's economy begin the long road home to stability.

I thank you for this opportunity to present our thoughts on TARP and the housing market. The National Association of REALTORS® stands ready to work with Congress and our industry partners to facilitate a housing recovery, and bring our nation out of this economic nightmare.

NCLR
NATIONAL COUNCIL OF LA RAZA

Rethinking TARP Implementation: Strategies to Reduce Latino Foreclosures

Presented at:

Priorities for the Next Administration: Use of TARP Funds Under EESA

Before:

Committee on Financial Services
U.S. House of Representatives

January 13, 2009

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Good afternoon. My name is Janet Murguía. I am the President and CEO of the National Council of La Raza (NCLR)—the largest national Hispanic[1] civil rights and advocacy organization in the United States. NCLR has been committed to improving opportunities for the nation's 44-plus million Latinos since 1968. To this end, NCLR conducts research, policy analysis, and advocacy on a variety of financial services issues that impact the ability of Latinos to build and maintain assets and wealth. I would like to thank Chairman Frank and Ranking Member Bachus for inviting me to share our concerns regarding the implementation of the Troubled Assets Relief Program (TARP). More than a year into this crisis, foreclosure rates continue to rise, and an entire generation of wealth in Latino communities continues to erode. We are confident, however, that reasonable and effective solutions to this problem exist, and we are pleased to work with you to remedy the economic fallout created by troubled assets.

For more than two decades, NCLR has actively engaged in relevant public policy issues such as preserving and strengthening the Community Reinvestment Act (CRA) and the Home Ownership and Equity Protection Act (HOEPA); supporting strong fair housing and fair lending laws; increasing access to financial services for low-income people; and promoting homeownership in the Latino community. For the last ten years, NCLR has been helping Latino families become homeowners by supporting local housing counseling agencies. The NCLR Homeownership Network (NHN), a network of nearly 50 community-based counseling providers, works with more than 37,000 families annually, and enabled more than 25,000 to become first-time homebuyers in its first decade. More recently, our focus has shifted to helping families keep their homes. NHN members have counseled more than 7,000 homeowners facing foreclosure. Our subsidiary, the Raza Development Fund (RDF), is the nation's largest Hispanic Community Development Financial Institution (CDFI). Since 1999, RDF has provided $400 million in financing to locally based development projects throughout the country. These relationships have increased NCLR's institutional knowledge of how Latinos interact with the mortgage market, their credit and capital needs, and the impact of government regulation of financial services markets.

NCLR is concerned that the Department of the Treasury chose to allocate funds in a manner that did not help homeowners avoid foreclosure, but rather favored investors and ignored crucial goals of TARP. While the overarching purpose of TARP was to stabilize the U.S. financial system, the legislation established two critical objectives of pivotal importance to Latino families: mitigate rising foreclosure rates, and increase the flow of consumer credit. We are gravely disappointed that no measurable progress toward these goals has yet been achieved.

We commend members of this committee for making this discussion a priority as we begin a new congressional session and Administration. Absent significant intervention that directly improves the ability of struggling families to pay their mortgages, foreclosure rates will continue to rise and our economy will continue to falter. In my testimony today, I will provide a brief overview of the need for an effective national mortgage loss mitigation strategy and discuss how the initial TARP allocations have fallen short of the goals of the legislation. I will conclude with a set of recommendations to ensure that the second TARP installment more fully meets the needs of the homeowners and communities impacted by foreclosures.

[1] The terms "Hispanic" and "Latino" are used interchangeably by the U.S. Census Bureau and throughout this document to identify persons of Mexican, Puerto Rican, Cuban, Central and South American, Dominican, and Spanish descent; they may be of any race.

Background

Soaring foreclosure rates is one of the most pressing issues facing the nation. For decades, many of us have worked together to build wealth in Latino and other underserved communities. As it is for all Americans, homeownership has been the traditional vehicle for Hispanic families to build wealth for their long-term financial well-being. Unfortunately, for many years, and for a variety of reasons, the conventional mortgage market has not served the Latino community well. In part as a result, many Latino homeowners were steered into mortgages that were never a good fit for them. Reckless and discriminatory lending has now been shown to endanger the safety and soundness of the entire mortgage market. Forecasters predict that eight million foreclosures will occur in the next four years—a figure that could climb even higher with rising unemployment rates.[2] For the Hispanic community, we expect the height of the crisis will likely come in 2009 and 2010, when interest rates are scheduled to adjust on loans common among Hispanic borrowers.[3]

NCLR has made a concerted effort to better understand how to prevent foreclosures among Hispanic and immigrant households and develop appropriate public policy and programmatic responses. NCLR has been funding foreclosure prevention counseling since 2005 and recently launched a campaign with the National Urban League (NUL) and National Coalition for Asian Pacific American Community Development (CAPACD) to expand efforts to help community-based organizations address the mounting foreclosure rates; partnerships with mortgage servicers and other industry stakeholders complement these efforts. In 2008, NCLR hosted three major convenings during which community leaders expressed their acute concern that responses to the financial crisis lacked balance. In particular, participants expressed their frustration at the substantial assistance directed to the financial services industry, as their community-level efforts struggled to meet the ever-increasing demands of their constituents facing foreclosure.

Furthermore, our work with thousands of families facing foreclosure has shown that despite many high-profile efforts, voluntary loan modification programs are not working. Those who need assistance the most are still not able to access it. A survey of NHN counselors revealed that it takes an average of *three months* to receive a loan modification approval or denial from a loan servicer and that many of the loan modifications that are offered to borrowers are not affordable or sustainable. One-third of our grantees report having to turn away clients because their agencies are operating beyond capacity; many have turned down the opportunity to participate in Home Rescue Fairs because they cannot afford to take on additional cases.[4] As we brace ourselves for even greater demand in 2009, we anticipate that so-called "piggyback" Option Adjustable Rate Mortgages (ARM) and upside-down loans will continue to present the greatest challenge to securing loan modifications.[5]

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[2] Rod Dubitsky et al., *Foreclosure Update: Over Eight Million Foreclosures Expected* (New York, New York: Credit Suisse, December 4, 2008).

[3] Ibid.

[4] Home Rescue Fair is a one-day outreach event that offers individuals facing foreclosure the opportunity to receive free advice and resources from housing counselors, attorneys, and loan servicers.

[5] "Piggyback loan" refers to a second mortgage loan given at the time of a home purchase or refinance. The borrower will have two loans—a primary and secondary (piggyback), which may be held by a different lender. Option ARMs allow borrowers to choose between payments that amortize in 30 years, 15 years, an interest-only payment, and a minimum payment that is less than interest only. Industry experts estimate that 60%–80% of Option ARM borrowers are making minimum payments. See Nick Carey, "Option ARMs, Next Chapter in U.S. Housing

During the Emergency Economic Stabilization Act (EESA) debate, NCLR expressed concern that the act did not contain language emphatic enough to motivate the Secretary of Treasury to implement a systemic loan modification program.[6] Assurances were made by the Treasury and financial institutions that good faith efforts would be made to modify loans. However, the Treasury has made no such efforts, and the voluntary efforts of servicers have been inconsistent at best. Now, more than ever, firm legislative language is integral to accomplishing our shared goal of reducing foreclosures and providing aid to homeowners.

Priorities for the Next Administration

As dozens of economists have stated, our current economic woes largely stem from the trouble in the housing market. Yet, the Treasury has refused to apply any TARP funding—or funding from any other source—directly to mending the housing matter. In fact, Secretary Henry Paulson has rejected serious proposals to create a large-scale modification program and has not applied any meaningful conditions to TARP recipients in this regard.[7] At this point, $365 billion has been designated for financial institutions, and prospects for homeowners facing foreclosure have not improved.

In addition to the substantial evidence available in published studies and reports, the actual conditions faced by real people substantiate the need for immediate intervention. Melissa M. is one of the few first-time homebuyers in Phoenix, Arizona who is able to qualify for a conventional mortgage. She completed a homeownership counseling program and began working with a real estate agent to find the house that was right for her family. She ultimately chose a Real Estate Owned (REO) property. Despite the fact that she is qualified and ready to purchase the home, the servicer has blocked the process. Working with her agent and housing counselor, she has spent the last four months attempting to satisfy the servicer's requests. Each time they call, the servicer demands a different piece of information, or she is transferred to a different agent.

In Los Angeles, California, an NHN counselor has been unable to obtain a loan modification for her 76-year-old client because the servicer uses national averages to determine what is acceptable for a family budget. Because the servicer is unwilling to use a local index that reflects costs in Los Angeles for the family budget, the elderly couple is in danger of losing their

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Crisis," *Reuters*, February 1, 2008, http://www.reuters.com/article/reutersEdge/idUSN2436651820080201 (accessed January 8, 2009). When borrowers make the minimum payment, the excess principal and interest is tacked on the balance of the loan (known as negative amortization), and the loan will reset when the amount owed is between 115% and 120% of the home value. Many Option ARM borrowers are "upside down," but so are many borrowers with standard mortgage products who are in areas where home values have dropped significantly.

[6] National Council of La Raza, "NCLR Urges Congress to Include Homeowners in Bailout Bill," news release, September 23, 2008; National Council of La Raza, "Civil Rights Groups Call on Congress to Assist Homeownership in its Economic Recovery Package," news release, September 30, 2008.

[7] See U.S. Department of the Treasury, "Remarks by Secretary Henry M. Paulson, Jr. on Financial Rescue Package and Economic Update," news release, November 18, 2008; House Committee on Financial services, *Testimony by Treasury Secretary Henry M. Paulson, Jr. before the House Committee on Financial Services*, 110th Cong., November 18, 2008; and Tami Luhby, *FDIC's Bair pushes aggressive mortgage plan*, CNNMoney.com, November 14, 2008, http://money.cnn.com/2008/11/14/news/economy/fdic_bair/index.htm?postversion=2008111416 (accessed January 5, 2009).

home. In Stockton, California, a working couple with an Option ARM was denied a modification because it was the second they were applying for. Their first modification was short-term and not affordable. When it expired, they found themselves in the same position they were in months before, facing foreclosure.

In Detroit, Michigan, an NHN counselor was finally able to obtain a loan modification for his client, the victim of a brutal beating who fell behind in her mortgage payments while waiting for approval for disability income. It took ten months of negotiations with the servicer and the involvement of the State Attorney General to secure the modification because the property was sent to foreclosure while the case was still in the loss mitigation process.

When the foreclosure crisis began, most NHN clients who were struggling to pay their mortgages found themselves in a foreclosure situation largely because their home loans were predatory or unaffordable from the start. Now, the faltering economy is further complicating the situation for multitudes of people. This nation's millions of hardworking Latino families are confronted by a dangerous combination of unaffordable home loans, declining home values, the threat of job loss and/or reduced income, and increased consumer expenses. Many are using their credit cards to make ends meet—setting up yet another potential bubble in the credit market. While financial institutions have access to TARP funds to shore up their balance sheet, working families are being left without a financial safety net.

The program has failed two of the objectives laid out in the legislation: to reduce the number of foreclosures and loosen the credit markets. These goals are not only critical to helping struggling Latino homeowners avoid financial disaster, but to helping our national economy to recover. TARP has failed to fulfill these goals in three specific ways:

- **Foreclosure rates continue to rise.** The Treasury's shifting strategy under TARP, rejection of the concept of purchasing troubled assets, and flagrant disregard for Congress's intended purpose of the legislation are well-documented. Upon passage of EESA, the Treasury had at least two meaningful foreclosure prevention strategies available. The department could have aided homeowners directly through the purchase of whole loans, or indirectly by making the modification of troubled loans a condition of receiving TARP funds; a number of viable variations on these concepts have since been developed. Instead, the Treasury has employed the very kind of piecemeal approach they advocated against when developing a strategy to bolster financial institutions. Rather than create and implement a systemic and cohesive approach to loan modifications, the Treasury has relied on voluntary loan modification programs that have proven ineffective and on sporadic commitments made by financial institutions applying for funding.[8] In the meantime, the market continues to make its own

[8] For a thorough discussion of the Treasury's approach to foreclosure mitigation, see U.S. Government Accountability Office, *Troubled Asset Relief Program: Status of Efforts to Address Defaults and Foreclosures on Home Mortgages*, presented by the U.S. Government Accountability Office (GAO) before the Subcommittee on Financial Services and General Government, Committee on Appropriations, U.S. Senate, December 4, 2008. According to GAO's testimony, the Treasury applied routine and vague contract language to TARP agreements in which companies would agree to make use of existing programs to the extent possible to modify mortgages. Contracts lacked specific benchmarks, expected outcomes, or measures of accountability regarding mortgage modifications. Moreover, existing modification programs have been inconsistent and ineffective. FHA Secure, which was intended to help 80,000 homeowners, has helped only 4,100 delinquent borrowers refinance since September 2007. Hope for Homeowners was intended to provide loan modifications for 400,000 families and has

case for an improved foreclosure prevention strategy. According to recent projections from Credit Suisse, foreclosures rates will continue their record-setting rise during the coming four years, while a spike in unemployment could worsen the situation.[9] Moreover, the evidence to date shows that anything short of a systemic loan modification tied to borrower affordability is unsustainable.[10]

- **The flow of credit to impacted communities has not increased.** Another stated goal of EESA and TARP was to get banks back into the business of lending. While there were initially mixed reports on the extent to which additional credit is currently available, the Federal Reserve Districts report decreased lending and tightened credit standards as contributing to the weak economies in their regions.[11] Access to affordable and safe financial products is critical to building wealth in Latino and other underserved communities, however, consumers are faced with severe obstacles to obtaining credit. Credit card companies have reduced card limits and raised interest rates, student loans are drying up, and flexible mortgage products have disappeared. Not only does this result in less consumer spending overall, but it also prevents qualified homeowners from purchasing excess housing stock. Housing counseling agencies and credit unions have experienced a sharp decrease in the number of creditworthy families for whom they can secure financing. With few families able to qualify, we are concerned that banks and servicers will sell significant numbers of REO properties, in bulk, to investors and speculators.

- **TARP lacks transparency and a mechanism for public accountability.** That the Treasury appears not to have a reliable record of how financial institutions are using funds allocated under TARP is a cause for serious concern.[12] In a recent poll conducted by the Associated Press, 21 bank recipients declined to account for how their funds have been spent. Clear disclosure of the distribution, uses, and impact of the funds is necessary not only because the money is taxpayer dollars, but also because the funding and authority to distribute were granted with a clear public purpose. Information obtained through a number of publicly available data sources, such as Home Mortgage Disclosure Act, Community Reinvestment Act, and Survey of Consumer Finances, is often used to hold institutions accountable, inform public policy, and develop new lending tools. Civil rights institutions, for example, have used these data both to hold financial institutions accountable for unethical practices such as redlining and predatory lending and to encourage investment in underserved communities. The lack of public disclosure, along with the absence of demonstrable impact, jeopardizes the integrity and, ultimately, the success of the entire TARP initiative.

Recommendations

As we begin a new Administration and congressional session, Hispanic families and struggling neighborhoods throughout the country need a bold foreclosure prevention strategy, starting with

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received less than 400 applications. Making matters worse, voluntary efforts by industry have often produced short-term workouts, rather than permanent loan modifications that are sustainable and affordable.

[9] *Foreclosure Update.*

[10] *Analysis of Subprime Mortgage Servicing Performance, Data Report No. 3,* State Foreclosure Prevention Working Group (September 2008) http://www.csbs.org/Content/NavigationMenu/Home/SFPWGReport3.pdf.

[11] *Summary of Commentary on Current Economic Conditions* (Minneapolis, Minnesota: Federal Reserve Bank of Minneapolis, December 2008).

[12] See Cheyenne Hopkins, "Follow the Money? With TARP, That May Not Be So Simple," *American Banker,* December 15, 2008.

a shift in the distribution of the remaining TARP funds. NCLR recommends that, as a basic threshold requirement in the application and approval process, the Treasury mandate applicants to indicate how their proposed allotment of funds will directly serve homeowners struggling to pay their mortgages. Approved recipients must demonstrate how they will ease the burden of foreclosures by increasing lending in the community, redeveloping foreclosed properties, and modifying failing mortgages. Specifically, we recommend that the Treasury:

- **Implement a mandatory systemic loan modification program.** We urge Congress to prohibit the Treasury from tapping into the remaining TARP funds until it implements policies and procedures to address the rising rate of foreclosures, including a mandatory systemic loan modification program. NCLR strongly supports the Federal Deposit Insurance Corporation's (FDIC) "Loan Mod in a Box" proposal. The FDIC program would create a true incentive for banks to participate in the modification program, and it ties loan modifications directly to affordability, two keys to a successful modification program. The FDIC proposal also encourages servicers to work with housing counseling agencies by paying counselors a fair fee for their work. In addition, as a condition for receiving TARP funds, financial institutions should be required to implement a loss mitigation program.

- **Keep homeownership a priority and increase the flow of capital and credit directly to Hispanic communities.** As supporters of homeownership for modest-income Hispanics, we have always recognized homeownership as a long-term investment. We urge Congress to require recipients of TARP funding to increase fair and affordable lending to impacted communities and ensure that REO properties are made available to renters and owners from within the impacted area and sold to owner-occupants. As we seek to restore balance to the mortgage market, we urge Congress to explore every meaningful opportunity to support investment vehicles that increase the flow of capital and credit to Hispanic communities. There are a number of models that could ensure TARP funding reaches those most impacted by the foreclosure crisis, including matched investment pools, CDFI programs, full inclusion of minority- and women-owned businesses, and other existing development tools.

- **Mandate disclosure and accounting of TARP funds.** The Treasury must disclose the recipients of TARP funds, their intended purposes for fund disbursement, measures for impact, and explanations of how the funding will directly mitigate the effect of rising foreclosure rates. Financial institutions should be required to disclose how they have used the funds, where money has been lent, for what purpose, and other criteria critical to determining whether the uses meet their public purpose. In addition, recipients must disclose changes to their own business practices, such as improved loss mitigation practices or investments in impacted communities, made as a condition of funding. NCLR encourages Congress and the Treasury to obtain these disclosures, to the extent possible, from existing recipients as well. Data should be made available on a quarterly basis, at minimum.

While the focus of this hearing is on TARP, this program alone cannot resolve all the issues facing our troubled mortgage and credit markets. NCLR supports a number of other measures that would curb foreclosures and protect vulnerable homebuyers and owners, including:

"Helping Families Save Their Homes in Bankruptcy Act of 2007" (S. 2136), "Home Retention and Economic Stabilization Act of 2008" (H.R. 6076), "Foreclosure Prevention and Sound Mortgage Servicing Act of 2008" (H.R. 5679), "Systematic Foreclosure Prevention and Mortgage Modification Act" (H.R. 7326), and "Credit Cardholders' Bill of Rights Act of 2008" (H.R. 5244). NCLR also continues to be a strong supporter of the U.S. Department of Housing and Urban Development (HUD) Housing Counseling Program. We recommend managing and funding all foreclosure relief services through the HUD program.

While the immediate challenges facing our economy take federal priority for the moment, the future of the American housing and economic sectors is not viable without sound, sustainable solutions. We support comprehensive, anti-predatory lending legislation, a strengthened regulatory structure, a redefined role for the government-sponsored enterprises to reestablish a healthy market in conventional and affordable loans, and new steps to improve financial literacy among vulnerable populations. We look forward to working with this Committee, the Congress, and the new Administration to enact these proposals in the coming months.

Testimony of

Joe R. Robson

On Behalf Of the
National Association of Home Builders

Before the
United States House of Representatives
House Financial Services Committee

Hearing on

Priorities for the Next Administration:
Use of TARP funds under EESA

January 13, 2009

On behalf of more than 200,000 members of the National Association of Home Builders (NAHB), I thank you for the opportunity to submit this statement on the issue of the Troubled Asset Relief Program (TARP) funding under the Emergency Economic Stabilization Act (EESA). My name is Joe Robson, and I am a builder and developer from Tulsa, Oklahoma, and the 2008 NAHB Chairman-elect of the Board.

NAHB was a strong supporter of the EESA, as well as TARP, as a means for addressing the dramatic deterioration in credit availability. Unfortunately, while the stated intent of the EESA was to expand the flow of credit to consumers and businesses on competitive terms, and to promote the sustained growth and vitality of the nation, the home building industry continues to experience severe credit problems since passage of the EESA. In addition, the TARP program does not adequately respond to the nation's foreclosure crisis, which must be addressed to keep people in their homes, help stabilize home prices and promote recovery of the housing market.

This statement focuses on three key areas, and with accompanying recommendations, to address the critical failings of the TARP program as it relates to the housing industry.

