S. HRG. 111–197

HEARING WITH HERBERT M. ALLISON, JR., ASSISTANT SECRETARY OF THE TREASURY FOR FINANCIAL STABILITY

HEARING

BEFORE THE

CONGRESSIONAL OVERSIGHT PANEL

ONE HUNDRED ELEVENTH CONGRESS

FIRST SESSION

OCTOBER 22, 2009

Printed for the use of the Congressional Oversight Panel

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CONGRESSIONAL OVERSIGHT PANEL

PANEL MEMBERS

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PAUL S. ATKINS

J. MARK MCWATTERS

RICHARD H. NEIMAN

DAMON SILVERS

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HEARING WITH HERBERT M. ALLISON, JR., ASSISTANT SECRETARY OF THE TREASURY FOR FINANCIAL STABILITY

THURSDAY, OCTOBER 22, 2009

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

The Panel met, pursuant to notice, at 10:03 a.m., in Room SD–562, Dirksen Senate Office Building, Elizabeth Warner, Chair of the Panel, presiding.

Present: Elizabeth Warren, Richard Neiman, and Damon Silvers.

OPENING STATEMENT OF ELIZABETH WARREN, CHAIR, CONGRESSIONAL OVERSIGHT PANEL

Chair WARREN. This hearing of the Congressional Oversight Panel is now in session.

I would like to start by welcoming you, Mr. Allison. The first time you came to see us, you had been in your office for one week and yet already were full of information. So we are glad to have you back and hope you will be able to update us on TARP.

As you know, TARP was able to accomplish direct and immediate help for the largest financial institutions, but smaller financial institutions, small businesses, and homeowners facing foreclosure have waited much longer and received much less help. People who funded the bailout, the American taxpayers, are bombarded with news that Wall Street firms that benefitted from TARP with windfall quarterly profits are now preparing to reward their executives handsomely with hefty bonuses. On the other hand, unemployment remains close to 10 percent. Loan defaults continue to rise, and the foreclosure crisis has no apparent end in sight.

I worry not only because of where we are in this crisis, but that the factors that led us to this crisis have not yet changed. The financial sector that we talked about a year ago as too consolidated, too big to fail, is more consolidated than it was back then. When we talked about toxic assets on the books of the banks, those toxic assets remain on the books of the banks. There is little to inspire confidence in the balance sheets of the banks, and the health of small and mid-sized banks remains a very serious concern. That concern is doubled because they are truly the lifeblood of small business lending. Ninety-nine of these banks have failed so far, as you know, and we have more than 400 on the watch list. And many are dangerously overexposed to commercial real estate. We continue to face a grim picture.

On regulatory reform, the very rules that will prevent this crisis from happening again, that process is just starting.

So I think taxpayers are concerned about what this means for their economic security. We hope you can provide some answers today and put TARP in the proper context and help us understand where we go from here. The panel's core mission, as always, is to ensure that TARP operates with transparency and accountability. We thank you. We thank your staff for working with us very closely on that. And we look forward to hearing from you today.

[The prepared statement of Chair Warren follows:]

ELIZABETH WARREN, CHAIR
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Congress of the United States

CONGRESSIONAL OVERSIGHT PANEL

Opening Statement of Elizabeth Warren

Congressional Oversight Panel Hearing with Assistant Secretary for Financial Stability Herb Allison

October 22, 2009

Welcome, Assistant Secretary Allison. We appreciate you taking your time to join us today. The first time you appeared before us, it was only your first week on the job and you were just getting started. We are very happy to have you back to give us an update on the Troubled Asset Relief Program.

It has been more than a year since Congress authorized $700 billion to rescue the financial sector and stabilize the economy. The program provided direct and immediate help for the largest financial institutions, but smaller institutions, small businesses, and homeowners facing foreclosure have waited much longer and received much less help. Meanwhile, the people who funded the bailout, the American taxpayers, are bombarded with news that the Wall Street firms that benefited from TARP assistance are reporting windfall quarterly profits and preparing to reward their executives handsomely with hefty bonuses while unemployment remains close to 10 percent, loan defaults continue to rise, and the foreclosure crisis has no apparent end in sight.

Many of the factors that caused the crisis remain in place. The financial sector is more consolidated today than it was a year ago, meaning the public is still at the mercy of institutions that are considered "too big to fail". Toxic assets remain on the books of the banks, and there is little to inspire confidence in bank balance sheets. The health of small and mid-sized banks remains a significant concern. These banks overwhelmingly support small business lending. Already this year, 99 of these banks have failed—a four-fold increase from 2008. Particularly worrisome is their exposure to commercial real estate assets, which pose a threat to overall financial stability.

Regulatory reform—the change in the rules that will prevent this crisis from happening again—remains in the future.

Quite naturally, taxpayers are concerned about what this means for their economic security. We hope you can provide some answers today, to put TARP in the proper context and to help us understand where we are and where we go from here. At the core of the Panel's mission is ensuring that TARP operates with transparency and accountability. We thank you and your staff at the Office of Financial Stability for working with us. We've come a long way, but many questions still remain.

Each month, the Congressional Oversight Panel releases a detailed oversight report on TARP. The September report examined TARP assistance to the domestic automotive industry. It highlighted a number of outstanding issues concerning the perils of public ownership of private companies and the challenges of exiting the market and returning the taxpayers' investment. This month, the Panel released an assessment of the first six months of Treasury's foreclosure mitigation program, Making Home Affordable. The report raises a number of concerns about the scope, scale, and long-term success of the program. In the coming months, the Panel will assess the impact of TARP and other stabilization initiatives on the economy. The November report will evaluate the role of government guarantees from Treasury, the FDIC, and the Federal Reserve in stabilizing the financial sector. The December report will provide a year-end review of the overall impact of TARP on the credit and housing markets and the economy in general. We look to you today to address these concerns and inform our future inquiries.

Finally, with only a few months left until TARP is scheduled to expire, the question of whether the Secretary will exercise his authority to extend the program looms large. The public should know the criteria upon which this decision will be made. They have a huge stake in the fate of TARP's $700 billion and a right to understand the decision-making process.

Thank you again for taking time to appear before the Panel today. We look forward to your testimony.

Chair WARREN. Now I call on the Deputy Chair, Damon Silvers, for an opening statement.

STATEMENT OF DAMON SILVERS, DEPUTY CHAIR, CONGRESSIONAL OVERSIGHT PANEL

Mr. SILVERS. Thank you, Chairwoman Warren.

Good morning. It is a pleasure again and an honor to welcome Herb Allison to be with us. I am very grateful for your willingness both to appear before us in these formal settings and the extent to which you and your staff have been available to the panel informally since you arrived at Treasury.

This hearing convenes as the Office of Financial Stability and the Treasury Department and the administration more broadly are undertaking a number of initiatives that appear to be efforts to respond to concerns raised by, among others, this panel regarding the provision of credit to business, particularly small business, the continued excessive and, at least to my mind, somewhat perversely structured executive compensation at major TARP recipient institutions, and finally, as our chair referred to a moment ago, the continued escalation of the home foreclosure crisis.

While my sense of these initiatives is that they are all directionally correct, I look forward to hearing today about the scope and design of these initiatives in some greater detail.

I also want to compliment you, Assistant Secretary Allison, on the OFS' handling of the cancellation of the Bank of America asset guarantee. Bank of America clearly benefitted from the perception on the part of the markets that this guarantee was effectively in place for a time, and it was only appropriate that it should pay a fee for having done so. I do not think it was a foregone conclusion that that would, in fact, occur and I attribute that to you and your staff's leadership. I think you should take some public credit.

Mr. ALLISON. Thank you.