- Foreclosure Mitigation Efforts – NAHB supports the foreclosure mitigation proposal of the Federal Deposit Insurance Corporation (FDIC). Additionally, we are prepared to revisit our opposition to a temporary change to the bankruptcy code to allow bankruptcy judges to address the problems faced by some struggling homeowners who find themselves underwater on their mortgage and struggling with their monthly payments.

- Credit Liquidity – The nation's credit markets are still frozen. Banks who have received TARP funds have come under deserved criticism for not using the funds to expand credit liquidity. For the home building industry, the dramatic deterioration in credit availability has severely impacted the Acquisition, Development and Construction (AD&C) credit market. NAHB is cautioning banking regulators about the seriousness of the AD&C credit crunch and warning that further tightening of credit will only make matters worse by further depressing home prices and increasing the number of stressed properties on the market. Banks who receive TARP funds must increase lending and improve accountability through guidance on lending to creditworthy borrowers.

- Stimulate Housing Demand – Falling home values are at the core of the current economic crisis; driven by a record high supply of existing homes. Congress must pass temporary and targeted incentives to encourage Americans to buy homes again to stabilize the home prices, values and the market overall. In conjunction with foreclosure mitigation efforts, NAHB's recommendations focus on the other side of the inventory problem that is at the core of the economic crisis – demand for housing. NAHB's proposal to stimulate housing demand through an enhancement of the Home Buyer Tax Credit and a program to offer below market fixed-rate mortgages for home purchases will increase home purchases by 1.1 million homes in 2009 and create more than 539,000 jobs.

Foreclosure Mitigation Efforts

Finding ways to help those having trouble paying their mortgage is an essential component of any solution to the housing problems so adversely effecting local communities and economies. There are huge waves of problem loans on the horizon, and it is critical to take prompt and decisive action to prevent the failure of these loans and avoid further surges in the inventory of unsold homes. Reducing foreclosures is a vital element to success in stabilizing housing markets, housing prices and to fostering the overall economic recovery.

NAHB strongly supports the plan put forward by the FDIC to use of TARP funds in foreclosure mitigation efforts. This plan is a creative approach to efficient and effective loan modification. It contains features, including risk-sharing with current mortgage holders and enhanced compensation for servicers, which will facilitate a systematic process in reworking the terms on troubled loans. NAHB believes such an approach can produce a significant reduction in impending foreclosures.

FDIC Chair Sheila Bair has proposed using $24 billion of the funds Congress authorized for the TARP to provide loan guarantees to achieve greater success in foreclosure mitigation efforts. In the proposed program, mortgage investors who agree to modify mortgage terms to reduce a troubled borrower's monthly payment burden would receive a federal guarantee on repayment of a portion of the restructured loan. FDIC estimates that the program could result in 2.2 million loan modifications (out of 4.4 million problem loans) and, after allowance for an expected rate of default on the restructured loans, 1.5 million foreclosures could be avoided. The goal is to break the current adverse cycle of increasing foreclosures, which drives down home prices, places more homeowners in mortgage jeopardy and leads to further waves of foreclosures and price declines.

The FDIC initiative is an attempt to overcome impediments that have limited the success of existing foreclosure mitigation programs, where mortgage holders must agree to significant reductions in principal repayment. Under the FDIC plan, investors are not forced to accept principal haircuts. Instead mortgage holders can improve loan affordability by calibrating various loan terms -- reducing the interest rate, extending the term of the loan and/or deferring (but not forgiving) principal payments. The FDIC has employed these techniques in foreclosure mitigation efforts on mortgages that are held by IndyMac, which failed and is operating under FDIC control.

The FDIC plan focuses on improving the net present value of the loan modification option to make it preferable to foreclosure proceedings. TARP funds would be used to share the risk of loss in a subsequent default on the modified mortgages. Another difference between the FDIC initiative and other existing foreclosure reduction efforts is that mortgage servicers would receive additional compensation of $1,000 for each loan modified. Another distinction of the FDIC approach is the emphasis on a more standardized and systematic reworking of troubled mortgage portfolios. Under other programs, the approach is loan-by-loan, limiting activity and promoting adverse selection, where investors only offer the loans with the greatest likelihood of failure. The FDIC program would be limited to mortgages secured by owner-occupied properties. The loan modifications would be targeted to reducing the borrower's first lien mortgage payment to

as low as 31 percent of monthly income. Each loan would be subject to a net present value test to ensure that a modification is the least-cost option. For loans with loan-to-value (LTV) ratios above 100 percent, the government's repayment guarantee would be progressively reduced from 50 percent to 20 percent as the current LTV rises. No government guarantee would be available for loans with LTVs that exceed 150 percent. The loss-sharing provision would end eight years following the mortgage restructuring.

In light of the prolonged and severe nature of the housing downturn, NAHB urges Congress to explore a broad array of options to stabilize the housing market and assist struggling homeowners. NAHB recognizes that one of the tools Congress will consider is changing how primary residence mortgages are handled in bankruptcy court. As part of a comprehensive plan to address the housing downturn, NAHB is prepared to revisit its opposition to a change to the bankruptcy code to allow bankruptcy judges to address the problems faced by some struggling homeowners who find themselves underwater and struggling with ballooning monthly payments. NAHB believes that these changes should be temporary and, to avoid further damage to the credit markets, apply only to specific, existing mortgages.

Credit Liquidity

When Congress passed the EESA, and TARP, the stated intent of EESA was to expand the flow of credit to consumers and businesses on competitive terms to promote the sustained growth and vitality of the nation. In conjunction with EESA, the government has taken some very dramatic steps to address unprecedented credit market problems.

- The Federal Reserve has established a number of new credit facilities as a backstop for sectors where normal credit channels are frozen.
- The Fed has also pumped liquidity into the system and helped reduce mortgage borrowing costs, which is greatly appreciated by the housing industry.
- The Treasury Department has employed TARP funds to establish a Capital Purchase Program (CPP) that is injecting $250 billion into hundreds of banking institutions.
- The FDIC has increased the level of deposit insurance coverage to $250,000 and is backing newly issued senior unsecured bank debt through the Temporary Liquidity Guaranty Program (TLGP).

Despite these efforts, TARP funding has come under criticism for failing to expand credit liquidity. The feedback we get over and over from our members is – *"My bank has received bailout funds but still refuses to lend or consider viable loan workout options."* While NAHB is appreciative of the recent statement by the banking regulators urging banks to lend to creditworthy borrowers, we are confounded that institutions that receive taxpayer provided TARP funds are not required to extend such credit.

We understand that the FDIC is developing guidance to implement the statement on lending to creditworthy borrowers. NAHB wholeheartedly supports this effort, and we urge all the banking

regulators to adopt such guidance. Further, we believe the guidance should be enforced for all regulated depository institutions, not just those receiving TARP funds. Additionally, NAHB urges the regulators to adopt a process for monitoring the use of TARP funds within the supervisory process.

NAHB's greatest concern is that credit seemingly is being cut off indiscriminately for acquisition, development and construction (AD&C) loans to builders and developers. Construction lending for multifamily projects is also at a standstill, even though that part of our industry is not burdened by an inventory overhang. It seems that institutions have placed an "off limits" sign on their real estate lending operations and are not willing to give serious consideration to even very viable projects. As discussed below, this will have dire near-term and longer-term economic consequences.

AD&C Credit Problems

The housing sector is an industry made up mostly of small businesses. About four-in-five of NAHB's member firms build fewer than 25 homes a year in a normal year. Each year, NAHB's builder members construct about 80 percent of all new housing in America.

These small businesses depend almost entirely upon commercial banks and thrifts for housing production credit. Our surveys show that 90 percent of all loans for residential AD&C projects come from commercial banks and thrifts.

Residential AD&C loans are used to purchase land; develop lots; build a project's infrastructure such as streets, curbs, sidewalks, lighting, and sewer and utility connections; and construct homes. Loans extended to builder/developers are short-term obligations lent as progress payments, i.e., portions of the loan commitment are advanced as stages of the construction project are completed. The advances, or draws, are generally made over a six-to-18 month period. The principal and interest on the loans is repaid to the lender when the home is sold. Builders typically secure this financing through personal guarantees and/or offering other assets as collateral.

Current AD&C Financing Conditions

Home builders have struggled as much as other businesses during this credit crisis. Much focus has been given lately to expanding TARP funds for other credit markets, but no similar attention has been given to supporting distressed builders or projects. However, the problems facing NAHB's members parallel those in the home mortgage market. Home builders are having extreme difficulty in obtaining credit for viable projects. Builders with outstanding construction and development loans are experiencing intense pressure as the result of requirements for significant additional equity, denials on loan extensions, and demands for immediate repayment. The credit window seems to have been slammed shut for builders all over the country.

In many instances, the construction projects are solid projects that simply need to be built out for completion. Even builders who are current on their AD&C loan payments are facing bank demands for additional capital. Most builders have no alternative financing sources, and thus

those who would otherwise be able to complete and sell their project under the original terms of the loans, are being bankrupted because they lack the additional money the banks suddenly demand. Performing loans are therefore rendered non-performing as a result of these actions.

These trends are supported by NAHB's member surveys of the availability and cost of AD&C credit. Our latest survey, conducted in November, shows continued, severe deterioration in credit availability for all types of residential AD&C loans – for both new loans and outstanding credit. Key findings of the November survey are highlighted below.

- 74 percent of respondents stated that the availability of credit for new single family construction loans worsened in the August – October 2008 period compared to the June – August period as reported in the September 2008 survey. This continues a progressive rise over the past year in the proportion making such an assessment.

- 87 percent of those seeking land acquisition loans reported worse credit availability;

- this reading was 85 percent for those seeking land development credit and 86 percent for those trying to line up construction funds for multifamily housing.

- Of those reporting deterioration of credit availability, 80 percent noted lower loan-to-value limits, while 79 percent indicated a reduction in the amount lenders are willing to lend.

- Nearly 40 percent reported tighter loan terms for outstanding land development loans;

- 37 percent stated stricter terms on outstanding single family construction loans.

NAHB also has been collecting case studies of builder financing problems, which show the problems are no longer confined to the housing boom-bust states, but have spread to almost all parts of the country. The feedback we are getting over and over from our members is that banks are unwilling to provide credit for AD&C loans and are not providing reasonable flexibility on outstanding loans.

Appraisals are a major issue. Appraisers are using short-sales and distressed properties, including foreclosed homes, as comparables which is inappropriately driving down values. Some of the appraisals are well below replacement cost, which shows how dysfunctional the process has become. As a result of reappraisals, equity calls have become commonplace, even on current loans with underlying projects that are performing well.

Performing loans that have been extended routinely in the past are now being called. Many banks are refusing to consider viable loan workout options. Some lenders are abandoning the construction lending business, without regard to a builder's ongoing projects, and some institutions are auctioning off loans without negotiating with the builder. These actions have increased foreclosures on D&C projects which in turn have hurt communities by unnecessarily increasing the inventory of unsold or half-completed homes.

Of concern to NAHB is that the stress in the AD&C market is being exacerbated by the actions of banks and bank regulators. While the banking regulators have stated the importance for institutions to continue making loans on viable projects, that message seems to be getting drowned out by the intensified warnings on the risks of declining markets and portfolio concentrations. NAHB has cautioned banking regulators about the seriousness of the AD&C credit crunch and has warned that further tightening of credit will only make matters worse by further depressing home prices and increasing the number of stressed properties on the market.

The latest setback for home builder borrowers is the rising number of bank and thrift failures. Builders with outstanding loans that are placed under FDIC control are frequently unable to contact a decision maker to deal with routine, but time-sensitive, matters related to loan draws or extensions. We have recently discussed these receivership problems with FDIC Chairman Bair, and we look forward to working with her and the FDIC staff to improve their receivership processes and to develop information for builders affected by FDIC takeovers.

Economic Impact of the AD&C Credit Crunch

The credit crunch faced by home builders will exacerbate the current housing inventory problem, prolonging the downward spiral in home prices and the housing slump. Clearing out the overhang of unsold homes is a key factor toward stabilizing housing markets and prices. While the level of unsold homes varies significantly across markets, builders in depressed areas have slashed home production to levels well below that needed to meet longer-term demand. Lenders in these markets will not resume lending until a supply-demand balance is restored. The credit crunch is also contributing to slowing housing production in areas not impacted by excessive inventories.

The problems in the housing sector have had a significant impact on the nation's economy. The sharp decline in home building from the 2005 peak – a drop of one million units – has translated into 1.4 million lost jobs for construction workers and the loss of $70 billion in wages.

The housing plunge has also impacted industries that provide materials and services to home builders. Over 560,000 jobs have been lost in the manufacturing sector due to the housing decline as makers of products such as lumber, concrete, windows, doors, plumbing, flooring and appliances have slashed their workforce in response to slumping demand. This has produced a loss of $25 billion in wages.

Further, jobs have been lost by lenders, architects, real estate agents, lawyers, support staff and others who provide services to home builders and home buyers. There has been a loss of over 580,000 jobs and $32 billion in wages for these service providers.

The total impact of the housing slump has been the loss of over 3 million jobs and $145 billion in wages in all housing-related industries. Detailed tables on these economic effects, which also show losses in federal, state and local tax and fee revenue, are attached to this statement.

The ongoing credit problems for home builders will further inflate these totals. Home builders cannot keep their doors open and provide jobs in their communities if they cannot get credit to

build even pre-sold homes. And builders in the middle of viable projects cannot pay subcontractors and other materials and services providers if lenders will not grant routine loan extensions or if banks require payment-in-full before homes can be finished and delivered.

The credit crunch also will cause longer-term economic damage. The development process is lengthy, taking years from the acquisition of land to the completion of homes. With lenders refusing to finance lot development, the pipeline of ready-to-build-on land will drain dry. This will result in a major delay in meeting demand for new homes when consumers return to the marketplace in more significant numbers. In cases where federal permits are also required, expirations of these permits will force builders to start the approval process anew, adding at least several years to the pipeline. The effect will be most severe in markets that have not suffered the boom-bust extremes and would otherwise be poised for more rapid recovery.

Solutions to AD&C Lending Problems

NAHB urges the banking regulators to achieve more balance in their messages on safe and sound lending practices. We want ensure that the regulators encouragement to keep lending on sound projects is not overwhelmed and forgotten by efforts to focus on problem loans and portfolio concentrations. We also urge regulators to include monitoring the use of TARP funds within the supervisory/examination system.

As noted, most of NAHB's builder members are small businesses with limited resources; so requirements for additional equity, fees and/or interest payments can prove to be an unbearable burden. NAHB urges the Committee to encourage regulators and lenders to give leeway to residential construction borrowers who have loans in good standing by providing flexibility on re-appraisals and forbearance on loans to give builders time to complete their projects. Lenders should be encouraged to explore loan modifications and all prudent alternatives to foreclosure. We believe that in almost all cases the best outcome for the lender will result from working through market difficulties with the current builder. As in the end-loan mortgage market, foreclosure is usually the highest-loss outcome.

As discussed above, equity calls on well-performing AD&C loans are having a negative impact on builders and communities. Under the current economic and real estate climate, appraisers are having an extremely difficult job determining appropriate fair values on AD&C projects. They are often overwhelmed with the economic uncertainty and the volume of delinquent and underperforming loans. In our view, this has resulted in very inconsistent and overly conservative appraisals that have turned well performing AD&C loans into troubled assets or even non-performing loans.

For this reason, NAHB is seeking an allocation from TARP, explicitly allocated to AD&C lending, which would enable financial institutions to defer equity calls and allow builders to complete viable projects. NAHB has a detailed plan that could include builder contributions as part of a dedicated TARP allocation. We estimate the cost of such a program would be approximately $20 billion, or less based on the level of builder contributions. The goal is to avoid unnecessary and onerous equity calls by financial institutions on projects that are

bankrupting many small and medium sized builders that rely exclusively on bank funding. If this situation is not aggressively addressed, it will unnecessarily put more real estate-related loans into default, additional pressure on the banking system and the insurance fund, and create more hardship on already stressed communities.

Multifamily Credit Problems

The credit freeze is spreading to the multifamily market. Even though the fundamentals of apartment development remain strong and delinquencies on loans remain low, the multifamily sector is viewed as risky as other commercial and residential real estate.

NAHB multifamily members report that construction lending is at a standstill. Multifamily developers with construction loans on viable projects in good markets are having difficulty obtaining permanent take-out loans. Commercial bank lending has slowed dramatically, life insurance companies have reduced lending for commercial properties by 50 percent compared to last year, and the Commercial Mortgage Backed Securities (CMBS) market is dead.

Fannie Mae, Freddie Mac and the FHA Multifamily mortgage insurance programs have kept the multifamily market afloat. But the agencies' underwriting requirements have tightened considerably, and we expect this trend to continue. Equity requirements of 35 to 40 percent have become the norm, but investors are deploying their equity conservatively or not at all.

In addition, acquisitions of existing apartments have slowed substantially. With cap rates rising, valuation has become more difficult. Thus, the bid-ask expectations have widened, stalling transaction activity.

Also of alarm, over the course of 2008, interest rate spreads for Ginnie Mae multifamily construction loan securities have widened by 100 basis points, making them significantly higher than on Ginnie Mae permanent loan securities. Typically, the rates are the same. The impact of the spread is a higher mortgage note rate, making many FHA-insured new construction and substantial rehabilitation developments infeasible.

The reason for the higher construction loan securities rate is that there are few investors willing to buy and hold these securities until they convert to a permanent loan security. Many of the traditional Ginnie Mae investors are experiencing balance sheet issues and holding construction loans until they can be placed in a Real Estate Mortgage Investment Conduit (REMIC) as permanent loans. This creates additional balance sheet risk, which has created the widened spreads.

There is an industry proposal to address this issue as part of the economic stimulus package by expanding the Federal Reserve program that is purchasing Fannie Mae, Freddie Mac and Ginnie Mae securities backed by single-family loans. This program could also include the purchase of Ginnie Mae construction loan securities at the same rate as the private market is paying for Ginnie Mae permanent loan securities. The ready market for permanent loan securities would set a benchmark for the pricing and would allow a private market for construction loan securities to reemerge once investors' balance sheets allow their reentry into this credit risk-free market.

Once the construction/rehabilitation is completed on these projects (usually 18 to 24 months), the Fed could sell the permanent loan securities and potentially return a profit. A relatively small investment of Fed funds could have a significant positive impact on the ability of FHA to finance needed affordable multifamily housing. NAHB supports this proposal and urges the Committee to consider it.

NAHB also urges the Committee to consider ways to alleviate the liquidity issues for the broader commercial real estate market, which would further assist the multifamily market.

Low Income Housing Tax Credit – Investor Market

While not specifically in the jurisdiction of the Financial Services Committee, the Low Income Housing Tax Credit (LIHTC) is the single most important affordable housing production program in the Federal Government. This critical importance and the collateral damage done to the program by the troubles in the financial markets compelled us to include it in this statement. In the last six months, the credit crunch and financial troubles in the larger financial markets have spilled over into affordable housing where equity investment in the Low Income Housing Tax Credit (LIHTC) has deteriorated significantly. This is a serious problem for the nation's only significant affordable housing production program.

Equity prices for LIHTC investment are declining to levels at which it is extremely difficult to finance new affordable housing properties. One primary reason for this is the departure from the tax credit investor market of Fannie Mae and Freddie Mac, which at one time were almost 40 percent of the investor pool for tax credits. Together with the troubles in the banking and financial sectors (which also traditionally are the strongest source of equity financing through the LIHTC), the program's ability to produce affordable rental housing is significantly impaired. Additionally, should investors that currently hold credits, but are now unable to use them because of a lack of income to offset, decide to sell them at fire sale prices, the market for new credits will decline even further.

The LIHTC has been successful for many years in attracting investors and providing much needed housing for low- and moderate-income Americans. NAHB is confident the current environment is only a temporary condition. However, with the market not expected to improve for several years, and many people losing their homes to foreclosure, it is not a time to slow down the production of new affordable units. In short, the program needs a temporary stabilizer for investment to carry it through this economic crisis.

To improve the financial health of this important program, NAHB recommends several options.

1. Bring individuals back into the LIHTC investment market.

As part of *Housing and Economic Recovery Act (HERA),* Congress enacted changes allowing individuals to offset their alternative minimum tax (AMT) liability with low-income housing tax credits. This provision is one important step toward bringing individual taxpayers (as opposed to only corporate taxpayers) back into the LIHTC program; once a core constituency for the program. The second logical step is to change the passive loss rules, established as part of the

Tax Reform Act of 1986 but not revisited since that time. These rules are the most significant hurdle to individual investment with respect to the LIHTC program.