Mr. SILVERS. However, I remain extremely concerned that as a result of having a strategy with the TARP program that it is fundamentally about buying time, in the hopes that the financial system will earn its way back to health, that we are at risk of a vicious cycle. Persistent high unemployment, in part generated by the initial financial crisis, breeds more foreclosures and a continuing housing depression, which in turn keeps our major financial institutions weak and causes continued high rates of failures of small banks. Weakness in the banking sector then threatens to act as a powerful headwind, preventing the revival of employment outside those firms that can access the public debt markets. We discussed this matter with Treasury Secretary Geithner when he last appeared before this panel.

With this concern in mind, I hope that you will be able to discuss with us with some specificity the current state and future prospects of the largest financial institutions that are continuing recipients of TARP assistance and I believe are at the core of the threat of continued headwinds from the financial sector, those being AIG, CitiGroup, Bank of America, and Wells Fargo. I recognize, of course, that AIG is a special case.

Ultimately, the Wall Street bonuses that got so much attention this past week make tangible and specific the growing feeling among the public that we are back to business as usual on Wall Street, while the financial system is failing to play its proper role in supporting the real economy on Main Street. I am interested in the immediate steps Treasury is taking to counter this perception in areas like executive pay, but the real test will be whether we really repair the banking system so that it can function again or whether we repeat the unpleasant experience of long-term economic stagnation Japan went through in the 1990s.

Again, I look forward to hearing your testimony this morning, and I again extend my thanks to you for joining us once again.

[The prepared statement of Mr. Silvers follows:]

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CONGRESSIONAL OVERSIGHT PANEL

Opening Statement of Damon Silvers

Congressional Oversight Panel Hearing with Assistant Secretary for Financial Stability Herb Allison

October 22, 2009

Good morning. It is again a pleasure and honor to welcome Herb Allison. I am pleased with your willingness to make yourself available to our panel both in these formal settings as well as more informally.

This hearing convenes as the Office of Financial Stability and the Treasury Department are undertaking a number of initiatives that appear to be efforts to respond to concerns raised by this Panel regarding the provision of credit to business, particularly small business, continued excessive and perversely structured executive compensation at major TARP recipient institutions, and the continuing escalation of the home foreclosure crisis.

While my sense of these initiatives is that they are directionally correct, I look forward to hearing today from Assistant Secretary Allison about the scope and design of these initiatives.

I also want to compliment Assistant Secretary Allison on the OFS's handling of the cancellation of the Bank of America asset guarantee. Bank of America clearly benefited from the perception on the part of the markets that this guarantee was effectively in place, and it is only appropriate that it should pay a fee for having done so.

However, I remain extremely concerned that as a result of having a strategy with TARP that is fundamentally about buying time, that we are at risk of a vicious cycle. Persistent high unemployment, in part generated by the initial financial crisis, breeds more foreclosures and a continued housing depression, which in turn keeps our major financial institutions weak and causes continued high rates of failures of small banks. Weakness in the banking sector then acts as a powerful headwind, preventing the revival of employment outside those firms that can access public debt markets.

With this concern in mind, I hope that Assistant Secretary Allison can discuss with us with some specificity the current state and future prospects of the largest financial institution that are continuing recipients of TARP assistance—AIG, Citigroup, Bank of America and Wells Fargo.

Ultimately, the Wall Street bonuses that got so much attention this past week make tangible and specific the growing feeling among the public that we are back to business as usual on Wall Street, while the financial system is failing to play its proper role in supporting the real economy on Main Street. I am interested in the immediate steps Treasury is taking to counter this perception in areas like executive pay, but the real test will be whether we really repair the banking system so that it can function again, or whether we repeat the unpleasant experience of long term economic stagnation Japan went through in the 1990's.

I look forward to hearing from Assistant Secretary Allison and again extend my thanks to him for joining us.

Chair WARREN. Superintendent Neiman.

STATEMENT OF RICHARD NEIMAN, MEMBER, CONGRESSIONAL OVERSIGHT PANEL

Mr. NEIMAN. Mr. Allison, thank you very much for being here today. You know more than anyone how important today's hearing is to the American public. It was about a year ago that the U.S. Government told the American taxpayer that the financial system faced possible collapse if taxpayers did not provide $700 billion to rescue it.

The taxpayers did what was asked, and they did it even though it meant swallowing what some perceive as a very bitter pill. I also do not have to tell you about the reluctance and, in some cases, the outrage of providing financial support to some of the very institutions that helped cause the crisis, many of which pay their employees more money in one year than many Americans make in a lifetime.

So the stakes of the effectiveness of Treasury's use of that $700 billion are very high. Treasury's programs have to work to stabilize the financial system, but they also have to work so people feel they have also gained from this massive capital infusion. Treasury's programs must restore credit for small businesses that promote entrepreneurship and create jobs, and the programs must keep people in their homes by preventing avoidable foreclosures. Success in these endeavors goes beyond just restoring confidence in our financial system. Success is critical to maintaining confidence in our democratic system.

Remembering back to our first meeting with Secretary Geithner in April, I am glad to say that we can have a different conversation today than we had then. The Department of the Treasury deserves credit for making substantial progress. We are by no means out of this crisis, but yours and Secretary Geithner's efforts averted a disaster and that should be recognized.

But our gains remain fragile, particularly as they apply to the people who need Treasury's programs the most. As you and I discussed in our last meeting together over the summer, it is critical that we redouble our efforts to help the millions of homeowners facing foreclosures. I am grateful to the Treasury and to you personally for participating and arranging the participants at the hearing last month in Philadelphia. It was the first time, to my knowledge, that Treasury, Fannie Mae, and Freddie Mac came together in a public forum with housing advocates and mortgage lenders to discuss the progress of the administration's foreclosure prevention programs. I intend to follow up on several of the issues that came out of that hearing with you today.

I also intend to ask you about improving access to credit for tens of thousands of small businesses that employ the vast majority of our economy's workers. I would like to commend your office and the administration for announcing initiatives just yesterday to provide capital for community banks that are substantial lenders to small businesses. One year later, the financial system needs to start working better for small businesses and for all Americans.

I look forward to our discussion.

[The prepared statement of Mr. Neiman follows:]

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CONGRESSIONAL OVERSIGHT PANEL

Opening Statement of Richard Neiman

Congressional Oversight Panel Hearing with Assistant Secretary for Financial Stability Herb Allison

October 22, 2009

Mr. Assistant Secretary, thank you for being here today. You know more than anyone how important today's hearing is to the American public. It was about a year ago that the U.S. government told the American taxpayer that the financial system faced possible collapse if taxpayers did not provide $700 billion to rescue it.

The taxpayers did what was asked, and they did it even though it meant swallowing what some perceive as a very bitter pill. I don't have to tell you about the reluctance, and in some cases the outrage, of providing financial support to some of the very institutions that helped cause the crisis, many of which pay their employees more money in one year than many Americans make in lifetime.

So the stakes of the effectiveness of Treasury's use of that $700 billion are very high. Treasury's programs have to work to stabilize the financial system, but they also have to work so people feel that they have also gained from the $700 billion infusion. Treasury's programs must restore credit for small businesses that promote entrepreneurship and create jobs, and the programs must keep people in their homes by preventing avoidable foreclosures. Success in these endeavors goes beyond just restoring confidence in our *financial* system; this success is critical to maintaining confidence in our *democratic* system.

Remembering back to our first hearing with Secretary Geithner in April, I am glad to say that we can have a different conversation today than we had then. The Department of Treasury deserves credit for making substantial progress. We are by no means out of this crisis, but yours and Secretary Geithner's efforts averted disaster, and that should be recognized.

But our gains remain fragile, particularly as they apply to the people who need Treasury's programs the most. As you and I discussed in our last hearing together over the summer, it is critical that we redouble our efforts to help the millions of homeowners facing foreclosures. I am grateful to Treasury for participating in our hearing last month in Philadelphia. It was the first time Treasury, Fannie Mae, and Freddie Mac came together in a public forum with housing advocates and mortgage lenders to discuss the progress of the Administration's foreclosure prevention programs. I intend to follow up on several of the issues that came out of that hearing with you today.

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I look forward to our conversation.

Chair WARREN. Thank you, Superintendent Neiman.