Currently, Section 469 of the Code establishes a $25,000 limitation on passive loss deductions, which include credits calculated as a deduction equivalent. In general, depending on marginal income tax rate, the credit amount individual investors are able to claim is approximately one third of that amount or $8,750 in LIHTCs per year without offsetting passive income. In other words, individuals who invest in LIHTCs may only apply those credits up to a maximum of $25,000 of ordinary income multiplied by the individual's tax bracket. With a marginal rate of 35 percent the maximum credit amount claimed would be $8750 in a given tax year. With this limitation, builders and syndicators must bring together many individuals for one deal; creating a costly and time consuming process and rendering individual taxpayer investment infeasible.

Historically, corporate investment in the LIHTC program was reliable and more than adequately filled any loss in the individual investor pool. However, it has also been difficult to attract corporate investor interest to small and rural deals, since corporate investors look for larger deals with higher amounts of tax credits to offset their federal tax liability. These kinds of transactions are more common in urban and suburban areas. The problem for the rural and small project is compounded by the current problems in the LIHTC investment market. Institutions investing in LIHTCs today have less competition and are therefore placing even greater focus on investments in urban areas, where the deals are larger and there is a larger pool of potential tenants.

As Congress considers ways to expand the pool of potential investors in LIHTCs or to increase the attractiveness of LIHTCs to investors, we believe it is important to consider limited changes to the passive loss rules to bring individual investors back into the program. One option is to suspend the passive loss rules for LIHTC investors, altogether. A second option is to increase the limitation on passive losses to an amount that makes individual investment viable again.

2. *Prevent "dumping" of existing LIHTCs back onto market by increasing the value of LIHTCs to existing investors*

   a. *Make the LIHTC a refundable tax credit*

      Investors increasingly find it difficult to predict their tax liability over the term of the LIHTC claim period. Without predictable tax liability, the value of the credit itself is reduced. Making the LIHTC a refundable tax credit would provide a tax refund for LIHTCs regardless of taxpaying status. This would help the current situation by stimulating investment and ensuring that existing credits are not resold in the syndication market, thus checking the decline in LIHTC prices.

   b. *Expand the LIHTC carry back rule from one-year to five-years*

      The carry back rule for Low-Income Housing Tax Credits is currently limited to one-year under the Section 38 General Business Credit rules. Expanding this carry back to five-years will ease the downward pressure on LIHTC

prices by allowing credits to be claimed by investors that may not have federal tax liability in the present year. This will reduce the incentive for some LIHTC investors to sell their credits. For those investors subject to the alternative minimum tax (AMT) in previous years, this proposal would require an expansion of AMT relief that was included in HERA for projects placed in service prior to December 31, 2007.

3. Enhance and diversify the pool of future LIHTC investors

In addition to bringing individual investors back into the LIHTC market, NAHB supports changes to the LIHTC that will enhance its overall attractiveness to new and existing investors. In 1990, Congress enacted legislation allowing investors to claim 150 percent of the otherwise allowable first year credit amount, with reductions in the remaining credit claim years by an equal amount of the enhanced credit. This temporary change was intended as a means of attracting new investors into the program. Technical changes, such as this or reducing the credit claim period, would make the LIHTC a competitive alternative to other investment options.

4. Gap Financing for LIHTC Projects

With investor demand for LIHTCs dramatically down from previous years' levels, the value of the credit has also declined creating significant funding gaps for these projects. Without the necessary equity, these affordable housing units will not be built at a time when many low-income Americans are losing their homes. NAHB recommends that funds be allocated to State Housing Finance Agencies to make up equity shortfalls in developments which have LIHTC allocations but have not generated sufficient equity for the developments to move forward.

Stimulate Housing Demand

Housing is central to the economic crisis that now affects the world economy. The declines in house prices, the surge in foreclosures, and the reduction in home building activity are historic in scope and threaten to generate the most severe recession in generations. In addition to focusing on foreclosure mitigation, policies that aim to improve the current economic environment must address conditions in the housing market on the demand side as well.

Under normal conditions, housing accounts for 16 percent of the U.S. economy. Housing, and jobs and economic impacts created by home building and its downstream and related industries, impacts every state, county, and Congressional District in the United States. However, home building has suffered the worst and sharpest decline in production in over 60 years. The intensity of the housing decline varies across states with the most significant impacts concentrated in about ten states. Importantly, the loss in household wealth from home value declines and the continued decline in home prices exacerbated by rapidly increasing foreclosures have left consumers with no confidence in buying a home. The weakened economy has added another nail in housing's coffin, further discouraging home purchases. As a result, the U.S. economy has lost over 3 million jobs in housing construction and related fields, and has over 6 million vacant homes on the market.

To bring consumers back to the market, reduce inventories of unsold homes and stabilize home values, NAHB is advocating for a two-pronged approach, focusing on temporary programs that will strengthen housing demand and promote economic recovery. Our plan combines the double spark of an enhanced home buyer tax credit and a mortgage rate buy down to help restore consumer confidence and stimulate demand for new homes by providing an incentive to drive new home purchases.

Specifically, our plan would enhance the Home Buyer Tax Credit passed as part of HERA by eliminating the current recapture requirement; increasing the credit amount and eligibility period; expanding the credit to all homebuyers; and making the credit available at the time of closing. Additionally, the interest rate buy down program would offer below market 30-year fixed-rate mortgages for the purchase of a primary residence by offering a 2.99 percent rate for contracts closed before June 30, 1009, and a 3.99 percent rate for contracts closed through the end of 2009.

This two-pronged housing stimulus approach is not new. In fact, this plan mirrors legislation passed by Congress in 1974 and 1975 to deal with the exact same problem. At the time, the Dow Jones Industrial Average was falling precipitously, the country was in the midst of a recession and unemployment rates were rising. At the end of 1974, the Consumer Confidence index was at its lowest point ever recorded – that is, until the new all time low in October 2008.

After the implementation of both the mortgage rate buy-down and new home buyer tax credit, the results came fast and were dramatic. Existing home sales increase by roughly 500,000 per year, reaching almost 4 million in 1978. Housing starts increased by roughly 400,000 per year and were back up to near 2 million by 1977. The impacts on the overall economy were equally dramatic. Real GDP growth rebounded to better than 5 percent the very next year. Unemployment also began to improve in 1976, although it took until 1978 for the rate to fall back into the neighborhood of 6 percent.

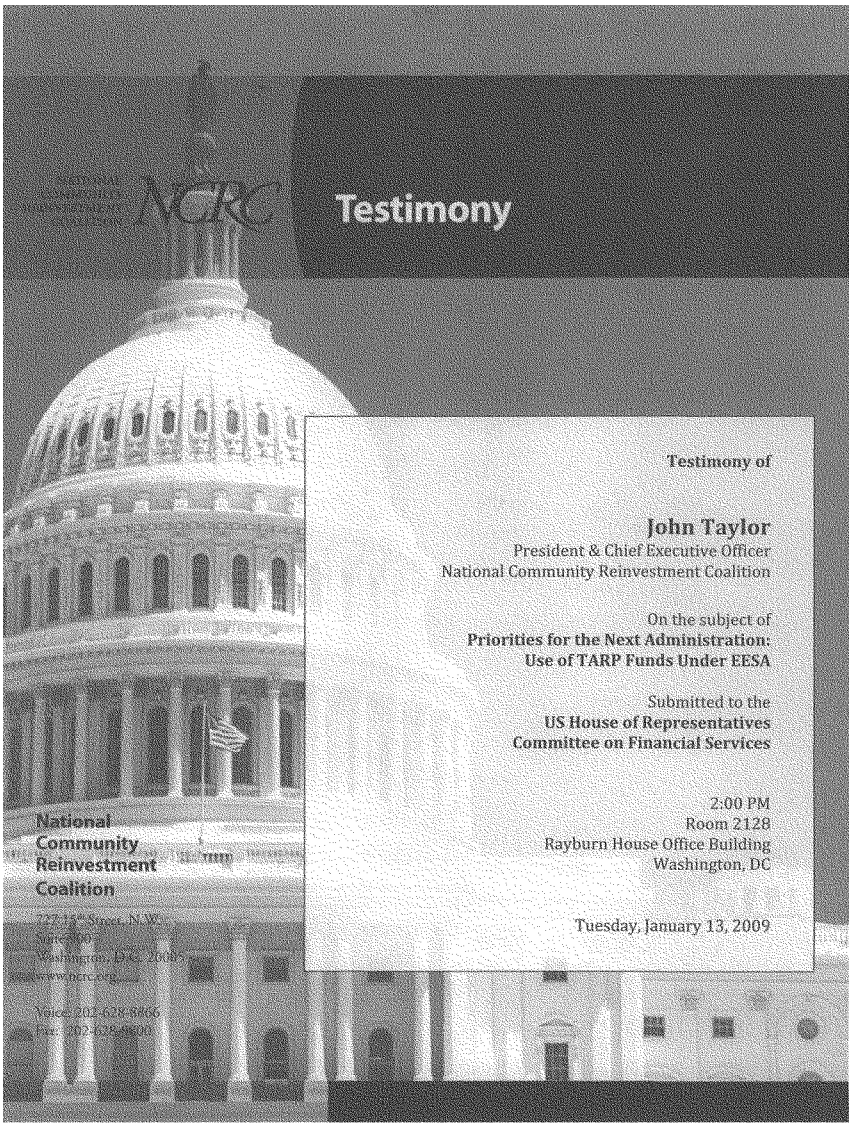
Based on our analysis, implementing this proposal will increase home purchases by 1.1 million homes in 2009, which would help soak up the excess supply and push house prices back in the positive direction. The economic stimulus created by established households moving into new homes, and the added construction necessary to answer demand where there is no excess supply, will create more than 539,000 jobs, $26 billion in wages and salaries, $21 billion in business income, $14 billion in federal tax revenues and $4 billion in state and local tax revenues. In short, the proposal will incentivize home buyers at a time when consumers remain uncertain about the future and energize our economy.

Housing demand and household formations are very positive for the future, but until a spark ignites demand, the pain from a lack of demand coupled with excess supply will cause further harm to all households and to the overall economy. The time is now to implement demand-side housing stimulus.

Conclusion

Thank you once again for this opportunity to provide the home builder perspective on the issue of TARP funding under ESEA. As I strong supporter of the EESA and TARP during

Congressional passage, NAHB was hopeful the program would address many of the critical issues facing our industry and nation. While the results of this legislation have been mixed at best, NAHB looks forward to working with this Committee to develop additional solutions aimed at addressing the critical issues of foreclosure mitigation, credit liquidity, and housing stimulus. I welcome any questions you may have for me.


NCRC
Testimony
Testimony of
John Taylor
President & Chief Executive Officer
National Community Reinvestment Coalition
On the subject of
Priorities for the Next Administration:
Use of TARP Funds Under EESA
Submitted to the
US House of Representatives
Committee on Financial Services
2:00 PM
Room 2128
Rayburn House Office Building
Washington, DC
Tuesday, January 13, 2009
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Introduction

Good Morning, Chairman Frank, ranking member Bauchus, and other distinguished members of the Committee. I'm John Taylor and I am the President and Chief Executive Officer at the National Community Reinvestment Coalition (NCRC). NCRC is an association of more than 600 community-based organizations that promotes access to basic banking services, including credit and savings, to create and sustain affordable housing, job development, and vibrant communities for America's working families.

I am honored to testify today on behalf of NCRC before the United States House of Representatives Committee on Financial Services regarding the use of Troubled Asset Relief Program (TARP) funds under the *Emergency Economic Stabilization Act of 2008* (EESA). Chairman Frank and other members of the Committee, NCRC commends your efforts to ensure that the remaining TARP funds be prioritized in the most effective and efficient manner. NCRC is also pleased that the Chairman's TARP Reform bill provides significant financing of up to $100 billion for foreclosure mitigation, addresses many of the barriers frustrating loan modifications, and institutes reforms of the Federal Housing Administration HOPE for Homeowners program.

NCRC recommends that a significant portion of the remaining TARP funds be used to address the foreclosure crisis. Financial markets will not stabilize and the economy will not rebound until the foreclosure crisis is addressed by the implementation of a large-scale loan modification program. Moreover, substantial intervention is necessary to respond to the contagion effects of the foreclosure crisis. Failure to address mounting foreclosures continues to drive down home prices, which results in a wide range of problems for the financial system and overall economy,

including reduced home equity, decreased consumer confidence, a loss of jobs, and a steeper decline in overall economic activity and performance that go beyond loan modification. Therefore, NCRC recommends the investment of remaining TARP funds in an economic recovery program that promotes infrastructure projects and small businesses that create jobs and rebuild communities. Finally, considering the magnitude of the current financial crisis and its potential long-lasting effects, action should be immediate to address the problems that caused this crisis, which are the unfair and deceptive practices that led to the undermining of the national economy.

I. Use TARP Funds to Address Foreclosures

To date, TARP funds have been spent on efforts that have not stabilized the financial system. The first $350 billion were used to inject liquidity into markets through cash investments into financial institutions and emergency loans to the automotive industry. However, the financial markets remain unstable, as *preventable* foreclosures continue to weaken the national economy and devastate local communities.

Recently, the Second Report of the Oversight Panel criticized the United States Treasury Department for failing to use any of the first $350 billion to alleviate the foreclosure crisis.[1] The Panel called into question the Treasury's stated intent of developing "a plan that seeks to maximize assistance for homeowners."[2] And while helpful, federal programs and voluntary efforts to stem the foreclosure crisis do not address the breadth and depth of arresting this crisis.

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[1] Accountability for the Troubled Asset Relief Fund, The Second Report of the Congressional Panel, January 9, 2009.
[2] Id.

Immediate solutions are needed to restore the health of the financial system and overall economy. Therefore, NCRC recommends that a significant portion of the remaining TARP funds be invested in a large-scale loan modification program that will assist homeowners and prevent additional foreclosures.

i. Voluntary and Federal Loan Modification Programs Are Insufficient[3]

Financial institutions have voluntarily modified loans on a large scale, but these modifications have been disappointing. In a sample of 3.5 million loans, Valparaiso University Law Professor Alan White found that more than half of the modifications did not result in lower mortgage payments.[4]

The federal government has also established loan modification programs that are not of the scale necessary to assist homeowners in a timely manner and prevent foreclosures. For instance, the Hope for Homeowners program offers distressed borrowers an opportunity to refinance into

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[3] **Obstacles to Voluntary and Federal Programs**: Various structural, market, and institutional obstacles have created formidable barriers to current programs and policies intended to modify loans. Programs that rely on voluntary participation of lenders, servicers, and investors have not been effective in overcoming these obstacles. One of these obstacles is the restrictions imposed by Mortgage-Backed Securities (MBS). When investors buy pools of loans called MBS, a pooling and service agreement (PSA) imposes various limits on a servicer (servicers receive borrower payments and then process payments to investors). For example, some PSAs allow just 5 percent of loans in a MBS pool to be modified. Other PSAs are vague and state that loans can be modified as long as servicers comply with "acceptable servicing standards." The outcome of the restrictiveness and vagueness of PSAs is that servicers fear investor lawsuits if they aggressively modify loans. Indeed, investors recently sued Bank of America when that lender tried to modify distressed loans in MBS.
A second obstacle is that compensation methods provide perverse incentives for servicers. Servicers receive fees that are a small part of monthly borrower payments on loan interest. In the case of foreclosure, a servicer can recoup missed borrower payments out of the proceeds of a foreclosure sale. In contrast, when a loan is modified, there is no clear way for a servicer to receive compensation, particularly when borrowers are granted waivers for unpaid past due interest. The current compensation system, therefore, can actually discourage servicers from modifying loans.
A third obstacle is the misaligned incentives of the different lenders that hold first and second mortgages. A prominent feature of high-cost and risky lending of recent years is that lenders would often make a first mortgage and a second mortgage (or piggyback loan) simultaneously to a borrower. When unaffordable piggyback loans need to be modified, one of the lenders may block a proposed modification. For instance, the lender holding the second mortgage may decline to agree to the modification, calculating that borrower payments under the new modification will be too low to payoff the second mortgage.

[4] Alan White, Deleveraging American Homeowners, December 18th Update to August 2008 paper.

loans that are guaranteed by the Federal Housing Authority. While this program had estimated to refinance up to 400,000 loans when it was authorized by Congress this past summer, the program is not demonstrating immediate results, as evidenced by the fact that only 357 applications have been submitted since the program's inception in October 2008.[5]

Under Sheila Bair, the Federal Deposit Insurance Corporation (FDIC) has positioned itself in a leadership role by emphasizing the need to modify loans and implementing a best-practice model based on the IndyMac program. When IndyMac, a large savings-and-loan institution based in California, failed in July 2008, the FDIC instituted an aggressive loan modification program for defaulting IndyMac loans. The FDIC program modifies loans using interest rate reductions, principal forbearance, and extended amortization in order to achieve a monthly housing payment-to-income ratio of no more than 38 percent. However, to date, significant reductions of loan principal have not been a regular component of the FDIC modifications.

Most recently, the FDIC created a plan to modify up to 1.5 million distressed loans based on the IndyMac model and offer a government guaranty of 50 percent for refinanced loans. In an effort to overcome disincentives for servicers, FDIC proposes to pay servicers $1,000 to modify distressed loans.[6] While the IndyMac program has been the most effective mechanism implemented at present, both it and the subsequent FDIC proposal may result in modifications that would not achieve long-term affordability for struggling homeowners, especially if the loan modifications do not reduce outstanding principal loan amounts.

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[5] Michael Corkery, Mortgage 'Cram-Downs' Loom as Foreclosures Mount, Wall Street Journal, December 31, 2008.
[6] http://www.fdic.gov/consumers/loans/loanmod/ and see Statement of Sheila C. Bair, Chairman, Federal Deposit Insurance Corporation on Oversight of Implementation of the Emergency Economic Stabilization Act of 2008 and Of Government Lending and Insurance Facilities; Committee on Financial Services; U.S. House of Representatives; Room 2128, Rayburn House Office Building, November 18, 2008, http://www.fdic.gov/news/news/speeches/chairman/spnov1808.html

ii. Create a Large-Scale Loan Modification Program that Provides HELP Now

Experts forecast as many as ten million foreclosures will occur before the end of the current economic crisis. Therefore, NCRC recommends that a TARP loan modification program modify between three to five million distressed loans.

In early 2008, NCRC proposed the establishment of a national Homeowners Emergency Loan Program (HELP Now). It would authorize the Treasury Department to buy troubled loans at steep discounts (equal roughly to their current write-downs by financial institutions) from securitized pools. This would result in a relatively low cost to taxpayers. The government would then arrange for these loans to be modified through existing entities such as Fannie Mae and Freddie Mac, and then sell the modified loans back to the private market. The program would be relatively easy to implement, as it does not require the creation of a new entity.

The purchase discounts would be applied to the modification of problem loans to create long-term borrower affordability. Reflecting the write-downs by financial institutions, the government would purchase loans at a 30 percent to 50 percent discount. If the discounted loans are still not affordable for some borrowers, the government could offer a low-interest second mortgage that would be due upon sale of the property.

HELP Now would be an efficient use of government resources. HELP Now would require an initial government outlay of about $50 to $100 billion to purchase loans and would institute a revolving loan fund mechanism. The government would be reimbursed for its loan purchases after it sells the loans (which have been modified) to Fannie Mae, Freddie Mac, or private-sector

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[7] Credit Suisse, Foreclosures Update: Over 8 Million Foreclosures Expected, December 4, 2008, Fixed Income Research, http://www.credit-suisse.com/researchandanalystics

investors. Moreover, the government would be able to establish mandatory underwriting criteria in order to guard against re-defaults. Unlike the Hope for Homeowners program, the IndyMac program, and the subsequent FDIC proposal based on the IndyMac model, the government would not guarantee the loans, and would, therefore, not incur significant losses beyond those required to administer the original loan modifications.

(Please see the attached paper on the proposed NCRC HELP Now program.)

iii. Use the Power of Eminent Domain

A number of legal scholars have suggested that there are legal impediments regarding the complexity of selling loans held in securitized pools. Therefore, NCRC recommends the alternative approach of using eminent domain with the HELP Now proposal to purchase loans from investors and servicers. The current economic crisis would justify the government's use of eminent domain laws for a compelling public purpose. In addition, eminent domain would overcome several barriers. Through compulsory purchases of troubled loans, reluctant servicers, investors, and lenders would not need to be persuaded to participate.

Utilizing the federal government's power of eminent domain avoids lawsuits from disgruntled investors. As Harvard Law Professor Howell Jackson points out, eminent domain can solve the barriers related to first and second liens by directly purchasing all mortgages on targeted properties.[8]

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[8] Professor Howell E. Jackson memo to the House Financial Services Committee, November 28, 2009, on file at NCRC.

The use of eminent domain could also alleviate pricing uncertainties to unfreeze the credit market, and it could establish fair prices for mortgages through existing judicial mechanisms.[9] Once fair prices are established, a secondary market can then be re-established and voluntary efforts to refinance mortgages will most likely accelerate. Professor Jackson proposes that eminent domain focus on the most problematic loans in geographical areas of the country where home prices have fallen significantly.

iv. Use Third-Party Counselors

The large-scale loan modification program must also use neutral third-party counselors to ensure its effectiveness and represent the interests of borrowers. The counselors would be able to ensure that borrowers obtain an affordable and sustainable mortgage. Studies have shown that as many as half of consumers in foreclosure have not proactively spoken with their servicers. A lack of trust of consumers' trust of financial institutions is speculated to be a major reason for this disconnect. Under a TARP program, the counselors should be empowered to review the proposed modification and suggest any further alterations necessary to achieve long-term affordability.

v. Protect Renters Interests

The government should ensure that renters receive protections under its program. A sizable number of distressed loans involve investors who do not live in the property they purchase but have rented the properties to tenants.[10] Currently, tenants face eviction with little or no notice

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[9] In cases of price disputes when the government has used eminent domain, a judge or mediator will rule on a fair price.

[10] Fifteen million tenants or about 40 percent of all renters live in single family homes, many of which are owned by small scale investors. A segment of this large population is at risk during the current foreclosure crisis. See J.W.

after a foreclosure. In these cases, the government must provide sufficient time and relocation assistance for the tenants.

vi. Enact Judicial Loan Modification

Judicial loan modification would assist borrowers facing foreclosure that the recommended TARP loan modification program may not reach because of the scale of the crisis. Allowing struggling borrowers access to bankruptcy protection could enable up to 600,000 families to seek immediate help to avoid foreclosure–and at no cost to the taxpayer. At present, the family home is the only asset for which a bankruptcy court cannot modify the terms of repayment to make it affordable to maintain. Yet, bankruptcy courts are able to modify outstanding debt on a luxury yacht, investment property, or even a *second* home.

Recently, Congressman John Conyers introduced the *Helping Families Save Their Homes in Bankruptcy Act of 2009* (H.R. 200) and Senator Dick Durbin introduced the *Emergency Homeownership and Equity Protection Act* (S. 61). Both bills support the enactment of judicial loan modification. NCRC supports the passage of both pieces of legislation as tools to modify loans, save homes, and strengthen the economy. NCRC recommends that Congress seize the opportunity created by the current momentum and immediately pass a judicial modification bill.

II. Address Unemployment, Which Is Now Creating a Secondary Foreclosure Crisis

Any plan to stabilize the economy must address the collateral damage stemming from foreclosures. Frozen credit markets, rising unemployment, and declining home values are

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Elphinstone, What if Your Landlord Faces Foreclosure, Associated Press article appearing in the Washington Post, January 3, 2009.

detrimental to communities hardest hit by the foreclosure crisis. NCRC recommends an economic recovery program that promotes job creation and community building through investments in infrastructure and small businesses. TARP funds and funds from other pools, such as the economic stimulus package that may be proposed by Congress and the President-elect, can be used to finance this program.

i. Invest in an Economic Recovery Program

Allocating a significant portion of the remaining TARP funds to support a well-crafted and consumer-focused economic recovery program can turn a dire state of affairs in the national economy into a major opportunity for the nation as a whole. However, prioritizing spending is essential to maximizing the return on investments. Priority should be given to the areas of greatest unemployment, those most severely devastated by the foreclosure crisis, and areas suffering most from under-maintained infrastructures. A majority of the communities most severely affected by unemployment, high foreclosure rates, and crumbling infrastructures are those communities that have been traditionally plagued with poverty and a lack of socio-economic opportunity and advancement. Though long overdue, the current economic crisis provides an opportunity to channel billions of dollars into rebuilding low- to moderate-income communities.

ii. Infrastructure Investments

By focusing infrastructure investments to promote sustainable employment growth, rebuild communities, enhance the use of clean energy technologies, and lay the foundation for a better trained and highly skilled workforce, the United States will emerge from the current crisis stronger and better prepared to meet the challenges in an increasingly competitive global

economy. Moreover, strategically targeted infrastructure investments can also level the playing field of opportunity across diverse communities in a manner not experienced for at least four decades.

For immediate results, new infrastructure investments should be made in housing, transportation, environmental hazard remediation, and green technologies. Regarding housing, there is a current need to reclaim abandoned foreclosed properties [Real Estate Owned (REO)]. REOs present a clear danger to neighborhoods, as abandoned properties are routinely vandalized and used for criminal activity. These activities depress home values and increase physical decay in neighborhoods. Without action to reclaim REOs, it will be difficult for neighborhood housing markets to rebound.

iii. Small Business Investments

Small businesses are a driver of the US economy. Specifically, minority small businesses or "Emerging Domestic Market" (EDM) companies are creating sustainable employment opportunities at a higher rate and growing three times faster than traditional small businesses. However, small businesses are desperately suffering because of the current economic crisis. The decrease in consumer spending, late payments by consumers, and a decline in cash flow are only the latest problems threatening small businesses. Investing TARP funds in small businesses will have the two-fold effect of assisting entities that help power the economy and promoting the creation of sustainable employment.

III. Act Now to Address the Problems That Got Us Here

Arresting the foreclosure crisis, which is the root cause of the current financial crisis, will result in immediate stabilization of the turbulent financial markets. However, the time to act is now. A few months ago, Moody's economy.com predicted an additional 5.2 million foreclosures through 2010. Since then, studies by Credit Suisse and Moody's economy.com predict as many as eight to ten million foreclosure as unemployment increases. In 2008 alone, Americans lost $2 trillion in housing equity and more than $7 trillion in wealth from the stock market.

It is also important to note the effect that unemployment will have on the foreclosure crisis absent immediate and broad-scale intervention. The year 2008 has been named the worst for job losses since 1945.[11] Recent estimates show that 2.6 million Americans lost their jobs in 2008 and the national unemployment rate is now 7.2%.[12] These statistics demonstrate that unemployment rates are increasing at a steady and unprecedented pace. Going forward, foreclosures will be increasingly driven by the effects of workers losing their jobs. These job losses are not expected to be recovered any time soon. With each passing month, Americans are exposed to more difficult economic conditions that limit financial recovery.

As previously stated, while immediate action is necessary to stem the foreclosure crisis, additional consumer protections must also be considered to ensure that the unfair and deceptive practices that led to the foreclosure crisis, and ultimately to the overall economic crisis, are forever purged from the market. Congress should act now to address financial system regulatory reform which, if implemented earlier, would have prevented the abusive practices that caused the

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[11] See http://money.cnn.com/2009/01/09/news/economy/jobs_december/?postversion=2009010908.
[12] Id.

current economic downturn. Therefore, NCRC recommends the enactment of national anti-predatory lending legislation, modernization of the *Community Reinvestment Act* (CRA), and regulatory system restructuring and reform.

i. CRA Modernization

CRA establishes an obligation on banks to serve the needs of all communities, particularly low- to moderate-income neighborhoods, consistent with safety and soundness. In order to build upon CRA's benefits and increase the safety and soundness of credit and capital, NCRC urges Congress to pass CRA modernization legislation—similar to the *CRA Modernization Act of 2007*—and the planned reintroduction of the *CRA Modernization Act of 2009* (to be sponsored by Representatives Eddie Bernice Johnson and Luis Gutierrez). The *CRA Modernization Act of 2009* would apply CRA to non-bank financial institutions, including mainstream credit unions, insurance companies, independent mortgage companies, and investment banks. Moreover, this legislation would strengthen CRA as applied to banks by enhancing publicly available data on lending activity, requiring CRA exams to consider lending to minorities and ensuring that the great majority of bank lending activity be scrutinized.

ii. Regulatory Restructuring and National Anti-Predatory Lending Legislation

Predatory lending has been widely documented for more than a decade. However, failed government regulation allowed unfair, deceptive, and otherwise predatory lending to contribute substantially to the current foreclosure crisis. Hundreds of studies, legislative testimony, and print news stories documented the abusive lending practices, but nothing has been done to purge these practices from the home mortgage market.

Rather than purge predatory lending, federal regulatory policy exacerbated the problem. In response to a robust anti-predatory lending law enacted by Georgia in 2002, the Office of the Comptroller of the Currency ruled in 2004 that federal regulations preempted state law for nationally chartered banks in its entirety. This ruling undermined actions of dozens of states attempting to protect the financial interest of their residents. In addition, the Federal Reserve refused to tighten regulations under the *Homeownership and Protection Act* (HOEPA) until July 2008, after more than two million borrowers lost their homes because of predatory lending.

Regulatory restructuring and retooling are urgently needed to avoid additional regulatory failure in the future. Moreover, in order to prevent another foreclosure crisis of the current magnitude, NCRC supports the enactment of a comprehensive anti-predatory lending law that uproots abusive and predatory lending practices.

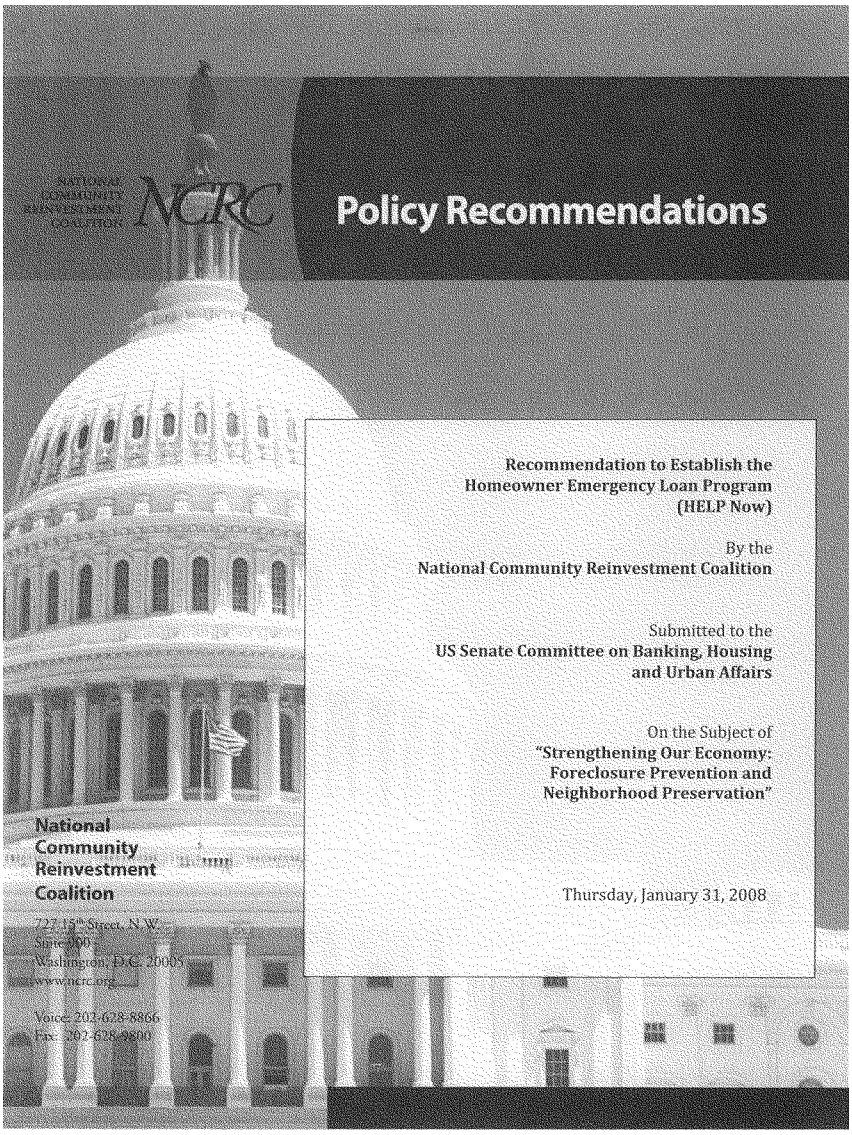
Conclusion

The current economic crisis presents an opportunity for America to rebuild both its crippled financial system and its fractured communities in a manner that is far-reaching and sustainable.

NCRC recommends that a significant portion of the remaining TARP funds be used to address the foreclosure crisis. Moreover, substantial intervention is necessary to respond to the contagion effects of the foreclosure crisis. Investments in an economic recovery program that promotes infrastructure projects and small businesses that create jobs and rebuild communities are imperative to mitigating the effects of the declining economy. Moreover, preventive consumer protections to purge the unfair and deceptive practices that led to this crisis must be enacted.

Time is of the essence. Americans continue to suffer under the weight of a collapsing economy. Congress must act swiftly because too many lives—hopes—dreams—will be destroyed the longer our legislators allow Americans to suffer in the gridlock of programs and policies that fail to address the underlying problem that continues to destabilize our national economy—which is rising foreclosures. The resilience of the American economy depends on targeted government spending that will strengthen the housing market and create jobs.

Thank you and we look forward to partnering with you on the long road ahead to economic recovery.


NATIONAL COMMUNITY REINVESTMENT COALITION
NCRC
Policy Recommendations
Recommendation to Establish the Homeowner Emergency Loan Program (HELP Now)
By the
National Community Reinvestment Coalition
Submitted to the
US Senate Committee on Banking, Housing and Urban Affairs
On the Subject of
"Strengthening Our Economy: Foreclosure Prevention and Neighborhood Preservation"
Thursday, January 31, 2008
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NCRC's HOMEOWNERS EMERGENCY LOAN PROGRAM (HELP NOW)

Currently no remedy in place is of the scale to seriously tackle the foreclosure crisis. The National Community Reinvestment Coalition, a nonprofit consumer group, is proposing a market-driven solution to the mortgage and foreclosure crisis. Proposals discussed to date; including those proposed by the mortgage industry (Bank of America plan), put taxpayer funds at risk. The Administration has made clear it will not support any plan that does so. For this reason, NCRC has proposed the Homeowners Emergency Loan Program (HELP Now), originally in February 2008, which offers minimal risk to taxpayer funds. This plan still remains the most sensible and promising of any offered.

- With the HELP Now proposal, loans are purchased from investors by the government at discounted rates; loans are then resold to the private market and then modified. The HELP Now program allows the private market to fix the problem it created in the first place.

- HELP Now targets mortgage loans where the homeowner is still employed and where there has been little or no reduction in the source of the homeowner's income. In other words, this program helps borrowers able to pay, but trapped in mortgages that were high cost and unreasonable to begin with.

- HELP Now creates a three-year program, not a new agency. The Treasury Department would purchase loans and/or loan pools held in securitized pools at a steep discount, using the government's authority under the laws of eminent domain. This allows the government to take an asset where a public purpose is served, and it requires that they pay the investor the "fair market value" for this taking.

- The fair market value of these loans would result in a steep discount (at present 30-50% of the current loan value) which could be passed along to the homeowner as a reduction in their mortgage. Discounting the purchase of these loan would strike a balance between assisting homeowners and ensuring that lenders, servicers, and securitizers are not rewarded for financing and servicing predatory and price-inflated loans. The government's taking of these via eminent domain will avoid any threat of litigation by investors against servicers, a commonly cited reason that loans are not being modified at a greater pace.

- The discounted loan price should be sufficient to writedown the loan balance of millions of loans such that they can be permanently refinanced or modified to ensure long-term sustainability.

- By way of example, a mortgage loan may have an outstanding balance of $200,000, but after paying fair market value, via the eminent domain taking, the loan would be at $140,000, (assuming a 30% discount). This outstanding mortgage of $140,000 for most homeowners, and the private banking industry, be

immediately refinanced without any government investment or guarantee. Instead, the government would be immediately reimbursed for the entire amount of its purchase and have no other obligation to the investor, lender or borrower. The Treasury would be repaid immediately for this and every other loan refinanced by the banks.

- Banks would be motivated to refinance these loans given the billions of dollars of taxpayer funds used to create liquidity in these institutions. Future uses of TARP funds would mandate participation in this refinancing/modification program.

- In having the private sector refinance or modify these loans, the government would issue mandatory underwriting criteria that insured such loans were fair, non-predatory and matched the borrowers ability to pay. This would hedge against future re-defaults of such mortgages.

- If the discount procured is still not enough to allow the private banks to refinance and take out the government, the Treasury can make a furthur discount in order to match the borrower's ability to pay. The government can recapture this amount when the property is sold or refinanced via a soft second and/or lien placed on the property.

- **The plan is different from other plans offered in several ways:**

  - Solving the problem through widespread loans modifications avoids the technical challenges associated with refinancing all loans.
  - Using Eminent Doman law requires no additional congressional legislative action and can be done immediately.
  - HELP Now does not require refinancing with FHA, so it does not place the government on the hook for 100% of the risk. No massive new government entity need be creating, but rather HELP Now utilizes the private sector to modify and secure these loans. The government will remain responsible for only a very small portion of these loans.
  - Under HELP Now the government could purchase loans in limited amounts, say $50 billion per taking and then when refinanced by the private sector, use those funds to purchase additional loans. The government's investment would be a sort of revolving fund, where the government is made whole via the private sector. This minimizes the government's exposure at any given moment.
  - The government leverages its TARP investments by requiring participation in this program and is paid out, nearly in full immediately upon the refinancing or modification of the loan by the private sector.
  - Requires a soft second for remaining difference between discounted purchase price and the current market value of the loan. This is recaptured upon sale of the property, ensuring the Federal government is not stuck with the bill.

Testimony of

Edward L. Yingling

On Behalf of the

AMERICAN **BANKERS** ASSOCIATION

Committee on Financial Services

United States House of Representatives

Testimony of Edward L. Yingling

On Behalf of the American Bankers Association

Before the

Committee on Financial Services

United States House of Representatives

January 13, 2009

Chairman Frank and members of the Committee, my name is Edward L. Yingling. I am President and CEO of the American Bankers Association (ABA). ABA works to enhance the competitiveness of the nation's banking industry and strengthen America's economy and communities. Its members – the majority of which are banks with less than $125 million in assets – represent over 95 percent of the industry's $13.6 trillion in assets and employ over 2 million men and women.

We appreciate the opportunity to testify on the current status of the Capital Purchase Program (CPP) and to provide suggestions on the future use of Troubled Asset Relief Program (TARP) funding. The CPP became a prominent part of the TARP, which was authorized under the Emergency Economic Stabilization Act (EESA). The CPP has helped calm financial markets and continues to be an extremely important tool to promote renewed economic growth.

The ABA sees this hearing and the legislation that is being proposed as an opportunity for a new beginning on the CPP and TARP. Everyone is frustrated about the current confused situation – the public, the Congress, and, I can assure you, traditional banks. Strongly capitalized banks that never made one subprime loan and that are the foundation for an economic recovery find themselves lumped together with failing institutions and institutions that helped cause this crisis. This is not fair and it is harmful to our economy. We are committed to work with this Committee and the Congress to clarify once and for all the purpose of the CPP, target the remaining TARP money where it will do the most good, and to provide the transparency needed to restore public confidence. As this statement shows, the non-bank credit markets are not working. All roads point to traditional, regulated, FDIC-insured banking as the foundation for a solid recovery – through the expansion of bank lending and, as the Chairman has stated, through applying bank-like regulation to

other sectors of the financial services industry. It is time to put together a plan that will get the job done and that has the clarity to restore public confidence.

Unfortunately, there has been much confusion between the CPP program, which was designed to provide capital to healthy banks, and non-CPP TARP money used to support troubled institutions, like AIG, General Motors and Chrysler. The bottom line is that the traditional banks that have been making loans in communities for decades should not be lumped together with other institutions that are in need of financial support. Traditional banks and bankers are a major part of the solution to our economic difficulties, and policies should be designed to support their efforts.

This confusion between capital for healthy banks and bailouts for weak firms is a source of great frustration to banks, but more importantly can lead to confusion about policy. While there were some FDIC-insured banks in a weakened position when the EESA was considered, the emergency program was driven by severe problems at firms that were ***not*** banks, such as Bear Stearns, Fannie Mae and Freddie Mac, and AIG. In suddenly announcing the CPP, the Treasury was responding to foreign governments, which had acted to support institutions that were far less capitalized than U.S. banks. However, commentators often fail to realize the situation was different: the vast majority of U.S. banks were well-capitalized and had nothing to do with making toxic mortgage loans. Unfortunately, when the capital program was announced, the headlines read "Bank Bailout." To my knowledge, no one in the banking industry requested a capital program prior to the day when nine of the largest banks were "requested" by Treasury and the Federal Reserve to use the newly created CPP.