Congressman Hensarling, I hope will be able to join us later, and Mr. Atkins, our fifth panelist, is traveling and not able to be with us today.

So that concludes the opening remarks of the panel.

Mr. Allison, I recognize you for five minutes. Your entire written statement will be made part of the record, but if you could take a little time, no more than five minutes, to bring us up to date, I think that would be helpful.

STATEMENT OF HERBERT M. ALLISON, JR., ASSISTANT SECRETARY OF THE TREASURY FOR FINANCIAL STABILITY

Mr. ALLISON. Thank you very much, Chair Warren and members of the panel. Thank you for the opportunity to testify today. I welcome this occasion to update you about the progress we have made in restoring financial stability and to discuss the impact of TARP programs.

The government actions taken last year, including the first phase of TARP, are widely acknowledged as helping to avert catastrophic failure of our financial system. When President Obama took office, the financial system was still extremely fragile and the economy was contracting rapidly. Measures taken by the Congress and this administration have helped bring stability to our financial system, are assisting responsible homeowners, and are getting credit flowing to consumers and businesses—all at a lower cost to taxpayers than was anticipated.

With these improvements, it is time to set a new direction for TARP. We will begin to wind down and terminate TARP programs that were launched at the peak of the financial crisis and cap programs to purchase legacy assets and to securitize credit at lower levels than anticipated. Now, the administration will reshape targeted assistance to the key challenges of helping responsible families keep their homes and helping small businesses get better access to credit.

Yesterday, President Obama announced new steps to improve access to credit for small businesses by providing lower cost capital to community banks. Small business lending represents 56 percent of business loans from small banks, compared to only 21 percent from larger banks. Therefore, community banks with less than $1 billion in assets will be eligible to receive new capital at an initial dividend rate of 3 percent when submitting a plan to increase small business lending. The corresponding rate will be 2 percent for community development financial institutions. In the coming weeks, Treasury will work with community banks and the small business community to finalize program terms to best support small business lending.

The other continuing focus will be our efforts to help responsible homeowners. Treasury's Home Affordable Modification Program has now provided immediate relief to more than 500,000 homeowners who have entered into trial mortgage modifications. Family in permanent modifications are saving over $500 a month on average, as this panel noted in its October 9th report, "An Assessment of Foreclosure Mitigation Efforts After Six Months." The panel made a number of findings and recommendations in that report. I have tried to address them in my written statement so will only touch on two of them now.

First, the panel recommended several areas to improve HAMP effectiveness and transparency. Treasury recently released guidance that streamlines and standardizes the paperwork needed for a modification. To make the process more transparent for borrowers who have been turned down for a modification, we have established denial codes that require servicers to report the reason in writing to Treasury and soon to borrowers as well. We are also improving transparency of the net present value, or NPV, model, a key component of eligibility, by increasing public access to the NPV methodology and encouraging a wider understanding of the model among housing counselors and borrowers.

Second, the panel recommended that Making Home Affordable should try to address a wider population, including borrowers of option ARM loans with negative equity and those who are unemployed. Treasury recognizes that these situations can be particularly challenging. As the panel's report reflected, our current program does permit borrowers with pay option ARMs to use HAMP when they meet other eligibility criteria. HAMP can also help homeowners with negative equity to reduce their mortgage payments to affordable levels with the Hope for Homeowners refinance from the servicer if the borrower qualifies.

Finally, as the recession deepened, unemployment became an increasing contributor to the ongoing foreclosure crisis. Therefore, unemployed borrowers that will receive at least 9 months of unemployment benefits are eligible for a modification under HAMP.

As our efforts progress, we will continue to study ways to meet the challenges of reducing total foreclosures. We are pleased to be winding down certain TARP programs, but recognize there are lingering weaknesses in housing markets and small business lending. We remain committed to helping American families and small businesses and building a broad economic recovery.

Thank you, and I look forward to answering your questions.

[The prepared statement of Mr. Allison follows:]

Herbert M. Allison, Jr.
Assistant Secretary for Financial Stability
U.S. Department of the Treasury

Written Testimony for Congressional Oversight Panel, October 22, 2009

Chair Warren, Members of the Panel, thank you for the opportunity to testify today regarding Treasury's efforts under the Emergency Economic Stabilization Act of 2008 (EESA) and the Troubled Asset Relief Program (TARP). You have asked me in particular to describe the progress of our efforts and to assess the effectiveness of our strategy in stabilizing the financial sector. You have also asked me to discuss the findings and recommendations of your recent report on our foreclosure mitigation efforts. I am happy to address these subjects and look forward to engaging in a dialogue with you after my testimony.

TARP – Progress to Date and Effectiveness

One year ago, we were in the midst of one of the worst periods in our financial history. Immediate, strong action was needed to avoid a complete meltdown of the financial system.

On October 3, 2008, Congress passed the Emergency Economic Stabilization Act of 2008, recognizing the need to take difficult but necessary action and giving the Treasury Department unprecedented authority to stabilize the U.S. economy by creating TARP.

The actions of the Treasury Department under TARP last fall must be viewed together with many other actions taken by the government to address the crisis, including Treasury's Money Market Mutual Fund Guarantee Program, the Federal Reserve's liquidity programs that support both financial institutions and the commercial paper market, and the FDIC's Temporary Liquidity Guarantee Program. These efforts collectively succeeded in preventing a catastrophic collapse of our financial system. However, when President Obama took office, the financial system remained extremely fragile and the Administration faced a rapidly evolving set of grave challenges.

In January 2009, what America faced was no longer just a financial crisis; it was a full-blown economic crisis. In January alone, we lost 741,000 jobs, the largest single month decline in 60 years. Home foreclosures were increasing at a rapid rate. Businesses and families were struggling to find credit. It was feared that those banks that remained standing had too little capital and too much exposure to risky assets. Secondary markets for credit had essentially come to a halt; and liquidity in a broader range of securities markets had fallen sharply. Overall, American families had lost $10 trillion in household wealth.

In short, the economy was in a free fall and there was increasing concern we were headed towards a second Great Depression. Christina Romer, the Chair of the President's Council on Economic Advisors, recently gave a speech outlining just how close we came to a second Great

Depression. She noted that the decline in household wealth from December 2007 to December 2008 was 17% - five times the decline that occurred in 1929.

The Administration confronted this situation by taking forceful action on several fronts. A comprehensive strategy was put in place to stabilize the financial system and the housing market, to stimulate economic activity, and to provide help to those in most need. We still have a way to go before complete recovery takes hold, but we have stepped back from the brink.

The work we have done under our Financial Stability Plan helped avert a collapse of our financial system. As such, the Treasury is now in a position to begin winding down TARP programs that helped put large banks and the auto companies on a sounder footing. It is time to set a new direction for the TARP, to account for the recent improvements in capital markets and to address lingering weaknesses in housing markets and small business lending.

While the next steps for TARP will focus on the twin challenges of helping responsible families keep their homes and small businesses get better access to credit, it is still appropriate here to provide an update on the progress and impact of the range of existing programs.

Capital Purchase Program

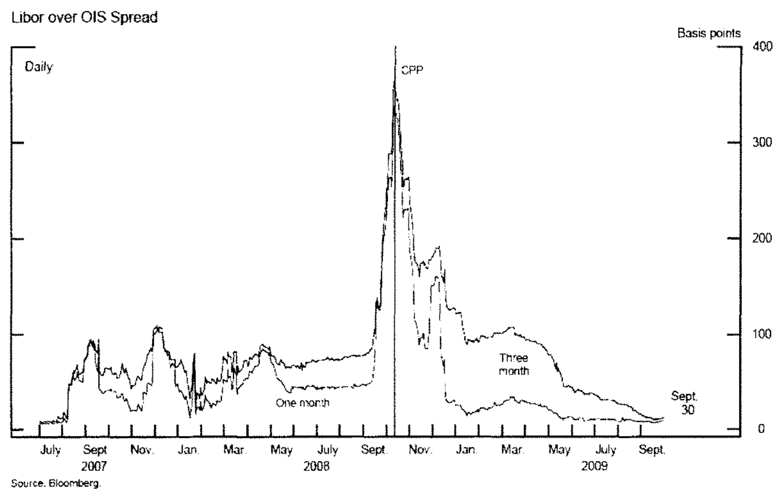
As you know, a key program under TARP has been the Capital Purchase Program (CPP), which has provided a total of $205 billion to 679 financial institutions, including over 300 small and community banks. This capital has been essential in stabilizing the financial system, enabling banks to absorb losses from bad assets while continuing to lend to consumers and businesses.