ABA greatly appreciates the consistent statements by members of this committee, and particularly its leadership, that the regulated banks were not the cause of the problem and have generally performed well. Not only did the regulated banks not cause the problem, they are the primary solution to the problem as both regulation and markets move toward the bank world.

Certainly, some FDIC-insured banks did become caught up in the mortgage bubble, but the great majority did not. Furthermore, banks are negatively affected when the economy in their local communities deteriorate. But it is important to recognize the sound underpinning that banks still provide for the economy and the fact that the bank regulatory model is now the basis for regulation for non-banks, some of which are now converting to bank holding companies.

Thousands of banks across the country did not make toxic subprime loans, are strongly capitalized, and are ready to lend; but they cannot do so if misguided policies increase their regulatory costs and provide disincentives to lend. Banks already face significantly higher costs from increases in deposit insurance premiums. And banks are already receiving contradictory government signals about lending, being told to use CPP capital to make new loans and, in some cases, being told by bank examiners not to increase lending because the risk is too great.

The ABA makes the following four recommendations for the future of TARP:

- ***Segregate the CPP program from other TARP programs***

  We would urge that the uses of TARP funds be clearly identified by the next Administration and Congress. In a recent letter to the TARP Congressional Oversight Panel, the Treasury did break out the various programs. However, in general the media, the public, the Congress, and the industry do not have a clear picture as the TARP funds have been used in so many different ways. There should be clearly defined buckets – for example, for the CPP, for foreclosure prevention, and for systematically important troubled institutions. Without clear delineation, policy becomes muddled. There are real differences between the CPP program – ***a voluntary program for healthy banks*** – and the various injections of TARP money into troubled institutions; and yet the media, in particular, often lumps them together.

  The policy prescriptions for each program clearly should be different. In addition, without clear delineation, Congressional oversight will not work effectively. Furthermore, the costs for each program should be kept separate. For example, as outlined below, ABA believes the government is almost certain to make a significant profit from the CPP program.

- ***Fully fund the Capital Purchase Program as originally announced***

  Banks continue to lend, and the CPP will help to further support expanded bank lending by healthy banks. It would be most unfair, and would result in competitive inequality, for the program not to be fully funded for community banks. Today, there are still no term sheets available for over ***3,000 healthy banks.*** These banks are mutual savings banks and S-corporation banks and account for over one-third of the banking industry.

Furthermore, there are hundreds of banks that have applied for funding, met the required safety and soundness standards, and have received regulatory approval – but have not received funding.

Of the $350 billion initial TARP allocation, $250 billion was set aside for the CPP program. We believe the commitment should be honored. Thus, we recommend that TARP money be used to complete the CPP as originally contemplated – this is critical to assure competitive equity among banks and in order that ***all communities*** have the opportunity for their banks to participate so that increased credit availability will spread across the country. For example, in many New England states, mutual institutions are an important segment of the banking system, and yet they are not currently able to participate in the CPP. That means New England will not have as much credit availability going forward as other parts of the country. In many communities around the country, no bank may currently be eligible.

- ***Use TARP Funding for Distressed Homeowners***

  The ABA supports the use of TARP funding to help distressed homeowners and lessen the number of foreclosures. The housing bubble is still at the core of the economic problem, and it needs to be addressed directly by government policy. The program put forward by the FDIC recently is a model that ABA supports, and we provide specific suggestions for improving it later in this testimony.

- ***Coordinate the CPP with other programs so as to avoid conflicting messages and disincentives to lending***

  It is critical to achieve the right balance between making sure banks are following sound policies and encouraging innovation and lending. Regulators certainly should be carefully reviewing banks and their capital, borrowing, and lending policies. However, a regulatory overreaction that signals to banks to pull back on certain types of lending will only exacerbate the credit crunch.

Finally, before explaining these suggestions in further detail, I would like to reiterate the points in my last testimony before this committee concerning mark-to-market accounting. Since CPP is now focused on creating additional capital, it must be noted that the misapplication of mark-to-market or "fair value" accounting in today's situation, particularly when there is no functioning market, has unnecessarily destroyed billions of dollars in capital. We appreciate the comments that you have made in this regard, Mr. Chairman, as well as the work of Ranking Member Bachus on seeking changes on the mark-to-market issue.

These accounting issues badly need to be addressed in the short term – for year-end 2008 reporting – as well as reconsidered in the longer term. Furthermore, ABA once again urges this committee to address the way accounting rules are made in its regulatory restructuring review this year in order to ensure that the standard-setting process is subject to adequate public accountability and that consideration of the practical impact of proposed standards is an important element in the consideration and development of new accounting standards.

I. Segregate the Capital Purchase Program for Banks from Other TARP Programs

There is great confusion about TARP, particularly with the media and the public. It is no wonder, with all the various twists and turns that the program has taken. Originally, the TARP, as the name implies, was for the purchase of troubled assets. Then in a matter of days after enactment, everything changed. After some European countries announced that governments were going to put capital in banks and, apparently, foreign government pressure for the U.S. to do the same, overnight the policy shifted to putting capital in U.S. banks. As is widely known, the leaders of nine large banks were called to Washington with no notice and "requested" to take the capital. Several of them had just raised private capital.

To my knowledge, no one in the banking industry requested a capital program; the ABA certainly did not. The announcement of the program really harmed the perception of our banking industry. Commentators jumped to the conclusion that many banks must be capital deficient and in trouble. They did not understand that U.S. banks were much more heavily capitalized than the European banks receiving capital, nor that about 98 percent of the U.S. banks were well capitalized. Also, the purpose of the program, as announced at that time, was to unfreeze the international credit

markets, particularly the interbank lending market. The idea of increasing domestic lending was not at the forefront at that time.

As the program was extended beyond the initial nine banks to other banks, it evolved that the program was to focus on ***healthy*** banks and its purpose was to ***promote the availability of credit.*** This focus is the exact opposite of the capital injection programs for weak banks in Europe and elsewhere; it is also the opposite of other uses of TARP and other government funds to help systemically important institutions in danger of failing. ABA was extremely frustrated by the failure of the Treasury to make this difference clear and said so in a letter to Secretary Paulson. Treasury did try to clarify the purpose, stating that the CPP was implemented "to attract broad participation by healthy institutions" in order to "build capital to increase the flow of financing to U.S. businesses and consumers and to support the U.S. economy." Neel Kashkari, Interim Assistant Secretary for Financial Stability, reiterated the goals of the CPP program just last Thursday in remarks at the Brookings Institution: "The CPP was designed to first stabilize the financial system by increasing the capital in our banks, and then to restore confidence so credit could flow to our consumers and businesses."

Unfortunately, the press, the public, and Members of Congress, understandably, did not differentiate between this voluntary program for solid institutions and "bailouts." Confusion still exists. Hearings like this one today, Mr. Chairman, are extremely important to provide clarity about these programs and banks' efforts to deploy this CPP capital. In this regard, there are several misperceptions that need to be addressed:

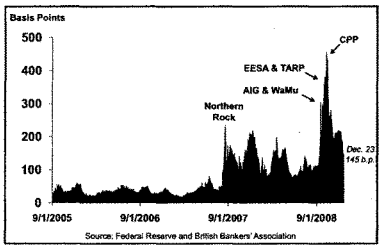
The Need for the Capital Injection

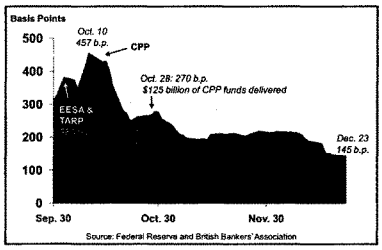
The public did not understand the importance of this change in focus from buying toxic assets to capital injections. Ever since the failure of the United Kingdom's mortgage giant, Northern Rock, risk premiums for any type of lending – particularly bank-to-bank lending – have been elevated. This meant that banks were unwilling to lend to one another or would do so only at very high interest rates. With each new crisis, credit-risk spreads widened. The problems of AIG on September 16 drove the Treasury-Eurodollar (TED) spread up 123 basis points from September

15 to September 17.[1] This event, and the subsequent failure of Washington Mutual, caused a dramatic increase in risk spreads. The TED spread continued to rise to historic heights through the enactment of the Emergency Economic Stabilization Act. However, with the announcement of the CPP on October 14, risk spreads declined from their pinnacle of 457 basis points on October 10 to 249 basis point on October 22, ***a drop of 45 percent***. Clearly, the program to inject capital in healthy banks had a dramatic and immediate impact. (See the charts below.)

Risk Spreads Increased

Spread between the 3-month LIBOR and the 3-month Treasury





The capital injection was also valuable because access to capital in the open market had largely disappeared for many banks. As the economy weakened, loan losses increased. As capital absorbed these losses, capital ratios began to fall somewhat. Nonetheless, the vast majority of banks (more than 98 percent as of the third quarter) ***were then and are still well-capitalized***, which is the highest rating the regulators can give. In addition, banks entered this current recessionary period with much higher capital relative to assets compared to other recessions (see the table on page 10).

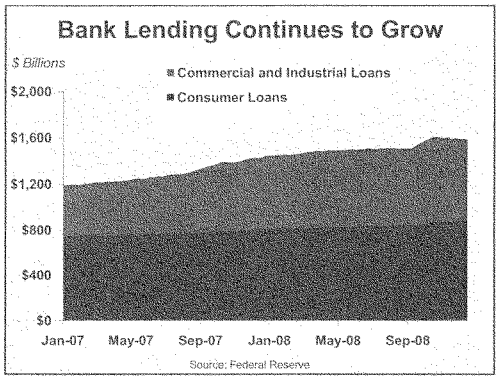
Under normal circumstances, banks would go to the private capital markets for additional capital. While some banks were able to raise new capital, the series of problems this past fall have made those markets extremely tight. In fact, compared to the last five recessions, banks in the last

[1] The TED spread measures the credit risk premium of short-term lending (particularly bank-to-bank lending) and is calculated as the difference between the London Interbank Lending Rate (LIBOR) and the risk-free U.S. Treasury bills rate (often using 3-month maturities).

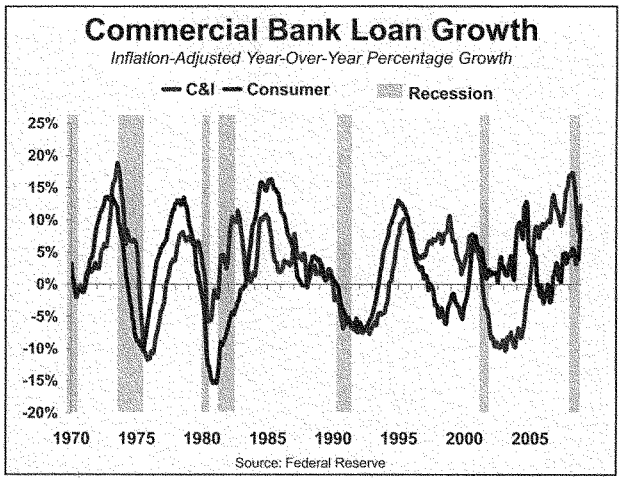
12 months have ***raised only one-third of capital typically raised during a recession,*** according to Federal Reserve statistics.[2] Thus, without additional capital to back more loans, banks might not be able to grow lending; others might even be forced to shrink lending in order to boost the capital-to-assets ratio. The CPP capital investments will also make it easier for banks to raise capital directly as investors will have more confidence in the overall financial underpinning of the bank.

Banks Continue to Lend in This Weak Economy

Even with the economy faltering and individuals and businesses struggling to make ends meet, banks continue to lend. (See the Federal Reserve chart on bank business lending below.) This is, in fact, in sharp contrast to the lending trends during other recessions. Typically, as the chart and table show on the following page, loan growth shrinks during and after a recession. During the current recession, business loans have ***expanded*** by 12 percent and consumer loans by 9 percent; in contrast, typical (median) business loans ***declined*** by -0.7 percent and consumer loans by -5.1 percent for the previous six recessions.



[2] According to the Federal Reserve's H.8 survey (Assets and Liabilities of Commercial Banks in the United States), commercial banks have raised $5.45 billion from November 2007 through November 2008. The median increase in capital for the previous five recessions (for the 12-month period beginning one month prior to the start of the recession) was $16.35 billion.

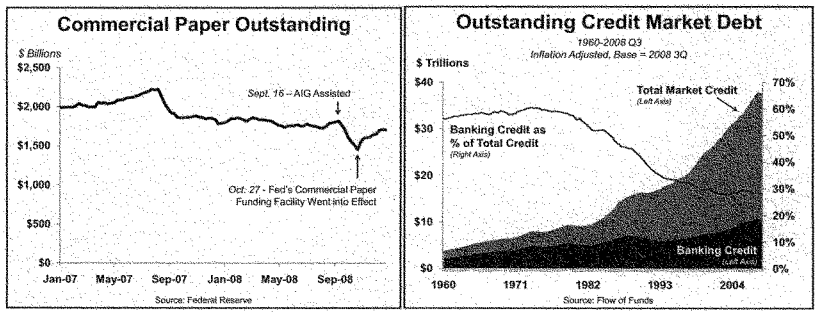


Change in Bank Lending and Capital During Recessions[1]

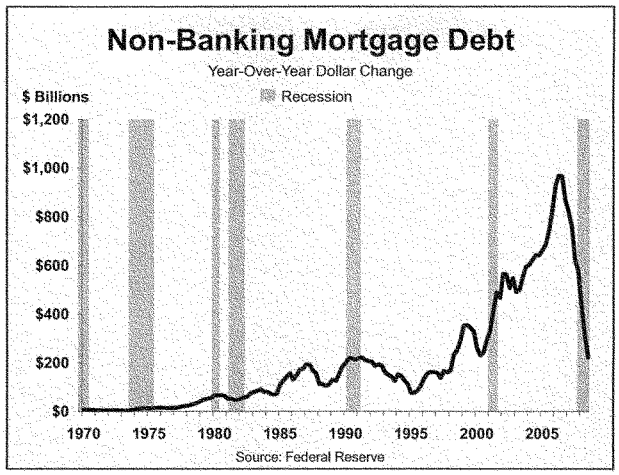
Recession	C&I (%)	Consumer (%)	Average Capital-To-Asset Ratio (%)	Change in Capital-to-Asset Ratio (Basis Points)[2]
Dec 1969 - Nov 1973	-0.9	-1.2	N/A	N/A
Nov 1973 - Mar 1975	5.7	-6.3	4.7	20
Jan 1980 - Jul 1980	-0.5	-12.8	5.0	-134
Jul 1981 - Nov 1982	9.0	-4.4	5.4	205
Jul 1990 - Mar 1991	-6.6	-5.9	8.2	52
Mar 2001 - Nov 2001	-8.0	1.9	9.6	88
Median of Past Recessions	**-0.7 %**	**-5.1 %**	**5.4 %**	**70 bp**
Dec 2007 - ?	**12.2 %**	**9.0 %**	**10.5 %**	**-104 bp**

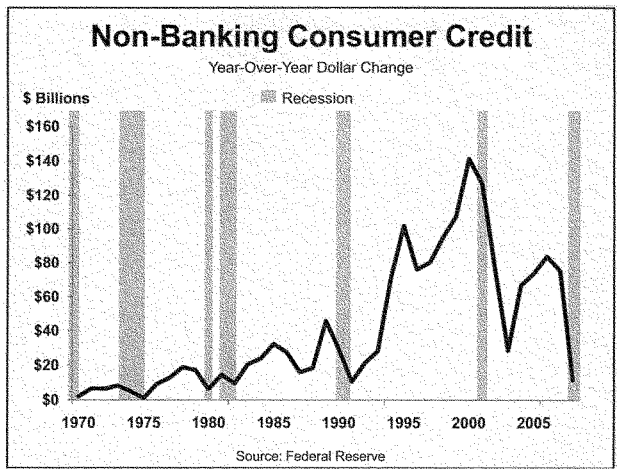
1. Twelve-month change from the month prior to the official start of the recession.
2. One basis point equals 1/100th of a percentage point.
Source: Federal Reserve, H.8, Assets and Liabilities of U.S. Commercial Banks; capital values based on estimates derived from Federal Reserve's asset and liability survey data.

In fact, many banks have said that they are seeing borrowers that used to rely on non-bank financing or Wall Street coming to their doors. Before the launch of the Federal Reserve's Commercial Paper Funding Facility in October, the commercial paper market had shrunk by $366 billion over the prior six weeks. The size of the commercial paper market is now $1.7 trillion, down from its peak of $2.2 trillion in July of last year – a decline of almost 23 percent. (See the chart below on commercial paper outstanding.) The same pattern was repeated for both residential and commercial mortgage backed securities. As is widely recognized, the securitization market has also largely closed down, undermining the availability of credit for autos, housing, and credit cards. Thus, many of the stories about the lack of credit are due to the weakness of ***non-bank*** lenders and the weakness of the securitization markets. In fact, while credit overall has expanded dramatically in the United States for many decades, the share of bank credit is about half of what it was just 25 years ago. (See the chart below on the right.)



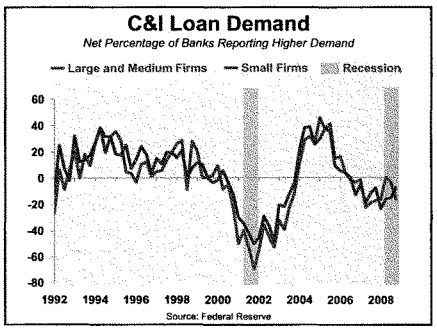
The complete collapse this past year of the secondary markets for mortgages and for other consumer credit products, such as credit cards and auto lending, has taken out an important pipeline of credit and has left banks as the lone lenders. The critical point is that while banks have been expanding lending, it cannot offset the complete fall off of credit ***outside*** the banking industry. (See the charts on the following page.)


Non-Banking Mortgage Debt
Year-Over-Year Dollar Change
$ Billions
Recession
$1,200
$1,000
$800
$600
$400
$200
$0
1970
1975
1980
1985
1990
1995
2000
2005
Source: Federal Reserve


Non-Banking Consumer Credit
Year-Over-Year Dollar Change
$ Billions
Recession
$160
$140
$120
$100
$80
$60
$40
$20
$0
1970
1975
1980
1985
1990
1995
2000
2005
Source: Federal Reserve

Naturally banks are following prudent underwriting standards to avoid losses in the future. But in spite of the difficult economic environment, only 7 percent of small businesses (according to a December survey by the National Federation of Independent Businesses, NFIB) reported problems in obtaining the financing they desired. The report concluded that: "No credit crunch has appeared to date beyond the normal cyclical tightening of credit."[3]

Borrowers are also being more careful, and, as would be expected in this economy, the overall demand for loans is declining, although this varies by market. (See the chart on Commercial and Industrial Loan Demand.) The NFIB reports that "only 31 percent [of businesses] reported regular borrowing, down two points and equal to the 35-year, record low reading." This combination of ***increased*** bank lending at the same time that loan demand is ***shrinking*** underscores the increased prominence of banks in meeting the credit needs of borrowers. It is very likely that loan demand in this economy will continue to decline. With the decline in demand, it is reasonable to expect that the current growth of business and consumer lending cannot be maintained. As the chart on page 10 shows, it often takes several years to reverse the impact of a recession. However, as the economy starts to grow again and loan demand increases, the ability of banks to meet these needs will be stunted if adequate capital is not available to back increased lending.



We recognize that there are some consumers and businesses in the current situation that believe they deserve credit that is not being made available. This is not because banks do not want to lend – lending is what banks do. The current credit markets have tightened largely because of problems outside the traditional banking sector. ***In fact, because of these problems, the traditional banking sector will have to play an even larger role in providing credit to get***

[3] The report also noted that: "The credit worthiness of potential borrowers has also deteriorated over the last year, leading to difficult terms and higher loan rejection rates, even with no change in lending standards." December 2008 issue of *Small Business Economic Trends,* National Federation of Independent Businesses.

the economy growing again. Banks are anxious to meet the credit needs of businesses and consumers, and we know that such lending is vital to an economic recovery in communities large and small across the country. ***The availability of capital through the Capital Purchase Program provides added flexibility to help assure these borrowing needs are met.***

The Use of CPP Capital to Promote Lending

The misconception continues that the capital invested by Treasury is sitting idle, or worse, hidden away somewhere. This is simply untrue. The government money is a ***capital*** injection, which is an ***ownership*** stake in ***healthy banks***. The CPP money is not hidden – it is clearly identifiable in the capital accounts of banks. This is not money that is used ***directly*** for lending, but rather is used to support lending many times the level of new capital. Thus, this capital allows banks to raise more funds – largely deposits – and increase lending. In fact, for every dollar of capital invested, banks can increase assets (e.g., loans and securities) by about $10. For lending in particular, $1 of capital can ultimately support up to $7 dollars of lending – provided the bank raises $6 in new deposits and there are qualified businesses or individuals that want to borrow. Banks do not track which particular loan each depositor's dollar helps support since one deposit dollar is indistinguishable from another. The same is true of capital invested. For example, if a small business receives a new loan, that loan is not CPP money lent out, and the bank does not distinguish whether that loan is attributable to existing capital or to CPP capital. What is clear is that the CPP capital enables the bank to raise more deposits and to be in a position to make more loans.

As noted above, there are thousands of banks that have not yet had the opportunity to participate in the CPP. As of December 31, 2008, only 208 of the nation's 8400 banks had received CPP capital. Total commitments for these institutions are $172.5 billion. Most of those that have received funding have only recently received it. And as just noted, the capital is not lent; first the banks have to raise more deposits to lend. Moreover, as banks' markets and businesses are dramatically different, how each bank will employ this capital will differ greatly as well. In my testimony before this committee in November, I provided four simple examples of how capital might be employed by a bank under different circumstances: (1) a well-capitalized bank with growing loan demand; (2) a well-capitalized bank with shrinking loan demand; (3) a solid bank with losses affecting capital; and (4) a strong bank using capital to acquire a weak bank. These examples are critical to understand the many ways that banks accepting capital will utilize it. Because of their

importance in understanding how capital works to support lending greater than the capital injection itself, I have included these examples once again as an appendix to this testimony. We have made these examples widely available to the press and public policy makers to help with understanding the goals of the CPP and how it will be used.

While it is still early, new loans are being made. In fact, lending by the 18 largest banks to receive a TARP capital injection increased by 8 percent – $295 billion – in the third quarter of 2008 based on quarterly Call Report filings by these banks.

Certainly, it is reasonable for Congress to ask how banks might demonstrate ways in which CPP capital is being deployed. Recently, the House adopted an amendment by Representative LaTourette relating to this issue. Mr. Chairman, the ABA would like to work with the Committee as it addresses this concern, and we believe Representative LaTourette's amendment provides a strong basis for a solution. Our only two caveats are, first, that heavy and unnecessary new regulatory costs not be imposed on banks, and second, that it be recognized that each bank's situation will be different.

As noted above, banks do not track how each dollar on deposit flows through to individual loans; capital as well supports ***all*** of banks' assets (loans and securities). ***In fact, all investors, not just the government, are interested in how effectively capital is being used.*** This information is currently provided to all shareholders through extensive reporting with the bank regulatory agencies on public Call Reports, as well as through SEC filings.

Fortunately, current reporting requirements can be used as a basis to address this concern of CPP capital use. For example, the Call Report could be used to show changes in lending for CPP participating banks (as the number for the 18 largest banks demonstrates). These Call Reports provide considerable detail on lending to businesses and individuals, including commercial and residential real estate loans.

Moreover, the Federal Reserve also conducts several surveys that might be adapted to provide more detail on the aggregate level of lending from CPP participating banks. The first is the Senior Loan Officer Survey, conducted four times a year, which asks questions about changes in banks underwriting standards and loan demand. Typically, special questions are added in each survey to collect information on topical trends. Questions designed to elicit information about changes in CPP-recipient bank lending could be added and tailored to reflect the current economic

environment. A second survey is one done weekly of the largest banks (and a sampling of smaller banks) to provide an aggregate level of lending activity. This survey, without modification, can provide a sense of bank lending trends for businesses and consumers. This survey could be broken out for the largest CPP participating banks.

While, as demonstrated, data can be provided, the meaning of that data will vary widely by bank. For example, a bank that can quickly raise deposits and has a local economy that is producing safe loan demand may show a significant increase in lending. Another bank in the same market may have taken a capital hit because it owned GSE preferred shares. That bank would have had to ***shrink*** its lending to maintain a well-capitalized ratio, but with the CPP capital can maintain ***current*** lending levels. A third bank may be in a market where the economy is shrinking and the demand for safe loans is just not there yet. Increasing lending would be unsafe now, but that bank is in a position to help accelerate growth as the economy turns around.

It is important to note that banks have every incentive to put the CPP capital to use by increasing lending. That is how banks make money. CPP capital has a significant cost in dividends paid to Treasury and in the warrants given the government. To cover that cost, banks must put the capital to good use.

Taxpayers Will Earn a Profit on the CPP

There is also the misperception that somehow taxpayers are going to lose money on the CPP. ABA strongly believes that Treasury will make money on the CPP – billions of dollars. Treasury is only investing in ***healthy*** banks. The net cash return to the Treasury from the investment is over $30 billion as banks pay for the use of this money.[4] Moreover, publicly traded banks issued warrants conservatively valued at between $10 billion and $15 billion.[5] Thus, the total return to the government is likely to be between $40 billion and $45 billion. This, of course, does

[4] The Treasury has allocated $250 billion to invest in bank preferred stock. The preferred stock will pay a dividend rate of 5 percent for the first 5 years and then go to 9 percent. It is highly likely that almost every bank will try to exit the program, substituting private capital, within five years. To finance the purchase of the stock, the Treasury will have to issue debt. Assuming the debt matures in five years and a yield of 2.51 percent (the rate on the 5-year Treasury bond on November 10, 2008), the net cash inflow to the Treasury from Treasury's investment would equal almost $31.4 billion.

[5] Publicly traded institutions that participate in the CPP will have to issue warrants to purchase common stock within the next 10 years, and we expect non-publicly traded institutions to have to issue instruments that yield comparable economic benefits for Treasury.

not include the benefit to small and large businesses (and indirectly, the taxpayers) that will have credit available and will continue to make money, pay taxes and keep people employed.

In this regard particularly, we would request that TARP funds used for the CPP be segregated from other uses for record-keeping purposes. It is important that the government and public know the costs – and ***potential benefits*** – of various parts of the program.

Dividend and Executive Compensation are Seldom Paid Out of Capital

Dividends and compensation are generally paid out of the ***income earned*** from the bank, ***not from capital***. That will be the case for the great majority of participating banks. It is possible that, in a few cases, there could be a temporary period where income does not cover all costs and, therefore, there would be a temporary dip into capital accounts. However, banks are heavily regulated and such a situation would be allowed by the regulators only temporarily. If it goes on for several quarters, or if regulators believe it will, then the bank will be required to undertake a program, among other things, to raise capital and/or cut dividends. Excess compensation would also not be allowed if it would cause capital to be impaired. The regulators have reiterated in clear form this traditional banking policy, and ABA supports this regulatory approach.

It is important that banks volunteering for the CPP not be cut off from reasonable dividend and compensation policies. These policies are necessary to encourage private investment in banks. Many banks joining the program have been paying regular dividends for years – even decades – without interruption. Dividends are particularly important for bank stocks, which are known for paying solid dividends. That is why many people in retirement and pension plans invest in bank stocks. These investors should not be punished by having the dividends needlessly cut out. Furthermore, the dividend supports the stock price and the ability to raise capital, and eliminating it would be exactly contrary to the purpose of the CPP program. Finally, the taxpayers would be hurt because the value of the warrants would be undermined.

The fact is that the great majority of banks would not participate in the CPP if prohibited from paying dividends or reasonable compensation, including bonuses. Again, it is essential that policy makers distinguish between capital infused in healthy banks and money provided to institutions seeking support to avoid failure, where such restrictions make sense.

Banks of all sizes, shapes and locations will be participating in the program. The only things they will have in common are that they are strongly regulated and are solid, not weak, banks. The recent regulatory guidance, building on traditional regulatory principles, provides the right roadmap and flexibility to address concerns about dividends, compensation, and other issues. We strongly urge Congress not to put additional restrictions, beyond those contained in the existing Treasury Term Sheets, on banks participating in the CPP after those banks, which did not ask for the program, have already signed up. To do so would be unfair and counterproductive.

The Need for Clarity

Much of the confusion about the CPP program is a result of the ever-changing nature of TARP and the various uses of TARP funds. ABA strongly recommends that the Congress and the next Administration establish clear-cut programs within TARP. For example, the CPP should be clearly separated from a program to address potential failures of systemically important institutions and, of course, from a program to address the foreclosures crisis. The current confusion is harmful. Only by clearly identifying the programs can there be proper Congressional oversight and effective policymaking. The public's confusion undermines confidence in the efforts to turn around the economy. Finally, the costs of each program should be separately determined.

The CPP program is different. On the next page, there is a side-by-side table that shows the differences. It is a program that encourages FDIC-insured banking institutions that are healthy to sell a specifically designed capital instrument to the government. Its purpose, as we understand it, is to increase the capital position of the banking sector (even though the great majority of banks are well capitalized) in order to stabilize the financial markets and provide the strong foundation on which an economic recovery can be built through the increased provision of sound credit. This is a role America's banks are committed to carry out.

II. Fully Fund the Capital Purchase Program as Originally Announced

The TARP program set aside $250 billion under the CPP to fully fund any bank that wished to participate in the CPP. We are very concerned that, first, the funding allocated for other purposes has already tapped a significant portion of this money, leaving the current allocation inadequate to meet the commitment. Second, we are very concerned that many banks do not yet have the

Comparison of Systemic Risk Rescues and the Capital Purchase Program	
Rescue of Companies That Pose Systemic Risk	Capital Purchase Program
For ***troubled or failing*** companies that pose systemic risk.	For ***healthy*** institutions; explicitly not for troubled or failing companies.
Troubled or failing companies ***ask*** for rescue	The government created the program; one banking industry did not ask for it. ***Voluntary***, but government requests banks participate.
Purpose is to ***prevent bankruptcy*** of companies that could have a systemic impact.	Purpose is to ***stabilize financial markets*** by providing capital to healthy institutions and increasing the flow of credit to businesses and consumers.
Rescues have been ***individually negotiated with participants.***	***Government determined same terms for all participants.*** No input on terms from participants.
Final ***cost*** of rescues ***uncertain.***	Government ***almost certain*** to receive tens of ***billions*** in net profits.
Exit strategy uncertain. How government involvement ends is unknown.	***Designed with exit strategy***. Government investments paid off within ***five*** years.

opportunity to participate. We believe strongly that the current commitment should be fulfilled in order to prevent competitive disparities from occurring and to assure that ***every community*** has the same opportunity for its banks to participate, ***so that increased credit availability will spread across the country***. Thus, we urge that the commitment to fund up to $250 billion for banks be honored. We are not asking that more money be provided, just that the initial commitment be honored to assure fair treatment for all healthy banks and all communities.

We recognize that much has been done in the past few months under difficult circumstances. However, more must be done. There are more than 3,000 banks – over one-third of our nation's banks – that are still waiting for Treasury to issue term sheets that would allow their participation in this program should they choose to accept the capital investment. These banks are organized as subchapter S-corporation banks or mutual institutions. They play a critical role in meeting the credit needs of cities and towns across America. These community banks are particularly important in funding small businesses, which are the first to generate new jobs as the economy recovers. While they did not cause the current problems in our economy, they stand ready to be a significant part of the solution.

Moreover, the failure to include these institutions in the CPP undermines the effectiveness of the program and places these banks at an unfair competitive disadvantage that is compounded each day that they remain excluded. They can only watch while many of their competitors, strengthened by capital injections from the government, seize opportunities to meet the credit needs of their communities. Simply put, the CPP should allow all healthy banks, regardless of their corporate structure or charter type, to participate.

As these corporate structures may not be fully understood by some policymakers, let me describe briefly the structure of those banks:

- ***Subchapter S-corporation banks:*** Many community banks are organized under this structure. These banks are subject to many restrictions, including on the number of shareholders, which is limited to 100, and on the type of stock they may issue. S-corporations may only issue a single class of stock. The senior preferred stock that Treasury has requested could constitute a second class of stock and, therefore, S-corporations would not be able to participate. ABA supports a proposal developed by the federal banking regulators that would allow S-corporation banks to issue to Treasury a type

of debt obligation with performance obligations, such as non-deductible interest, so that the CPP investment would be on the same level as other participants. This would allow approximately 2,500 institutions the option to participate in the program.

- ***Mutual banks:*** There are about 735 banks organized under mutual ownership, of which about 175 are in the form of mutual holding companies. Those without mutual holding companies cannot issue shares. Some mutual holding company structures have issued minority shares, but must retain a majority interest in the hands of the mutual ownership interest if they are to remain mutually owned. Even if they have the capacity to issue additional preferred shares, they may not be able to comply with requirements established by Treasury for exchanged-traded, SEC filing companies. Finally, a majority of mutual holding companies have not been authorized to issue minority shares, and cannot comply with the terms currently available under the CPP. We propose two alternatives. Instead of preferred stock, subordinated debt could be used as a replacement investment with some type of redemption fee. Alternatively, mutual capital certificates could be used. Mutual capital certificates are subordinate to all deposit accounts and debt obligations, and are entitled to be paid dividends.

I cannot say strongly enough that it would be patently unfair to exclude over 3,000 healthy institutions from having the choice of whether or not to use the CPP capital. In letters to the Treasury, ABA has pledged our assistance to help develop the appropriate term sheets so that these institutions can fully participate in the CPP. Regardless of the corporate structure, all banks provide vital services to their communities and all should be allowed to compete on equal terms.

I would also emphasize that the current situation is unfair to regions of the country where mutual institutions are a critical source of financing and unfair to many individual communities where S-corporation or mutual institutions may be the most prevalent local source of credit.

III. Use TARP Funding for Distressed Homeowners

The housing crisis is still at the heart of the current economic turmoil and should be a major focus of the economic stimulus package and of TARP. In my November testimony, I stated that

ABA advocated a four point approach to the housing issue: First, efforts should be made to reduce mortgage interest rates and the unprecedented gap between mortgage rates and Treasuries; significant progress has been made in this area. Second, ABA recommends that the stimulus package include a temporary tax credit for the purchase of homes; consideration should also be given to stimulating the purchase of homes to be used as rental properties, for example by increasing depreciation deductions. Third, the ABA wishes to work with this committee in its upcoming efforts to address the problems of negotiating foreclosures of mortgages that were securitized. Fourth, more direct efforts to mitigate foreclosures are needed; despite the best efforts of Congress and the private sector, the foreclosure problem, made worse as the economy deteriorates, continues to haunt individuals and communities.

The unprecedented turmoil in the nation's credit and mortgage markets, combined with significant challenges in reaching affected homeowners, have called for innovative, far reaching efforts to address the particular needs of homeowners in distress. There are several efforts underway that complement each other. First, financial service industry leaders, working through the HOPE NOW alliance, have made significant progress in assisting borrowers. The alliance estimates that 2.2 million foreclosures have been avoided through its efforts, which include almost one million mortgage modifications, workshops held across the United States, and a hotline that has received an average of 7,000 calls per day. Second, the Hope for Homeowners program is another unique program that may be more successful now that the Department of Housing and Urban Development (HUD) has made some changes to the program. Mr. Chairman, ABA is committed to working with this committee to further improve Hope for Homeowners.

Now, the FDIC has proposed a program that has the potential to reach many more borrowers nationwide. We believe the program has promise. Since I testified to this effect in November, ABA has convened a group of bankers to work with the FDIC and Congress to make this FDIC proposal as effective as possible. The proposal would require funding approved by Congress for the program's partial guarantee against secondary default. We believe that the Troubled Asset Relief Program is the logical source of funding for this program.

Recommended Changes to Improve the FDIC's Loan Modification Proposal

Below are recommendations to improve the FDIC's concept based on discussions with bankers that are very knowledgeable about mortgage modifications.

- ***The debt to income (DTI) requirement should be 38 percent.*** Currently, the proposed program will accept anyone that is 60 days or more delinquent, provided that term modifications to as low as 31 percent DTI result in at least a 10 percent payment reduction, and the borrower can make the first payment. To better control moral hazard and gaming risks, borrowers should ***not*** be eligible to enter the program unless their current mortgage debt to gross income (DTI) ratio is 38 percent or above. Lower ratios, down to 31 percent, could still be addressed through other modification programs or through more traditional problem loan workouts. The moral hazard problem created by potentially inducing delinquencies and the prospective costs of resultant federal guarantees would be controlled by not including moderately high mortgage debt burdens under the automatic program. We see the requirement of at least a 10 percent reduction in payment as a safeguard against gaming, but feel that borrowers with moderately high debt burdens already have reasonably affordable mortgages and should not be eligible to participate in this particular guarantee program. More importantly, changing the DTI requirement would focus the program more on those households where significant reductions in mortgage payments are likely to prevent foreclosure.

- ***Re-defaults should be optionally covered after 3 months of on-time payments.*** Currently, the proposed program would cover 50 percent of losses from re-defaults on modified mortgages ***following 6 months of on-time payments***. Unfortunately, the data show that there is still a high rate of re-default during the first six months of a modification. This may discourage adoption of the program by banks that believe there is a high risk of early re-default. As a result, ABA recommends that a second option be provided to guarantee against re-default after three months of on-time payments, with an appropriate and corresponding reduction in the level of guarantee.

- ***Participation should be voluntary and smaller institutions should be allowed to participate under more flexible terms appropriate to their business models.*** Many community banks have small numbers of troubled loans, both in absolute size and relative to the total portfolio, which might benefit from the modification and guarantee program. These banks should be allowed to participate in the program with adjustments to permit greater individualization and attention to specific borrower circumstances than would be possible at larger seller-servicers. The loan modification and guarantee should be available to community banks that typically engage customers more directly on a loan-by-loan basis.

- ***Private mortgage insurance proceeds should remain with lenders and investors.*** The FDIC should clarify that it would not have a claim on proceeds from private mortgage insurance obligations intended to support lenders and investors, at least in part, during modifications.

There are some issues that should be reviewed in conjunction with the implementation of the FDIC model. First, explicit exemptions from new TILA requirements for modifications are needed, either from the Federal Reserve or through legislation, to ensure that lenders will participate in the modification program. Section 226.20(a)(4) of the Truth in Lending Act indicates that a modification is not a refinancing (which requires new disclosures). The commentary to this section further clarifies with regard to workouts that "[a] workout agreement is not a refinancing unless the APR is increased or additional credit is advanced beyond amounts already accrued plus insurance premiums." While this is helpful, we are concerned that a workout under the FDIC program in which missed payments are capitalized may be considered to be a further extension of credit. Lenders may fear TILA class actions unless it is made explicit that modifications under the FDIC program, including those in which missed payments are capitalized, do not require additional TILA disclosures.

Second, accounting issues relating to Other Than Temporary Impairment (OTTI) status must be resolved. Banks that participate in the program are likely to face scrutiny of their entire portfolios for OTTI classification, and may end up with many loans which share similar characteristics as the loans modified (but which remain current in payments and are not eligible for modification under the program) being classified at OTTI. Such an outcome would discourage

banks from participating in the program. We strongly encourage Treasury, the FDIC, the Securities and Exchange Commission and the Federal Accounting Standards Board to work together to address this issue. OTTI status should not necessarily be imparted to loans which share similar characteristics to the troubled loans being modified under the FDIC program if those loans do not meet the qualifications for modification.

Recommended Changes to Improve the Hope for Homeowners Program

Finally, we would like to address our continued support for the Hope for Homeowners program. We believe the changes to the program recently implemented by the Department of Housing and Urban Development have the potential to attract many more borrowers and lenders. We suggest the following principles, which may help to improve the program even more:

- **Streamlining the process.** The current underwriting process for Hope for Homeowners is complex and confusing, both for borrowers and lenders. Existing technology platforms cannot be used to originate a Hope for Homeowners loan, and the investment of both time and money to modify or create new platforms is too substantial to be economically feasible, especially when loan origination departments are running above capacity. As a result, Hope for Homeowners loans all have to be done ***manually***. This is time-consuming and frustrating for the borrower and lender alike. We encourage FHA to explore the use of the streamlined underwriting process it currently employs for FHA refinances as a model for Hope for Homeowners originations. Additionally, we urge FHA to relax Direct Endorsement requirements to give servicers (and their contract underwriters) greater flexibility to structure broader home retention solutions for more borrowers.

- ***Second lien holders must be given greater incentives to extinguish or subordinate their interests.*** Second lien holders present a substantial impediment to refinancing under the Hope for Homeowners program. Recent changes adopted in law allow for payments to second lien holders as incentives to extinguish or subordinate their interests. FHA should immediately implement a process for providing sufficient cash payments as incentives for second lien holders.