Treasury also worked with the federal banking regulators to develop a plan for "stress tests". This was a comprehensive, forward looking assessment of the capital held by the largest 19 US banks. The design of the tests and their results were made public, a highly unusual step taken because of the unprecedented need to reduce uncertainty and restore confidence.

Since the stress test results were released in early May, banks of all sizes have raised over $80 billion in common equity and $40 billion in non-guaranteed debt. Importantly, that capital raising has enabled more than 30 banks to repay the TARP investments made by Treasury. We have received over $70 billion in principal repayments, and over $6.5 billion in dividends, interest and fees from CPP participants. In addition, we expect banks to repay another $50 billion over the next 12 to 18 months.

Other metrics further support our conclusion that TARP capital has had a positive effect. First, the TED spread, which measures the difference between interbank lending rates and T-bills and is a measure of the risk in the banking system, had grown to 338 basis points (bps) in December 2008. As a point of reference, the TED spread rose to 219 points in December of 1930. At the end of last week, the TED spread was approximately 23 bps. Second, conditions in interbank markets have continued to improve. The spreads of LIBOR rates to overnight index swap ("OIS") rates, a useful measure of banks' short-term borrowing costs, declined in the third quarter (see Figure B below). The spreads of the one-month and 3-month LIBOR over OIS have narrowed to levels about equal to those prevailing before the financial crisis after having spiked to previously unforeseen levels. In line with these improvements in bank funding markets, the use of the Federal Reserve liquidity facilities directed at depository institutions has declined.

Figure B



When the Obama Administration took office, the Treasury had outstanding commitments to banks under the CPP and other programs of $238 billion. Since mid-January, we have invested $11 billion in nearly 400 institutions, while receiving the repayments noted above of $70 billion. Thus, since January, we have reduced the size of the Treasury's investments in the banking system by $59 billion to $180 billion, shifting the mix of remaining CPP investments significantly toward small and community banks.

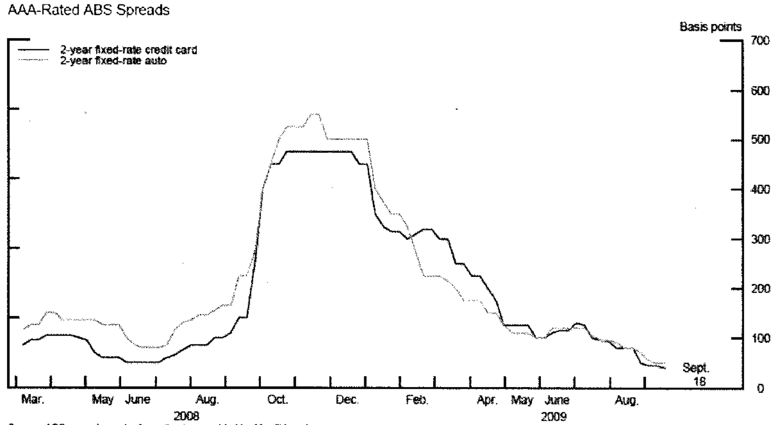
Other Programs

Let me turn now to some of the other EESA programs and their impact on the overall economy. The Public-Private Investment Partnership (PPIP) was designed to help cleanse the balance sheets of major financial institutions and re-liquefy key markets for financial assets. Recently, the first closings with asset managers selected to run the PPIP funds have taken place, and to date Treasury has closed on approximately $9.2 billion of capital commitments, representing \$12.3 billion of purchasing ability when combined with private capital. Although purchases of assets under the program are just beginning, the announcement of the program itself helped reassure investors. Since the announcement, non-agency mortgage-backed securities have gone up substantially in price. Prime fixed rate securities issued in 2006 that traded as low as \$60 in March have increased in value by over 40 percent as additional liquidity has come back to the markets. That improvement in financial market conditions has created the positive backdrop to enable us to proceed with the program at a scale smaller than initially envisioned. Treasury expects to provide approximately \$30 billion in equity and debt financing to special purpose entities (SPEs) formed by the PPIP fund managers.

Another problem area of the economy one year ago was the asset-backed securities markets, through which credit is extended to consumers, small businesses and students. The Term Asset-Backed Securities Loan Facility (TALF) has been a successful effort to help restart those markets. Opened in March 2009, TALF is a lending facility operated by the Federal Reserve Bank of New York (FRBNY) under which FRBNY provides term non-recourse loans collateralized by certain types of AAA-rated asset-backed securities (ABS). Treasury has consulted in the design of the program and will provide up to \$20 billion for the purchase of ABS in the event of a default.

I am pleased to report that, since March, a total of \$79.6 billion of new TALF-eligible ABS has been brought to market, of which \$46.5 billion was funded using TALF loans. This aid to the securitization market has had a decidedly positive impact on liquidity, spreads, and the availability of consumer and small business credit. The figure below details the entire market impact (TALF and non-TALF) on the for AAA-rated interest rate spreads for credit card receivable and automobile loan-backed securities.

AAA-Rated ABS Spreads



Source: ABS spreads are trader estimates provided by Merrill Lynch.

This decline in spreads leads Treasury to believe that there will be less reliance on TALF funding in the future as TALF "money" becomes more expensive in comparison to financing now available in the private markets – an original design of the program.

As you know, Treasury has also implemented a number of programs designed to stabilize specific institutions or sectors of the economy. For example, Treasury has implemented the Automotive Industry Financing Program (AIFP) for General Motors (GM), Chrysler, GMAC, Chrysler Financial and automotive parts suppliers, the Targeted Investment Program (TIP) for Bank of America and Citigroup, the Asset Guarantee Program (AGP) and has provided support, in conjunction with the Federal Reserve, to American International Group (AIG). In each case, Treasury responded quickly to help stave off further deterioration in the financial condition of the institutions involved and the overall economy. In the case of the automotive industry, Treasury's leadership and forceful action helped GM and Chrysler effect large-scale asset sales through bankruptcy court proceedings that resulted in leaner and more efficient companies.

The effects of EESA and TARP cannot be evaluated in a vacuum – they must be considered in conjunction with the many other measures the government has taken to combat this crisis. Nevertheless, in many ways, as noted above, we believe the programs have been successful. As the utilization of the extraordinary policies put in place to combat the financial crisis declines, Treasury looks ahead to a prudent exit and the sustainable supply of credit for consumers and families. The financial system still has significant issues which must be addressed – key parts of the financial system remain impaired and the system as a whole is still somewhat fragile. Unemployment is too high and the equity markets remain volatile. We must continue to be ready to provide support if needed, and we must unwind these programs carefully, so that the nascent recovery is not disrupted.

Housing – Updates and a Response to the October 9th Recommendations

You have asked that I address the findings and recommendations of the Congressional Oversight Panel in their recent October 9th report. We welcome the thoughts of the Congressional Oversight Panel on the nation's housing crisis, and we thank you for your suggestions on how to improve the Making Home Affordable Program.

The Congressional Oversight Panel report correctly recognizes that the Home Affordable Modification Program (HAMP), is achieving its intended goal of providing struggling borrowers with more affordable modified monthly payments – it reports that HAMP is saving families an average of $500 a month on permanent modifications. I am pleased that on October 8, almost one month ahead of the November 1 benchmark set earlier this year, we reached a new milestone of more than 500,000 trial loan modifications underway.