- ***Lenders and servicers must be provided protection against litigation when acting reasonably and in good faith.*** All loan mitigation programs, including Hope for Homeowners, face the hurdle of litigation risk from investors when loans have been securitized. After the announcement of the Hope for Homeowners program, at least two MBS investors sent letters to their servicers threatening litigation if the servicers were to implement the Hope for Homeowners program. Investors have been particularly opposed to the principal reductions required by Hope for Homeowners. Legislation is needed to provide a 'safe harbor' for lenders and servicers which implement loss mitigation solutions under which it can reasonably be concluded that such solution is in the interest of investors through a net present value calculation. Such a safe harbor should explicitly include principal reductions that demonstrably result in a better return for investors than foreclosure.

- ***Incentives to participate should be provided for borrowers with no equity.*** A sad reality is that some borrowers who find themselves with no equity in their homes will choose to simply walk away from the property (and the loan obligations) rather than participate in Hope for Homeowners. This is largely because the Hope for Homeowners does not provide them incentives to keep the property and/or does not provide the borrower with a monthly payment that is affordable. We believe that the equity and appreciation sharing components of Hope for Homeowners discourage potential borrowers from participating in Hope for Homeowners. Most homeowners view their home not just as a place to live, but also as an investment. Denying equity or appreciation to borrowers puts them in the position of renters rather than owners, and many borrowers will find it cheaper to simply become a renter after walking away from the property. The equity and appreciation sharing components of the program should be eliminated or significantly reduced.

- ***The insurance requirement should be reconsidered.*** The current structure of the Hope for Homeowners program requires up front and annual insurance premiums and requires that loans must be structured as 30-year fixed rate loans (40-year loans will be allowed when recent statutory changes are implemented). These requirements limit the affordability of Hope for Homeowners loans for many borrowers. We recommend the elimination or

substantial reduction of the upfront and annual premiums in the early years of the loan and the use of more flexible rate requirements for loss mitigation. For example, we urge the consideration of interest only features or lower interest rates in the early years of the loan with gradual payment increases to facilitate keeping borrowers in the home now.

IV. Coordinate the CPP with Other Programs to Avoid Conflicting Messages and Disincentives to Lending

Not only have banks been receiving ***confusing*** messages from the government, they have been receiving ***conflicting*** messages. As has often been the case, there may well be a disconnect between the regulatory headquarters in Washington and the examiners in the field. It is a matter of achieving the right balance between making sure banks are following sound lending policies and not discouraging innovation and good lending. Regulators certainly should be carefully reviewing banks and their capital, borrowing, and lending policies. As I detailed in my November testimony before this committee, several problem areas remain. Here is a quick summary of these concerns:

- ***Capital:*** There continues to be concern that bank examiners are taking the opportunity afforded by the CPP injections to raise the expected capital threshold. This means that new capital supports ***existing*** loans, and ***cannot*** be used for ***new*** ones, thus making the CPP capital injection moot as a basis for increased lending. While the heads of the banking agencies have told us that this is not the policy of their agencies, field staff may be much more demanding, particularly in areas most affected by the housing crisis.

- ***FDIC's Guarantee Program of Senior Unsecured Debt and Transaction Accounts:*** The recent actions taken by FDIC to guarantee debt and fully insure transaction accounts represent a significant departure from the traditional role of the FDIC. What is generally ***not*** understood is that this guarantee is first and foremost backed by the capital of the banking industry. These actions by FDIC under the systemic risk exception should not become permanent facilities. Moreover, as the banking industry must bear the costs of these initiatives, it is important that the risk of these new guarantees be closely monitored and changes made if negative unintended consequences arise.

- ***The Danger of a Regulatory Overreaction:*** A regulatory overreaction that signals to banks to stop certain types of lending will only exacerbate the credit crunch. Just as too much risk is undesirable, a regulatory policy that discourages banks from making good loans to creditworthy borrowers also has serious economic consequences.

- ***Doubling of FDIC Premiums:*** Our members understand the importance of having a financially sound FDIC insurance fund. Since banks are responsible for the fund's financial health, the ultimate cost to the industry will be virtually the same no matter what recapitalization plan is implemented. At issue is the ***timing*** of payments to rebuild the fund. It is critical to achieve the right balance so that the fund can remain strong without pulling funds unnecessarily from banks that need them to support loans in their communities.

- ***Discouraging the Use of Federal Home Loan Bank Advances:*** The FDIC has proposed significant additional costs (i.e., added insurance premiums) for use of Federal Home Loan Bank (FHLB) advances. The threshold proposed by the FDIC unfairly penalized banks that have relied on these very stable sources of liquidity. Moreover, FHLB advances are a cost effective way to raise funds, help banks manage interest rate risk by match-funding to the term of the loan, and often facilitate community development loans.

- ***Discouraging Retention of Local Deposits:*** The FDIC also proposes to charge higher premiums to banks that use elevated levels of brokered deposits, but the FDIC proposal fails to distinguish among ***different*** types of brokered deposits. This is critical as some so-called "brokered deposits" – such as reciprocal deposits and sweeps from broker-dealers to affiliated banks – are designed to maintain relationships with customers and provide safe, stable and low-cost funding for banks.

  The law governing brokered deposits needs to be explicitly modified to distinguish these types of customer deposits from the more volatile brokered deposits the law was intended to cover. In the meantime, the FDIC and other bank regulators should distinguish between different types of "brokered" deposits in the supervision of banks and in the assessment of deposit insurance premiums.

- ***Address the $250,000 FDIC Insurance Limit Expiration Soon:*** As noted, the CPP capital serves as a basis for additional lending, but that lending can only take place after a bank obtains lendable funds, generally in the form of additional deposits. In the Emergency Economic Stabilization Act, the Congress increased the deposit insurance limit from $100,000 to $250,000. This increase helped increase consumer, and particularly small business, confidence and also provided some additional funding for banks.

  However, this increase expires at the end of 2009. It is important that this issue be addressed by Congress as quickly as possible. As a practical matter, with each passing month, it becomes more difficult to banks to effectively offer certificate of deposits (CDs) over $100,000 with longer maturities because the insurance increase expiration is moving closer. For example, by June, banks will only be able to offer six-month CDs in the $100,000 to $250,000 range that are fully insured. This limitation will hurt the ability of banks to fund loans.

Conclusion

Mr. Chairman, we appreciate the opportunity to present the views of the American Bankers Association today on TARP. We hope this testimony helps clarify the CPP and that our four suggestions for the future of TARP are of value to the Committee.

Appendix

Examples of How the CPP Capital Can Be Employed by Banks

The availability of capital through the Capital Purchase Program provides added flexibility to help assure that borrowing needs are met. There is so much confusion about the program that it may be helpful to provide some simplified examples as to how it can work to increase lending, which both Treasury and Congressional leaders have said is the purpose of the program. In these examples, hypothetical community banks with $100 million in assets and $10 million in capital are used. The hypothetical banks will then sell $2 million in equity capital to the government.

In these examples, it is important to note several factors where there is a great deal of misperception. First, as a general rule, only strongly capitalized, healthy banks are eligible. This is the exact opposite of the capital injection programs in Europe and elsewhere; it is also the opposite of other uses of TARP and other government funds.

Second, the government money is a capital injection; it is not money that is used directly for lending. What capital does do is to allow banks to employ the deposits of their customers more fully. In fact, banks are able to support about $10 of assets (e.g., loans and securities) with $1 of capital. As a rule of thumb, $1 of capital could support $7 of lending. Even though loan losses have increased, which has caused capital ratios to fall somewhat, the vast majority of banks are still well-capitalized, which is the highest rating the regulators can give. Under normal circumstances, banks would go to the private capital markets for additional capital, but those markets are now extremely tight. Thus, without additional capital to back more loans, banks might not be able to grow lending; others might even shrink lending in order to boost the capital-to-assets ratio.

Example 1: Well-Capitalized Bank With Growing Loan Demand

Consider a well capitalized bank in a market where loan demand is currently growing. That growth is a combination of some economic growth and the fact that, in current markets, other non-bank sources of credit have dried up. Additional deposits to fund lending can also be acquired as money is seeking the safer haven of insured deposits. There are a large number of banks in this category, although the level of local economic growth can obviously vary.

This bank starts with $100 million in assets and 10 percent capital. After obtaining $2 million in additional CPP capital, the bank can make new loans and grow to $120 million in assets and still have a 10 percent capital ratio. This shows how $2 million in capital can support up to $20 million in additional assets, most of which could be loans. If there are lending opportunities available, as there are in this example, the extra credit can be made available fairly quickly. However, there are two caveats here. One, this example assumes that regulatory capital ratios are not increased by bank regulators. While raising capital requirements may be appropriate in individual circumstances, a general move in that direction will neutralize the CPP program. Note that if the regulatory capital level in this example is raised to 12 percent, the new capital will not support any increase in lending. Two, the bank must apply sound credit standards to its lending programs; there should be no pressure to push out loans as that will just lead to more defaults.

Example 2: Well-Capitalized Bank with Shrinking Loan Demand

Like the bank in Example 1, this bank is well-capitalized but is in an area where the economy is not growing or is shrinking. There are, of course, many areas of the country that look like this. Here, a well-capitalized bank could also increase assets by 20 percent, but it would be unsafe to do so quickly. Careful underwriting is needed to assure that the loans are going to creditworthy borrowers. This bank may not be able to grow its deposits to fund the loans rapidly either, as job loss may be high and income growth low. However, importantly, with additional capital this bank is now in a position to fund loans as the local economy begins to grow and thereby ***accelerate*** the economic recovery.

Example 3: A Solid Bank With Losses Affecting Capital

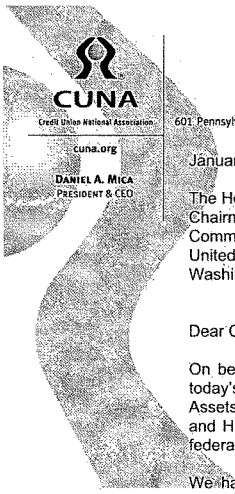
The great majority of banks are covered in the first two examples. However, there are some banks that are still in good financial shape, but that have taken a capital hit. For example, some banks that were well capitalized and profitable took a hit when the value of their preferred shares in Fannie Mae and Freddie Mac were virtually wiped out overnight. In this example, the bank had to write off a $2 million loss, and therefore its capital level was reduced to 8 percent. Since it cannot raise capital in current markets, this bank must ***shrink*** to get back to 10 percent. In fact, it will have to trim $20 million in loans and other assets in order to shrink to $80 million in assets. Thus, the

bank will generally stop making loans – including not rolling over loans to existing customers and reducing lines of credit. The bank may even try to sell loans, which, in this market would be difficult to do. If this bank had $2 million in new CPP capital, it would not have to stop making loans and would be able to continue meeting the needs of its local businesses.

Example 4: A Strong Bank Would Use Capital to Acquire a Weak Bank

This example is one that has raised some controversy. It is clearly not the intent of Congress that the TARP funds be used to support acquisitions generally. However, when there are banks that are weak enough that they cannot increase or even maintain lending levels, facilitating their acquisition may well increase overall lending. In this example, a well capitalized $100 million bank with 10 percent capital is interested in acquiring a weak bank of the same size in a neighboring town. However, in acquisitions, the value of the assets of the acquired bank must generally be immediately written down under fair-value accounting rules. In this example, we assume a very modest $2 million write-down. (This is another area where current applications of accounting rules are causing problems.) Instead of 10 percent capital, this acquired bank will only have 8 percent. Thus, the combined entity will have only 9 percent capital on its $200 combined assets. The acquisition will probably not take place, as the reduced capital ratio would drop the bank out of the "well capitalized" regulatory classification. If $2 million in CPP capital are infused into the acquiring bank to help facilitate the merger, the new combined entity will have 10 percent capital, the acquisition can take place, and lending can be maintained in the neighboring town.

The point of these four examples is to show that there are many ways that the capital infusion can be effectively deployed by the accepting banks. While different, all have the effect of stabilizing credit availability, expanding lending in the near-term to meet demand, and making credit available as the economy turns the corner and new business opportunities arise for bank customers. Treasury needs the flexibility to invest in banks like those in the examples, and banks need the ability to deploy this capital in the most appropriate way to facilitate economic growth in their communities. Most banks in this country have been in existence for decades, and often for more than a century. They expect to be in those communities for the next 100 years and understand the needs for credit to promote economic growth. The CPP program can help each participating bank in its own way.



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January 13, 2009

The Honorable Barney Frank
Chairman
Committee on Financial Services
United States House of Representatives
Washington, DC 20515

The Honorable Spencer Bachus
Ranking Member
Committee on Financial Services
United States House of Representatives
Washington, DC 20515

Dear Chairman Frank and Ranking Member Bachus,

On behalf of the Credit Union National Association (CUNA), I am writing regarding today's hearing entitled, "Priorities for the Next Administration: Use of TARP (Troubled Assets Relief Program) Funds under EESA (Emergency Economic Stabilization Act)" and H.R. 384. CUNA represents approximately 90% of America's 8,200 state and federally chartered credit unions and their 90 million members.

We have been very concerned that the implementation of the TARP program has excluded the participation of credit unions. We note that H.R. 384 does not specifically reference credit unions, with the exception of the permanent increase in deposit insurance coverage, which we greatly appreciate. Like community banks, credit unions continue to lend in the face of the economic crisis. Also like some community banks, some credit unions may need access to TARP. In that regard, we respectfully ask that you ensure that H.R. 384 includes credit unions as appropriate, and that the National Credit Union Share Insurance Fund (NCUSIF) lending authority be expanded as the bill would do for the Federal Deposit Insurance Corporation (FDIC).

We hope as Congress considers the conditions under which the administration may be able to use the second installment of funds, that Congress will encourage Treasury to include credit unions in additional programs it may develop for mutual institutions, support credit union participation in TARP by reconsidering the decision not to purchase troubled assets from financial institutions and use some of the available funds to back-up loan modifications.

Loan Modification and Foreclosure Mitigation

We share your concern regarding the number of borrowers facing foreclosure. While credit unions did not generally make the types of loans that caused the crisis, credit unions continue to assist borrowers facing foreclosure; in many cases, these borrowers obtained loans from other lenders.

As the economy worsens, one phenomenon that we are seeing in loan modification is a significant number of re-defaults, as recently reported by the Office of the Comptroller of the Currency. Part of the reason for these re-defaults may be the fact that the initial loan modifications were not significant enough. We believe that with some support and backup from TARP, more substantial modifications, especially those that reduce loan balances, would be more effective. Therefore, we support the provisions of H.R. 384 that require between $40 billion and $100 billion to be set aside

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for foreclosure mitigation. We hope that Treasury will follow the directions described in Title II of this legislation.

Credit Union Participation in TARP

Section 101 of the Emergency Economic Stabilization Act (EESA) authorizes the Secretary of Treasury, "to establish the Troubled Asset Relief Program (or 'TARP') to purchase, and to make and fund commitments to purchase, troubled assets from any financial institution, on such terms and conditions as are determined by the Secretary, and in accordance with this Act and the policies and procedures developed and published by the Secretary."

Credit unions are included among the institutions defined in Section 3 of the Act as financial institutions. However, the implementation of the TARP by Treasury has not even attempted to include credit unions. More specifically, TARP has not been focused on the purchase of troubled assets; rather, Treasury decided to inject capital into financial institutions. As a result, credit unions, including corporate credit unions, that may need access to TARP funds are shut out because the Federal Credit Union Act does not generally permit credit unions to obtain capital from outside sources (there is an exception for low-income credit unions). Section 1790d(o)(2) of the Federal Credit Union Act defines credit union net worth as the retained earnings balance of the credit union, as determined under generally accepted accounting principles. While Congress intended for credit unions to be eligible to participate in the TARP, the current implementation of TARP effectively blocks credit union participation.

In order for credit unions to access TARP funds, we encourage Congress to consider a statutory change to the definition of Net Worth [added language in *italics*]:

(2) **Net worth.**—The term 'net worth'—

(A) with respect to any insured credit union, means *(i)* the retained earnings balance of the credit union, as determined under generally accepted accounting principles, together with any amounts that were previously *the net worth* of any other credit union with which the credit union has combined *and (ii) any deposit, loan, investment, purchase of assets, account or guarantee by the federal government (including but not limited to special assistance from the Board under Section 208(a))or any state government;* and

(B) with respect to a low-income credit union, includes secondary capital accounts that are–

(i) uninsured; and

(ii) subordinate to all other claims against the credit union, including the claims of creditors, shareholders, and the Fund.

The Board shall implement Section 1790d(o)(2)(A)(ii) by Regulation within thirty (30) days of enactment.

This amendment to the Federal Credit Union Act would permit those credit unions in need of participating in TARP to have access to the funds, just as other depository institutions do. While we anticipate that demand for this provision will be measured, and the dollar amount of funds required will be substantially smaller than the assistance required by other sectors of the financial services industry, there are a number of credit unions located in areas of the country which have been particularly hard-hit by the financial crisis that could use this authority in order to continue providing high-quality financial services to their members.

Systemic Risk Authority

We also respectfully request that you consider providing systemic risk authority to the National Credit Union Administration Board (NCUA), on a similar basis to what the Federal Deposit Insurance Corporation enjoys. While we cannot imagine that Congress intended NCUA would not have such authority, the FDIC was able to point to specific provisions in its act to provide unlimited deposit insurance coverage for non-interest bearing transaction accounts. Without a specific systemic risk provision, NCUA has been reluctant to take this action. We believe that given the uncertainty of the economic crisis, parallel authority for NCUA to address systematic risk issues in a timely fashion is reasonable.

We recognize that the challenges that our economy is facing are extraordinary, and that credit unions, as an industry, remain relatively healthy. While there is rightly a tendency to deal with the largest problems first, the legislative changes described herein would provide avenues to assistance for which Congress intended credit unions to be eligible, and which some credit unions may need in the near future.

On behalf of the Credit Union National Association, we appreciate your consideration of these proposals. We also appreciate your efforts to make Treasury and the banks that received assistance accountable to the American people and hope you will continue to take action to ensure TARP funds are utilized in the manner Congress intended.

Sincerely,

President & CEO

National Association of Federal Credit Unions
3138 10th Street North • Arlington, Virginia • 22201-2149
(703) 522-4770 • (800) 336-4644 • Fax: (703) 522-0594

B. Dan Berger
Senior Vice President
Government Affairs

January 13, 2009

The Honorable Barney Frank
Chairman
House Financial Services Committee
2129 Rayburn House Office Building
Washington, DC 20515

The Honorable Spencer Bachus
Ranking Member
House Financial Services Committee
2129 Rayburn House Office Building
Washington, DC 20515

Dear Chairman Frank and Ranking Member Bachus:

On behalf of the National Association of Federal Credit Unions (NAFCU), the only trade association that exclusively represents the interests of our nation's federal credit unions (FCUs), I am writing in regards to the Committee meeting today on the "Priorities for the Next Administration and the Use of the Troubled Asset Relief Program (TARP) Funds under the Emergency Economic Stabilization Act." NAFCU welcomes this important discussion and would like to offer some comments.

NAFCU was disappointed to see the current Administration's use of taxpayer money to fund capital infusions in bank and non-bank institutions through the Capital Purchase Program (CPP), instead of adhering to a Congressionally-mandated commitment to purchase illiquid mortgage-related assets from financial institutions. NAFCU believes Treasury's redirection of TARP funds created an uneven playing field, to the advantage of the bad actors whose unscrupulous practices are at the root of this financial crisis.

As Chairman Frank has stated, credit unions were not the cause of the current turmoil in the mortgage market, which has led to the nation's deepening financial crisis. Nevertheless, with the passage of the EESA, lawmakers ensured that credit unions and their approximately 90 million members were provided parity in treatment with other financial institutions. Because the CPP does not allow for the participation of member-owned cooperative institutions, credit unions are unfairly constrained in their ability to address the economic challenges that they now face through no fault of their own. NAFCU strongly believes that any benefits from the TARP program should be done in such a way that all types of financial institutions have access to those benefits if those institutions need the assistance.

E-mail: dberger@nafcu.org • Web site: www.nafcu.org

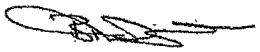
NAFCU strongly urges the 111th Congress and the incoming Obama Administration to uphold this mandate set forth in the Emergency Economic Stabilization Act by allocating funding to the

purchase of mortgage-related troubled assets just as funding being allocated to the CPP. Doing so would not only help credit unions, but also help bring TARP relief to Main Street and not just Wall Street.

We appreciate you holding this important hearing and look forward to working with the Committee on ways to ensure that the implementation and execution of the Trouble Assets Relief Program and the Capital Purchase Program coincide with the intent of the Emergency Economic Stabilization Act.

Should you have any questions or would like to discuss this issue further, please call me or Brad Thaler, NAFCU's Director of Legislative Affairs, at (703) 522-4770.

Sincerely,



B. Dan Berger,
Senior Vice President, Government Affairs

cc: Members of the House Financial Services Committee

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TEL 316-946-2007
FAX 316-946-2220

January 9, 2009

Honorable Lynn Jenkins
U.S. House of Representatives
Washington, DC 20515-1602

Dear Representative Jenkins:

I am writing to ask you to contact Chairman Dodd of the Senate Banking Committee, Chairman Frank of House Financial Services Committee, and President-Elect Obama's economic team to urge them to oppose efforts in Congress to punish corporations that own or lease business aircraft. This is a matter of utmost urgency.

As you recall, the Auto Loan Financing bill that passed the House in December required corporations receiving government assistance to divest any business aircraft they owned or leased. The Bush Administration later incorporated the same measure in its loan package after the bill died in the Senate, and I fear that there are efforts underway to replicate the provision for banks and financial firms that own or lease aircraft. While I understand that Congress and the Administration have been reacting to the criticism the CEO's of GM, Ford, and Chrysler encountered when they flew business aircraft to Washington, the fact is that these provisions, if replicated, will lead to fewer aircraft orders, cost jobs, and tarnish the image of the general aviation industry.

You know as well as anyone how important general aviation is to the national economy and to the State of Kansas, and that general aviation manufacturers are already suffering from a weak economy. The last thing we need is for Congress to pursue an effort that may feel good but that will ultimately weaken an important domestic manufacturing industry. Chairman Dodd, Chairman Frank, and the President-Elect's economic team need to hear from leaders like you about how important general aviation manufacturing is for the U.S. economy. Targeting general aviation is an unacceptable and counterproductive response to our nation's economic situation which will cost us good, high-paying jobs in Kansas and throughout the United States.

I thank you for your continued support of general aviation and for considering this urgent request.

Sincerely,

David M. Coleal
Vice President and General Manager
Learjet

Cc: Kansas Congressional Delegation

January 13, 2009

Jack J. Pelton
Chairman, President & CEO

The Honorable Lynn Jenkins
United States House of Representatives
Washington, DC 20515

Dear Congresswoman Jenkins:

On behalf of Cessna Aircraft Company, and the thousands of Kansans who are employed at our facilities in Wichita and Independence, I want to express our appreciation for your strong opposition to a provision especially harmful to general aviation that has been included in HR 384, the Troubled Assets Relief Program (TARP) reauthorization bill. This legislation has been referred to the House Financial Services Committee of which you are a member.

As you know, this particular provision would require TARP participants to divest themselves of any general aviation aircraft currently owned, and to terminate any existing leases of general aviation aircraft. It would be disastrous to the general aviation industry, which is of vital importance to Kansas and the nation. We know that this provision would set a very bad precedent, and that its ultimate effects would be highly counterproductive – fewer aircraft orders, severe reductions in high quality manufacturing jobs, and harm to the valued presence of general aviation in the national and world economies. We can least afford this now, especially in light of the severe challenges already being faced by general aviation resulting from the economic downturn over the past several months, which have already caused significant layoffs at many of our companies, including Cessna.

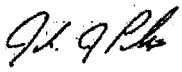
Overall, general aviation contributes more than $150 billion per year to the national economy and employs 1,265,000 people in highly skilled, well paying jobs throughout the manufacturing and supply chain communities. Last year, our industry delivered almost 3,300 aircraft, with a total value of almost $12 billion, in the United States and around the world. Over 38% of these aircraft were exported to other nations, leading to a trade surplus for our industry.

Cessna Aircraft Company One Cessna Boulevard, Wichita, Kansas 67215-1400. 316.517.0049. Fax 316.517.6430
Mailing Address: P.O. Box 7706, Wichita, Kansas 67277-7706

Congresswoman Jenkins
January 13, 2009
Page 2.

Thank you for your support of the general aviation industry and for your opposition to this provision of the TARP legislation. We look forward to continuing to work with you in Congress on other matters of high importance to our industry, to our employees, and to the people of Kansas and the nation.

Sincerely,



Jack J. Pelton

James E. Schuster
Chairman and CEO
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+1.316.676.4718 fax
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Hawker Beechcraft Corporation
10511 E. Central
Wichita, Kansas
67206 USA

January 9, 2009

The Honorable Kathleen Sebelius
Governor
State of Kansas
Capitol, 300 SW 10th Avenue, Suite 2125
Topeka, KS 66612-1590

Dear Governor Sebelius,

I am writing to ask for your help with an important business matter that affects jobs in Kansas. Hawker Beechcraft, along with all of the other general aviation manufacturers, needs your assistance urging key leaders to oppose efforts in Congress that punish corporations who own or lease business aircraft. We ask that you contact Chairman Dodd of the Senate Banking Committee, Chairman Frank of the House Financial Services Committee, and President-Elect Obama's economic team, as this is a matter of utmost importance to our business.

As you recall, December's Auto Loan Financing bill that passed in the House required corporations receiving government assistance to divest any business aircraft they owned or leased. The Bush Administration later incorporated the same measure in its loan package after the bill died in the Senate, and I fear that there are efforts underway to replicate the provision for banks and financial firms that own or lease aircraft. I understand that Congress and the Administration are reacting to the criticism the automotive industry CEOs encountered when they flew business aircraft to Washington. The fact is that these provisions tarnish the image of the general aviation industry and, if replicated, will lead to fewer aircraft orders and additional lost jobs in Kansas.

You know as well as anyone how important general aviation is to the State of Kansas. Our company is already suffering from one of the most challenging economic environments in our history and the last thing we need is for Congress to pursue an effort that will significantly weaken our business. Chairman Dodd, Chairman Frank, and the President-Elect's economic team need to hear from leaders like you about the importance of general aviation manufacturing to the U.S. economy. Targeting general aviation is an unacceptable and counterproductive response to our nation's economic situation. It will cost us good, high-paying jobs in Kansas and throughout the United States.

I thank you for your continued support of general aviation and for considering this urgent request.

Sincerely,

Thanks!!

James E. Schuster
Chairman and CEO

cc: Kansas Congressional Delegation

Insert at page 139, line 3148:

Michigan banks get short end of TARP; some say Treasury avoiding state

By Tom Henderson
Crain's Detroit Business

With the deadline for federal approval fast approaching, a summary of Michigan-based banks that have received funding from the U.S. Treasury as part of the Troubled Asset Relief Program is short and, from the perspective of local bankers, not so sweet.

The Treasury has set a deadline of Jan. 15 for approving applications still pending.

As of Dec. 29, according to the Treasury Web site, a total of $172.5 billion of the first round of $250 billion of TARP money has been disbursed to 208 banks nationwide. Two of them were headquartered in Michigan and none in Southeastern Michigan -- Flint-based Citizens Republic Bancorp Inc. got $300 million and Ionia-based Independent Bank Corp. got $72 million.

That works out to two-tenths of one percent of the TARP funds invested so far going to state banks, a figure easily surpassed by Puerto Rico, whose Popular Inc. bank got $935 million. (It was announced on Dec. 29 that Detroit-based GMAC Financial Services L.L.C. would receive $5 billion but that money is not included for this story because GMAC is not a traditional bank.)

One other state bank was approved for funding but declined the offer of $84 million -- Midland-based Chemical Financial Corp.

Many national and large regional banks that have branches in Michigan have been approved but analysts expect their lending in the state based on TARP money to be limited.

And in October, Pittsburgh-based PNC Financial Services Group announced it would use $5.2 billion of its $7.7 billion in TARP money to buy the beleaguered National City Corp. of Cleveland. National City had the second most bank branches in Michigan as of June 30, its 272 trailing Chase's 297.

Several area community bankers, who asked not to be named because their applications for TARP funding are still pending, fear the Treasury is hesitant to invest in state banks because of troubles in the auto industry and the local economy, which has been in recession far longer than other states.

"That's a valid concern," said Don Mann, regulatory liaison for the Lansing-based Michigan Association of Community Bankers and a bank regulator for the state of Michigan from 1970 to 2002 in what is now called the Office of Financial and Insurance Regulation.

"Regulators aren't going to talk about it. What they'll say is -- and I know because I was a regulator -- 'we treat all our children the same, we apply the metrics fairly.' The same old baloney. The truth is I don't hold out much hope for our community banks getting much TARP money because of the auto crisis. The regulators won't say it publicly. They're saying it privately, I know they are."

Mann said that national and regional banks that have received TARP funding won't lend much of it here, if any. He said they all have sharply reduced the number of commercial lenders and are cutting long-time commercial customers loose, even some of those with good credit.

"The big banks are all saying, 'Look at the auto industry. We're pulling out,' " he said.

In December, the Associated Press contacted the 21 banks that had received at least $1 billion in TARP money to ask them their plans for the money and how any had been spent. None provided specific answers.

Scott Talley, a vice president of communications for Comerica, said that the bank will use its TARP funding in all its existing markets, including Michigan.

"Fifth Third Bank is open for business in Michigan," said David Girodat, president and CEO of Fifth Third Bank, Eastern Michigan. "Like most other banks, we are selective with regard to certain distressed sectors. ... We are still pursuing qualified deals in Michigan."

"We are working closely with our federal regulators to ensure that Michigan institutions get their fair shake in the TARP application process, and we have every indication that is the case," said Jason Moon, public information officer for OFIR.

"We think we're getting hit harder by the federal regulators than the rest of the country," said Michael Kus, managing member of the Auburn Hills law firm of Kus, Ryan & Associates P.L.L.C., which specializes in legal issues affecting community banks. "I hate to use the word 'redline,' but there is a feeling that Michigan has been written off."

"We're all hoping at some point they will unleash some money to Michigan bankers," said Kus, who estimated more than half of Michigan's 136 state chartered banks have applied for TARP funding. "The large institutions have absolutely stopped lending in Michigan. It's the community bankers who will be making loans to small businesses, and they'll be hamstrung if they don't get TARP funding."

Publicly traded banks had to apply for TARP money by Nov. 14. Private banks had a deadline of Dec. 8. Banks headquartered in Southeast Michigan that have applied include Dearborn Bancorp Inc., $28 million; Mt. Clemens-based Community Central Bancorp Inc., $12.6 million; New Liberty Bank of Plymouth, $2.8 million; Troy-based Flagstar

Bancorp Inc., $260 million; PSB Group Inc. of Madison Heights, $11 million; and Paramount Bancorp Inc. of Farmington Hills, $7.5 million.

"I'm not frustrated with the process. I didn't expect to be on top of the list," said Robert Krupka, president and CEO of New Liberty.

"I find it really ironic that they really need banks like mine to make loans at the street level, but we'll be the last ones to see any benefit," said one banker, who asked not to be named because his application was still pending. "It has you scratching your head. My clients are small businesses and small businesses provide a big chunk of the employment in this country."

"We're small. They round numbers like us off," said another banker. "Basically, Michigan is irrelevant."

"I'm afraid the Treasury is biased toward big banks," said a third banker. "They're happy to let the little ones fail."

"It will be small banks that step forward and make loans in Michigan to make the economy grow. Big banks aren't making loans in Michigan," said Terry McEvoy, an equity analyst who covers Midwest banks for Oppenheimer & Co. Inc. of New York.

He said at least one major regional bank in Michigan he declined to name pays bounties to its commercial bankers for cutting customers loose and shrinking the portfolio. "That's reflective of what is going on with big banks in that market," he said.

McEvoy said that the $3 million a small bank in Michigan might be hoping to get "is next to nothing when they're talking about releasing the next $350 billion in bailout money, but that can really effect positive change on Main Street. But community XYZ is not a priority."

BENNIE G. THOMPSON
SECOND DISTRICT, MISSISSIPPI

COMMITTEE ON
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CHAIRMAN

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Congress of the United States
House of Representatives
Washington, DC 20515–2402

January 8, 2009

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Honorable Ben S. Bernanke
Chairman
Board of Governors of the Federal Reserve System
20th Street and Constitution Ave. NW
Washington, D.C. 20551

Dear Mr. Chairman:

The lack of credit continues to impact broad segments of our economy. While the Department of Treasury and the Federal Reserve Board have taken positive steps to inject capital into our markets, one critical sector, manufactured housing, has been left out. More must be done.

We applaud your efforts to expand the reach of the Troubled Asset Relief Program (TARP) to non-bank lending institutions. Initiatives, such as those to lend money against securities backed by certain commercial loans and to establish the Commercial Paper Funding Facility (CPFF) as a backstop for U.S. issuers of commercial paper, have helped to increase liquidity.

However, access to capital remains a serious problem for other segments of the economy, particularly the manufactured housing industry. Manufactured (HUD Code) housing is the most affordable type of non-subsidized entry-level housing available to most Americans. Unfortunately, a lack of liquidity threatens the positive role that manufactured housing can play for American families in need of affordable housing, as well as the recovery of the housing industry and the broader economy.

The current successful distribution system for manufactured housing involves the production by manufacturers of the home, as ordered by the retailer. The retailer uses short-term loans (floor plan financing) to cover the cost of the home until it is sold to the homebuyer. This system has provided an effective source of financing for manufactured housing retailers and is crucial to the entire distribution system.

There are a limited number of commercial lenders who offer such floor plan financing. Unfortunately, those lenders are now facing difficulties in accessing credit -- a situation which threatens the entire industry. Without floor plan financing, retailers will reduce their inventory, forcing manufacturers and related suppliers to reduce their workforce and, as we have already seen, close factories. Instead of being part of the economic recovery, the manufactured housing industry and its thousands of workers -- together

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(662) 741-9007: FAX

with hundreds of thousands of American consumers of affordable housing -- could become victims of the recession.

As with floor plan lending for the manufactured housing industry, other specialized lending programs for key segments of our economy face similar difficulties. Thus we urge you to consider steps to improve liquidity for specialized lending efforts, including floor plan lending. Prudent steps such as expanding the CPFF to include A2P2 issuers could ensure that the funds are available to stabilize the affordable housing market and help preserve the thousands of jobs in the manufactured housing industry.

Thank you for considering our request.

Sincerely,

Bennie G. Thompson
Member of Congress

Joe Donnelly
Member of Congress

Steven C. LaTourette
Member of Congress

Charlie Wilson
Member of Congress

Mark Souder
Member of Congress

BENNIE G. THOMPSON
SECOND DISTRICT, MISSISSIPPI

COMMITTEE ON
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January 8, 2009

Honorable Timothy F. Geithner
President
Federal Reserve Bank of New York
33 Liberty Street
New York, NY 10045

Dear President Geithner:

The lack of credit continues to impact broad segments of our economy. While the Department of Treasury and the Federal Reserve Board have taken positive steps to inject capital into our markets, one critical sector, manufactured housing, has been left out. More must be done.

We applaud your efforts to expand the reach of the Troubled Asset Relief Program (TARP) to non-bank lending institutions. Initiatives, such as those to lend money against securities backed by certain commercial loans and to establish the Commercial Paper Funding Facility (CPFF) as a backstop for U.S. issuers of commercial paper, have helped to increase liquidity.

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Bennie G. Thompson
Member of Congress

Joe Donnelly
Member of Congress

Steven C. LaTourette
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Charlie Wilson
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Mark Souder
Member of Congress

BENNIE G. THOMPSON
SECOND DISTRICT, MISSISSIPPI

COMMITTEE ON
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CHAIRMAN

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Congress of the United States
House of Representatives
Washington, DC 20515–2402

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January 8, 2009

Honorable Henry M. Paulson Jr.
Secretary
Department of the Treasury
1500 Pennsylvania Ave. NW
Washington, D.C. 20220

Dear Mr. Secretary:

The lack of credit continues to impact broad segments of our economy. While the Department of Treasury and the Federal Reserve Board have taken positive steps to inject capital into our markets, one critical sector, manufactured housing, has been left out. More must be done.

We applaud your efforts to expand the reach of the Troubled Asset Relief Program (TARP) to non-bank lending institutions. Initiatives, such as those to lend money against securities backed by certain commercial loans and to establish the Commercial Paper Funding Facility (CPFF) as a backstop for U.S. issuers of commercial paper, have helped to increase liquidity.

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Thank you for considering our request.

Sincerely,

Bennie G. Thompson
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Charlie Wilson
Member of Congress

Mark Souder
Member of Congress

Additional Material Provided by Edward L. Yingling
As requested during the hearing

In response to a request by Mr. Foster:

Percent Change in Outstanding Loans by Dollar Value at Commercial Banks

	Total	C&I	Residential	HELOC	CRE	Revolving Consumer	Fixed Consumer	Interbank	Other
2007	11.1%	21.2%	4.9%	3.7%	10.3%	9.1%	9.0%	9.2%	17.6%
2008	4.6%	8.6%	-3.3%	21.9%	7.7%	11.5%	7.0%	-17.5%	-1.6%

Source: Federal Reserve H.8 Survey

From the same Federal Reserve data series cited in the January 13th testimony, the above chart shows a breakdown of outstanding credit growth to greater detail. The values in the chart are nominal changes and are inclusive of all commercial banks. Some of the increase in outstanding credit in 2008 was indeed due to customers utilizing their existing credit lines as is evidenced by the high growth rates of HELOC and revolving consumer loan growth. Good thing that these financial resources were available. This is bank lending just as much as if these were brand new loans. These categories grew 21.9 percent and 11.5 percent respectively, compared to total loan growth of 4.6 percent over the same year. Commercial and Industrial loans grew 8.6 percent; the data does not break down lines of credit and fixed loans. Banks were available to lend to their customers as financing in other markets deteriorated over that period. In addition, though the rate of growth of total lending decelerated in 2008 from 2007, the fact that bank credit extended in the teeth of a deep recession is still impressive, particularly when compared to past recessions where outstanding credit has historically declined due to weaker demand.

Additional Material Provided by Edward L. Yingling
As requested during the hearing

In response to a request by Mr. Scott:

The Federal Home Loan Bank System (System), despite temporary losses at certain Federal Home Loan Banks (FHLBanks) in 2008 similar to those incurred by most of the financial services industry due to the economic downturn, remains viable and strong. Going forward, we believe that the new regulator of the System, the Federal Housing Finance Agency, should remain diligent in regulation of the System, but that no major structural changes to the System or its regulation are required.

The FHLBanks have delivered innovation and service to the U.S. housing market for 76 years, and currently have more than 8,100 members in all 50 states and the District of Columbia, American Samoa, Guam, Puerto Rico, and the Northern Mariana and U.S. Virgin Islands.

Indeed, without the ability by banks and other lenders to borrow from the Federal Home Loan Banks, the financial crisis of the last would have been significantly worse. For instance, during 2007 advances to member institutions increased 37 percent to $875 billion. Advances increased an addition 6 percent to $929 billion as of the end of 2008. Advances fell by 12 percent during the first quarter of 2009 as the liquidity crisis has abated. Throughout the crisis, the FHLBanks have provided member institutions with reliable access to liquidity to support community lending when it is most needed.

Combined net income for 2008 was $1.249 billion, a 55.8 percent decrease from the $2.827 billion recorded in the previous year. Combined net income for the year was reduced by $1.982 billion in Other Than Temporary Impairment (OTTI) charges on certain private label residential mortgage backed securities and home equity loan investments, and $252 million in write-offs/reserves on receivables due from Lehman Brothers Special Financing and Lehman Brothers Holdings, Inc., as well as net losses on derivatives and hedging activities related to SFAS 133.

A large portion of the OTTI charges taken during 2008 resulted from mark-to-market losses on the impaired securities, far exceeding the actual credit losses the Banks expect to incur based on the expected cash flows to be received by holding the securities. In April 2009, the Financial Accounting Standards Board (FASB) issued changes to OTTI standards, which treat only the expected credit losses as losses for income statement purposes (while other market-related losses are recorded in other comprehensive income).

On June 15 the Office of Finance for the FHLBank system announced highlights of first quarter combined operations. Notable was an improvement in capital of almost $7 billion as a result of classification of non-credit OTTI losses as other comprehensive income. Also, advances declined 12 percent from year end as short-term liquidity needs diminished. Income was down 50 percent from the prior year period, reflecting economic and financial conditions. While deterioration of delinquency rates and home prices will continue to have an adverse effect on the Banks' results,

the impact on earnings and Tier 1 capital will be tempered by accounting changes which more accurately reflect the Banks financial condition.

The System is not only viable, but vital to the banking industry as a whole. Many small banks and credit unions rely on the System for term advances to meet day to day liquidity demands. Because the System is a cooperative, members have a vested interest in the prudent lending and operations of the Banks. The result is a liquidity source which is transparent and self monitored. Additionally, the recent GSE reform legislation which combined the regulation of Fannie Mae, Freddie Mac and the Federal Home Loan Banks has led to a more sophisticated, detailed and experienced regulatory regime for the System and its members.

Long-term prospects for the System remain strong.

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