As of September 30th, we have signed contracts with 63 servicers, including the five largest. Between loans covered by these servicers and loans owned or guaranteed by the GSEs, more than 85 percent of all residential mortgage debt in the country is now covered by the program. As of September 30th, more than 757,955 trial modifications have been offered under HAMP, and as of October 8th, more than 500,000 trial modifications are underway.

Today, I want to outline some of the recent steps that Treasury and the Administration have taken or will shortly be taking to improve the effectiveness of HAMP with the goal of strengthening the housing sector, helping millions of homeowners and laying the foundation for economic recovery and financial stability.

First, we are committed to helping eligible homeowners obtain a final modification if they are qualified for HAMP. We do not want eligible borrowers to fail the trial period because the document requirements are unnecessarily burdensome. We recently released guidance – Streamlined Borrower Documentation – that reduces the volume of paperwork needed to obtain a trial modification or final modification, and standardizes documentation across servicers. We worked with the Internal Revenue Service, for example, to to simplify the process of obtaining income tax return transcripts directly from the IRS, eliminating the need for borrowers to mail or fax bulky returns. The new standardized forms provide borrowers with more information about the modification process but in a format that is easy to understand. We hope and expect that the streamlined document revisions to HAMP will enable more borrowers to successfully complete the requirements of the trial period and enable them to obtain a permanent modification.

Second, we are developing a foreclosure alternatives program for HAMP, which will provide incentives for short sales and deeds-in lieu of foreclosure where borrowers are unable or unwilling to complete the HAMP modification process. We are aware that there are many borrowers whose modifications under HAMP will not be sufficient to keep them out of foreclosure; for example, borrowers who do not have sufficient income to support a modified payment. The Foreclosure Alternatives Program can help prevent costly foreclosures and minimizes the damage that foreclosures impose on borrowers, financial institutions and communities.

Third, we have established denial codes that require servicers to report the reason for modification denials in writing to Treasury. We will shortly require servicers to use those denial codes as a uniform basis for sending letters to borrowers who were evaluated for HAMP but denied a modification. In those letters, borrowers will be provided with a phone number to contact their servicer as well as the HOPE hotline, which has counselors who are trained to work with borrowers to help them understand reasons they may have been denied a modification and explain other modification or foreclosure prevention options that may be available to them.

Fourth, we have expanded the efforts of the federal government to combat mortgage rescue fraud and put scammers on notice that we will not stand by while they prey on homeowners seeking help under our program. On September 17, Secretary Geithner hosted Attorney General Eric Holder, Housing and Urban Development (HUD) Secretary Shaun Donovan, Federal Trade Commission (FTC) Chairman Jon Leibowitz, Financial Crimes

Enforcement Network (FinCEN) Director Jim Freis and attorneys general from 12 states to discuss emerging trends and proactive strategies to combat fraud against consumers in the housing markets as well as best practices to bolster coordination across state and federal agencies.

In its October 9th report, the Congressional Oversight Panel recommended that Making Home Affordable address option ARM loans and negative equity, as well as unemployed borrowers. Let me briefly describe these issues.

Option ARMS

Some types of mortgage loans, like pay option ARMs, present unique challenges. The goal of HAMP is to reduce monthly payments to manageable levels, and place troubled borrowers into amortizing, fixed rate mortgages. Where borrowers on an option ARM are already having trouble paying the introductory low teaser rates – the relatively short initial fixed-rate periods when the option ARM bears an interest rate that is substantially below the "fully indexed" rate – it may be difficult to reduce the monthly payment and modify into an amortizing fixed rate loan. Despite these challenges, our current program permits borrowers with pay-option ARMs to use HAMP when they meet other eligibility criteria. In fact, the COP report showed that some borrowers with adjustable rate mortgages are getting modifications under HAMP.

Negative Equity

The Administration's plan focuses on affordability because achieving an affordable payment is essential to keep at-risk homeowners in their homes. Data from past cycles suggest negative equity alone is unlikely to be sufficient to cause default, and though this cycle could be different, there is little evidence suggesting a dramatic change in behavior. However, (Making Home Affordable) MHA recognizes and addresses the problem of negative equity as well. HAMP can help homeowners with negative equity reduce their mortgage payments to affordable levels. Servicers will be required to evaluate borrowers for a Hope for Homeowners refinance at the same time they are evaluated for a Home Affordable Modification, and to offer the Hope for Homeowners refinance if the borrower qualifies. The Department of Housing and Urban Development recently issued a mortgagee letter and other materials to assist implementation of Hope for Homeowners. Greater use of an improved Hope for Homeowners program will help to reach borrowers with negative equity and allow them to regain a positive equity position.

HAMP also uses incentives to servicers and investors to reduce borrowers' interest rates – or write down their principal, if the servicer chooses – to bring down the monthly payment to a level the borrower can afford. Additional incentives are available to borrowers to help them pay down principal more quickly. The Administration's goal is to maximize program participation in order to provide an affordable and sustainable solution for as many struggling borrowers as possible.

Unemployment

We recognize unemployment is a significant problem contributing to the ongoing foreclosure crisis. Rising unemployment and other recessionary pressures have impaired the ability of many otherwise responsible families to stay current on their mortgage payments. Unemployed borrowers that will receive at least nine months of unemployment benefits are eligible for a modification under HAMP. The COP report showed that this is working – the report showed that unemployed borrowers are receiving modifications through HAMP. We continue to study ways to help unemployed homeowners and we remain committed to meeting the challenges of reducing foreclosures and helping people maintain their homes.

Improving Transparency

The Panel recommended in its October 9th report that Treasury should increase transparency of MHA – in eligibility, reasons for denial and other issues touching homeowners, and in disclosure of performance data. We agree that borrowers should be provided with clear explanations for loan modification denials. For that reason, we established the denial codes described above that require servicers to report the reason for modification denials to Treasury, and we intend to require servicers to use those denial codes as a basis for sending written letters to borrowers who were evaluated for HAMP but were denied a modification.

We also agree that transparency of the Net Present Value (NPV) model – a key component of the eligibility test – is important. We are increasing public access to the NPV white paper, which explains the methodology used in the NPV model. We are also working to increase transparency of the NPV model, so that there can be a wider understanding of how the model works among housing counselors and borrowers.

We are working with participating servicers to establish operational metrics to measure the performance of servicers in responding to borrowers, such as average borrower wait time for inbound borrower inquiries, and response time for completed applications. We plan to publish these metrics on a servicer-by-servicer basis in our monthly public reports.

Streamlining HAMP Processes

The Panel also recommended that Treasury should implement greater uniformity and streamline processes in MHA. As described above, we have recently released the streamlined documentation program, which standardizes and simplifies the documentation required for modifications.

In addition, within the next few weeks, the Treasury expects to implement internet capabilities that will allow borrowers to fill-in, download, and print these standardized documents to send to their servicer. As we continue to enhance the Making Home Affordable website, we look forward to providing borrowers with a centralized location through which they can access borrower documents, apply directly for a modification, and ultimately communicate with their servicer to track the status of their modification.

Making Program Enhancements to HAMP

The October 9th report recommended that Treasury should consider program enhancements to HAMP, such as localizing NPV models, and lowering the debt-to-income (DTI) eligibility test. Servicers are permitted to enter in their own variables for several elements of the NPV calculations. For this process, servicers rely on standardized home price valuation products and service providers that can accommodate housing data as granular as street-by-street pricing information.

Foremost among Treasury's efforts to localize the NPV models has been the Home Price Decline Protection (HPDP) incentive payment. The HPDP payments provide lenders additional incentives for modifications where home price declines have been most severe and lenders fear these declines may persist. These incentives will encourage servicers to undertake more modifications in areas hard hit by home price declines.

Improving Servicer Accountability

The Panel also recommended that Treasury should ensure rigorous compliance and accountability with strong sanctions for non-compliant servicers. Freddie Mac, Treasury's compliance agent for HAMP, began servicer reviews in July. Recognizing that many of the servicer's processes are newly developed and most modifications are still in their trial periods, these reviews have focused on the servicer's implementation activities, looking to identify process improvements at this early stage. As loans move into the official modification status and as servicers' processes mature, Freddie Mac's reviews will focus more on risk-based activities and compliance trend issues.

Freddie Mac also began a "second look" review process, where Freddie Mac will audit servicers to review a sample of HAMP modification applications that have been declined by the related servicers. This "second look" process began in August, and is designed to minimize the likelihood that borrower applications are overlooked or that applicants are inadvertently denied a modification. In addition, the second look program is examining servicer non-performing loan (NPL) portfolios to identify eligible borrowers that should have been solicited for a modification, but were not.

Following these reviews, Treasury will receive performance assessments of each servicer's program compliance as prepared by Freddie Mac, and we plan to institute substantial penalties for non-compliance. These penalties may include withholding or reducing payments to servicers, requiring repayments of prior payments made to servicers with respect to affected loans, or requiring additional servicer oversight.

Furthermore, Treasury has recently developed a compliance committee for HAMP to review and understand servicers' compliance results and determine appropriate remedies. The compliance committee's actions range from requiring improperly rejected loans to be modified, to operational enhancements to monetary actions.

We recognize that any modification program seeking to avoid preventable foreclosures has limits, HAMP included. HAMP does not, nor was it ever intended to address every delinquent loan. For those who fail the NPV test, but fall within HAMP's eligible population, Treasury is finalizing guidelines that would provide incentives for borrowers and servicers to pursue alternatives to foreclosure through a deed in lieu or short sale transaction.

We remain committed to helping American families during this crisis and will aggressively continue to build on our progress to date. Sustained recovery of our housing market, and the mitigation of foreclosures, is critical to lasting financial stability and promoting a broad economic recovery. Consequently, we appreciate your suggestions for improvement to HAMP and we look forward to working with you to help keep Americans in their homes, restore stability to the US housing market and ensure a sustained economic recovery.

Conclusions

It has been over a year since the most devastating financial crisis since the Great Depression. In the panic that followed, our financial system nearly ground to a halt. Congress' swift response in enacting EESA and approving the TARP funds prevented a truly catastrophic collapse. Fortunately, we have moved back from the financial brink and are headed toward economic recovery, thanks in part to the programs we have enacted under EESA. Nevertheless, risks remain. We must make sure the financial recovery continues to take hold. In particular, sustained recovery of our housing market and of small businesses is critical to lasting financial stability and promoting a broad economic recovery. We look forward to working with you to help keep Americans in their homes, restore stability to the US housing market and to the financial system, help ensure small businesses have access to credit, and ensure a sustained economic recovery.

Chair WARREN. Thank you, Assistant Secretary Allison. We appreciate your remarks.

I must say I am encouraged to hear that Treasury is talking about winding down large parts of this program and shifting much of its focus to foreclosures and small business lending. I will be even happier the day when we are put out of business because this process is complete and there is no more TARP.

This also changes oversight, obviously. We have to go where you go. So let me focus first on foreclosure and the foreclosure mitigation programs, if I can. I just want to make sure that we are tracking the correct numbers here.

We put the numbers together, as you saw, in the report suggesting that the current mortgage foreclosure mitigation program or programs, when they are fully operational based on the most optimistic assumptions that Treasury has given us, that nonetheless foreclosures will likely outrun modifications by about two to one. Does that fit with the numbers you are seeing?

Mr. ALLISON. Thanks for the question, Chair Warren.

I think we have to keep in mind that this program, Making Home Affordable, was designed to help people who are in their primary homes, and these are working Americans. The program was not designed for second homes or investment homes. So one has to look at the foreclosure rate among the eligible population. And we believe we made great strides in at least matching the rate of foreclosures or potential foreclosures in that category with trial modifications.

Chair WARREN. I understand the point, but surely you are not suggesting that the half of all people, even on the most optimistic assumptions, who are still going to lose homes are all investors and vacation homeowners. I understand you have tried to target more. There will still be a substantial number of homeowners who will be left out of the program. Is that right? I just want to make sure that we are dealing with the same set of numbers here.

Mr. ALLISON. Well, we are obviously trying to reach as many people as we can in this program. We are now able to reduce the debt-to-income ratios of people who qualify from above 38 percent all the way down to 31 percent. So we are reaching a very large number of people. There are some people who will not qualify for this program. For instance, if you have a jumbo mortgage, you do not qualify for the program.

Chair WARREN. I understand.

Mr. ALLISON. Or, people with extremely low incomes can receive other forms of relief. But this program will be able to serve, we think, a very large number of working Americans who are having trouble staying in their homes.

Chair WARREN. So then let me see if I can understand this the other way. You give many reasons why there still may be many foreclosures. But if we think of this problem from a step-back perspective, and that is, the problem of dealing with foreclosures in our economy, the impact on neighbors, the impact on communities, we can still expect substantial numbers of foreclosures over the next few years?

Mr. ALLISON. Well, actually there are other measures underway as well. Under the ARRA legislation, about $12 billion has been appropriated to help especially distressed neighborhoods where many people are at risk of losing their homes. So there are a number of other programs in addition to the HAMP program that have been instituted by the Obama administration to try to deal with the broader housing crisis that the country is facing.

Chair WARREN. So let me just then, if I can—I want to drill in a little bit on the principal program here, though, for homeowners. And that is, Treasury has estimated that it will bring—in fact, has announced that it has brought 500,000 homeowners into the first program, into the HAMP program. Now, of that 500,000 who are brought in, those are people who just have what are called temporary modifications that last for only three months. What is the rate at which those people are making it into what are called permanent modifications?

Mr. ALLISON. Let me first say that we have extended the trial modification period up to 60 days for people who are having difficulty submitting their paperwork. And we are doing our best to streamline the paperwork so that more people can get through this process and receive a permanent modification.

Chair WARREN. And we are very glad to see those changes. We are very pleased.

Mr. ALLISON. Thanks.

Chair WARREN. But the question is, of the 500,000, how many are likely to make it into permanent modifications? What are your numbers so far and what are your projections?

Mr. ALLISON. Well, so far, the numbers are low because we are still in the trial period for most of these people, and it is going to be some months—I would say sometime in the first quarter of next year—before we have a really good idea statistically of what the conversion rate seems to be.

Chair WARREN. But I thought they were only in the trial part for three months. So why can we not tell it on the 91st day how many people are making into permanent modifications?

Mr. ALLISON: As I mentioned, we have actually extended that trial period for many people to five months.

Chair WARREN. To five, all right. So I will just do the math. On the 151st day, why is it that we cannot tell what the conversion rate is to permanent modifications?

Mr. ALLISON. The reason is that they are small numbers to date. We have less than 10,000 people who have moved into permanent modifications out of the 500,000 because the program was ramped up rapidly, and given the three- to five-month delay before they are given a permanent modifications

Chair WARREN. All right. But from this point going forward, it cannot take you more than a couple of months. I mean, they are into the pipeline.

Mr. ALLISON. That is right, a couple of months, and then we will be into the new year. So we are figuring that early in the new year, we will have a much better idea statistically of how many people are moving from trial to permanent modifications.

Now, let me say our biggest concern in the program right now is making sure that as many people as possible are able to convert to a permanent modification.

Chair WARREN. Are you using any projections on this number? Surely, Treasury is doing its own modeling and using some internal projections.

Mr. ALLISON. Yes. Well, we had projections before the program even started. Now we are interested in the actual rates.

Chair WARREN. So what were your projections?

Mr. ALLISON. Well, the projections were——

Chair WARREN. From temporary to permanent.

Mr. ALLISON. Yes. The projections were very rough at the time and——

Chair WARREN. What were they?

Mr. ALLISON. They were—it depended on the type of individual we are talking about. So it was a very complex set of calculations.

Chair WARREN. But you had a number.

Mr. ALLISON. I would not go with any one number as an overall rate.

Chair WARREN. So give me a range of numbers.

Mr. ALLISON. Well, as you know, in the past where there were not actual deep reductions in expenses, the rates could be as low as 50 percent. Given the nature of these modifications, which have not been done before on a large scale, that is, where there are large reductions in people's monthly payments, we do not have good statistics.

Chair WARREN. I understand, but you have designed the program. So you surely must have some model. How many people is Treasury projecting will make it from these temporary, short-term modifications into a so-called permanent modification?

Mr. ALLISON. Well, the estimate is significantly more than 50 percent, but I do not want to place overdue emphasis on any one number.

Chair WARREN. Surely you are already using a model internally. You are not using a model that says significantly more than 50. You must have a number.

Mr. ALLISON. The reason is, as you know, models are simply models, and they do not reflect the outcome.

Chair WARREN. I know. So I am asking just a model number.

Mr. ALLISON. It is ranging up to 75 percent, somewhere between 50 and 75. But again, the real issue——

Chair WARREN. That was not so painful.

Mr. ALLISON. Well, the real issue for America—because I do not want to give overdue emphasis to any one particular number because I think we can focus on the wrong thing. The real issue——

Chair WARREN. But you do understand to engage in oversight, we need to understand your numbers and the projections here so we can see if this is working even on your assumption.

Mr. ALLISON. The real issue, though, is converting people as fully as possible to the permanent modifications. And that is why we are taking these steps to try to make it simpler.

Last week, we brought in, again, the main servicers in this program and we sat down with them to discuss the issue of trying to increase conversion rates and maximizing those. We have also told them that we are going to start publishing service metrics for the servicers starting in early December, and they will provide measures such as how long does it take between the time that someone applies for a modification and the time they actually receive a permanent modification. Also, how long does it take for the servicers to answer the phone and provide answers to people who are very concerned about whether they will qualify or not? So we are trying to——

Chair WARREN. And you will be naming names.

Mr. ALLISON. We will be naming names. We will be naming individual banks against more than five of these different service measures starting in early December. The banks are on notice, and we think by providing sunlight on the data around services, that these banks will try even harder to meet the highest standard.

Chair WARREN. Thank you. I look forward to it.

I apologize to both of you, and I will skip my next round of questions if need be. Mr. Silvers.

Mr. SILVERS. Thank you. I am all for thoroughness. So you have no problem with me.

Assistant Secretary Allison, you have heard a bit about mortgages. I understand my colleague, Superintendent Neiman, is going to talk to you a bit about small business. I would like to focus on very big business, but do not take that as a lack of interest in the other two subjects.

Yesterday, I think, although it is a little hard to tell with the combination of official announcements and leaks, but it appears that yesterday the pay czar, Ken Feinberg, announced a plan to require that the very largest recipients of TARP funds cut their executive pay significantly, particularly in relation to the cash component of that pay. There have been some anonymous quotes in the press this morning from executives at these firms pointing out that a lot of what Mr. Feinberg has in mind is to shift that pay toward long-term compensation, equity-based compensation. I hope you will tell me if what I am saying is not true. I am gleaning it from the published accounts.

There is a concern I want you to address about this, which goes right to the statements that have been made by the Federal Reserve about the proper way to do executive pay in financial institutions. On the one hand, it appears that Mr. Feinberg is moving in the direction of lengthening the time horizons of pay, and I think that is a very good idea.

On the other hand, I am very concerned, and I would like you to address the question of whether or not we have got the risk element correct particularly in the context of banks with very low stock prices, that in pushing pay into equity form where the stock price is low, it is not clear these folks really have that much downside exposure. And so as a result, I am concerned that we are incentivizing a certain amount of risk-taking with the public's money as a backstop. And I wonder if you could comment on that.

Mr. ALLISON. Well, as you know, the Special Master will soon be announcing his compensation determinations and will be explaining to the public how he made those determinations. So I will leave some of that explaining to him. And he has operated in a very independent way. He is making his own decisions.

But it is important that we protect the interests of the taxpayers who have invested so much of their money into these companies over the past year. Therefore, these programs are being designed in a way that will provide that most of the pay will be long-term in nature. Some of the pay will be conditioned on returning TARP money to the taxpayers. They are designed to discourage excessive risk-taking. At the same time, under the interim final rule that governs the Special Master, he is encouraged to consider the need for the long-term survival and competitiveness of these institutions in the interest of taxpayers getting their money back while ensuring that the pay is not excessive, taking away from the overall profitability of the banks and their ability to rebuild capital.

Mr. SILVERS. I guess my question—let me hone my question. If you pay an executive—I think this problem is most severe at Citi and potentially at AIG, depending on exactly what the Special Master does. If you pay an executive at Citi with a package that is stock-based primarily—the stock is at $4, as I believe it is roughly today—there is just not that much downside in that package. And what downside there is is going to be absorbed frankly by us, by the public, because we all know if Citi takes large losses, the pressure to try to do something on the part of the government will be profound.

What is your view—I know you are not the Special Master, but you are in front of us today—as to how we avoid and incent a situation where those people have all the upside of risk but none of the downside?

Mr. ALLISON. Well, let me, first of all, say that since the United States Government is a significant shareholder in CitiGroup, we are aligning the interests of those employees with the interests of taxpayers. And if the stock price of CitiGroup does go up, the American taxpayer will benefit as well.

Mr. SILVERS. I am worried about what happens if it goes down because if you are thinking about this from the taxpayer perspective—we have the downside. They do not, they being the executives we are incentivizing. I recognize this is not a simple problem to solve in compensation design, but I want you to focus on it.

Mr. ALLISON. Well, sir, the executives do have considerable downside because, as you mentioned, much of their compensation is paid out over the long term and is dependent upon performance metrics, including the stock price——

Mr. SILVERS. But you recognize, do you not, that the downside for the executive is counted at zero. When the value of the stock hits zero, that is as low as they can go. We will take the rest of it, and it is the full value of all Citi's liabilities potentially.

Mr. ALLISON. Well, first of all, these banks did undergo the stress test last spring. They raised a considerable amount of equity capital. In fact, the total raised by the large banks was about $80 billion. Their capital positions are far better today than they were then, thanks to the stress test initiated by the Secretary of the Treasury and conducted by the Fed and other regulators. So, I think the banks are in a much stronger position today and we hope in a position to start repaying the Federal Government before too long.

Mr. SILVERS. My time has expired. I will pass on.

Chair WARREN.. Thank you

Mr. Neiman.

Mr. NEIMAN. Thank you.

So I would like to come back to the initiatives to enhance and promote small business lending that were announced yesterday. I was pleased to see the inclusion of capital for smaller community banks who provide a substantial amount of credit to small businesses. I was particularly pleased to see that the extension of capital to community banks is contingent on a submission of a business plan to demonstrate the amount and type of lending where that capital would go to support small businesses and that there would be a follow-up requirement of quarterly reporting detailing those lending transactions. I think you would not be surprised that many of us would have liked to have seen a similar contingency and requirements earlier in the CPP when that was announced by the prior administration.

There are a number of questions that I think still remain and many which I think you acknowledged are final decisions that will take time as you roll out the specifics of the program. But some of the questions I have—and there seems to be some inconsistent reports in the press as to, in addition to the three percent dividend, are there other charges for the capital that would be provided to the banks. For example, will there be a requirement of issuing warrants? There was a report in the American Banker today that it would include warrants.

Mr. ALLISON. Well, there is a de minimis exception for issuing warrants, and the exception is that those banks that receive less than $100 million. Virtually every bank in this program would be receiving less than $100 million. Now, these have yet to be fully worked out. We are going to be issuing detailed guidance on this program after we discuss the program features with the banks, as well as small business. But it is very likely that these banks will not be subjected to the same degree of a warrant requirement as was in the case of CPP for the larger banks, for example.

Mr. NEIMAN. Now, one of the other program provisions is modeled after the CPP program that requires that it be based on a determination that the institution is deemed viable without the capital. Have you or the administration considered modifying that program to permit under certain circumstances banks that would be deemed to be viable after receipt of that capital?

What we are seeing and what we have heard from others is that in order to attract private capital, a determination by the administration that an institution is not viable serves as a red letter to discourage private capital. So I would be interested if you had considered under certain circumstances—it is my understanding, in fact, that FDR's program did have specific categories of those banks that would be viable without and those banks that would be viable only after a contribution of capital.

Mr. ALLISON. First, we want to make sure that the capital is used for the intention of the program, to stimulate lending, and not simply to fill a capital hole on the bank's balance sheet that will not produce additional lending. And we have considered this issue very carefully, Mr. Neiman, because we have been asked this question many times and it is an important question. But we believe that this program, to be most effective, should be aimed at viable banks so they can use the additional capital to promote lending;

With the additional capital, they can leverage that capital and lend quite a bit more than the amount of the capital itself.

Secondly, we have to protect the interests of the taxpayers. Their interests are better protected if we are lending to viable banks, and there are a very large number of these. By the way, this program covers about 91 percent of all the banks in America, about 7,500 banks. So it is a very broad program. But we think that for it to be most effective, every dollar of this additional capital should go to additional lending.

Mr. NEIMAN. So there was internal discussion and analysis of whether that viability test should be reconsidered.

Mr. ALLISON. Yes, sir, there was.

Mr. NEIMAN. And was there the same analysis and discussion around the $1 billion cap? Should it be increased to $5 billion or even $10 billion in terms of the contributions to small business lending?

Mr. ALLISON. We did consider that very carefully for a number of months actually, and we determined that because of the outside role that the smaller community banks play—up to $1 billion of assets. Because of their outside role, we think it is important to direct the funding to them, and they have the highest rates of small business lending of all the different segments of banks. So we think this is the best use of taxpayers' dollars to get this economy rolling, especially in communities all across the country.

Mr. NEIMAN. Do you have an estimation of the timing? There has been a clear level of concern around the number of banks and the time it has taken to process these applications. Do you expect that these will be approved by the end of the year, or will it be dependent whether the TARP program is extended beyond the end of the year?

Mr. ALLISON. Well, the good news is we have the infrastructure for this program already in place. We do not have to build it. We can use the existing Capital Purchase Program infrastructure since we have the procedures and the policies largely in place already. So we can roll this program out very rapidly.

We are anxious to get going. We want to meet with bankers and small business people just as soon as we can to finalize the program and then get it moving. So we feel a sense of urgency to roll this out rapidly.

Mr. NEIMAN. Any estimates on the timing of receipt of applications?

Mr. ALLISON. Well, we want to begin to take the applications very soon. I cannot give you an exact date when we will be doing that, but we will be announcing that very shortly.

Mr. NEIMAN. Thank you.

Mr. ALLISON. Thank you.

Chair WARREN. Thank you.

Okay. I am still on the hunt for some numbers on foreclosure. So I want to make sure I understand this. We talk about the HAMP program, 500,000 people into it by mid-October. We raised the question about whether or not this will be enough to slow down the rate of foreclosures so that we can get some stabilization in the housing market. We then asked if the people who come into the program, the 500,000, just to use that example, how many will make it into permanent modifications. And you said somewhere between a quarter and a half are unlikely to.

So I want to ask the next part, and that is, of the people who make it into so-called permanent modifications, what are Treasury's projections on how many people will actually be able to make those payments and still be in those houses at the end of the 5–year period and make the transition back into their permanent mortgages? In other words, I just want to draw as fine a point on it as I can. Are we preventing foreclosures or are we simply delaying them?

Mr. ALLISON. Well, first of all, I would like to correct the record on this. I did not say that we expect that one-quarter to a half of the 500,000 trial modifications will not be converted.

Chair WARREN. I thought that was our 50 to 75 percent success rate. I was doing the math the other way.

Mr. ALLISON. What I was saying was that we had looked at some modeling last winter and early spring. In fact, it was before I arrived. What we are interested in, now that we are actually operating and growing rapidly, is looking at the actual conversion rates and trying to maximize those as much as possible.

Chair WARREN. Of course.

Mr. ALLISON. So I am not prepared to say what we think the rate will be of successful conversions. All I can say is that we will have much better information and much better estimates based on real experience by early in the first quarter.

Chair WARREN. Right. But you are also not telling that Treasury is flying here with no projections on how this program works in terms of numbers. You cannot be telling me that. There must be projections on how this program will work.

Mr. ALLISON. What we have projected is what we will be able to do within the three-year period of this program when we are actively bringing people in and modifying mortgages—we expect to be able to succeed with about 3 million to 4 million people, which is a very large portion. We also believe that, given the eligible population of people for this program today, that we are about keeping pace at least, and maybe ahead of, the foreclosure rate for that population.

Chair WARREN. You do not mean foreclosure filings because the foreclosure filings are accelerating.

Mr. ALLISON. I am referring to what the rate would be without this program. And so I think we are making tremendous progress.

Now, we are not satisfied with the place we are at today. We are working with the servicers to increase, as much as possible, the rate of trial modifications. Some banks still have a long way to go to reach their eligible populations here. We want them to move as rapidly as possible. And then the challenge is going to be—and you are absolutely right, to minimize the failure rate of getting people from a trial modification to an actual modification.

Chair WARREN. So let me ask so that I do not have to run 4 minutes over again.

Mr. ALLISON. Okay.

Chair WARREN. What projection is Treasury using for the proportion of homeowners who will be able to make it from a trial modification to a permanent modification?

Mr. ALLISON. Well, again, we would like to have as many people as possible. If we were to achieve——

Chair WARREN. And I would like all the children to be above average, but that is not the world we live in. You must have a projection here.

Mr. ALLISON. I think if we can get this rate to something like three-quarters then, that is a very ambitious success rate.

Chair WARREN. So are you telling me that that is what you are projecting? As you are working this program out——

Mr. ALLISON. No, I am not.

Chair WARREN. You must have a projection for what number you are using for the conversion rate from temporary modifications to permanent modifications. Treasury must. You cannot have a program for which you are not projecting how many people will be in it and how many will be in at each stage.

So the question I am asking is what is your projection on the proportion that will make it from temporary modifications to permanent modifications so that we can evaluate this program, whether or not it is likely big enough to deal with the problem.

Mr. ALLISON. Right. Again, based on past experience with different types of modifications, which were not materially reducing people's monthly payments, you saw a failure rate of about fifty percent. So we could use that as a bare minimum success rate, but we would like to achieve a much higher rate. If we were to get to something like 75 percent, which is an aspiration, we would deem this quite a successful program.

Chair WARREN. So I just want to make sure I am understanding. The projection is that the floor will be that you will have at least fifty percent of those who get into a trial modification will make it—I am sorry. I did the wrong one. Fifty percent of those who make it into a permanent modification will actually be able to make their mortgage payments for five years.

Mr. ALLISON. No, actually we would say that the bare minimum of getting from a trial modification to an actual modification should be above, and then the failure rate——

Chair WARREN. I am sorry. I also confused it.

Mr. ALLISON. Yes.

Chair WARREN. I confused it.

Mr. ALLISON. I understand.

Chair WARREN. The redefault rate, the rate at which those people who get these so-called permanent modifications actually stay in their homes for at least five years, and we are not simply delaying foreclosures. We are actually preventing them. What is the rate there? How many people who make it to permanent modifications does Treasury anticipate will actually be able to pay those mortgages?

Mr. ALLISON. Well, there is not a historical basis for a program like this. What is so important about the program is that we are materially reducing people's payments.

Chair WARREN. I understand. The Panel has been quite complimentary about the approach. The question is what is the number you are using in your projection. Of those who make it to permanent modifications, what proportion in fact will still end up in foreclosure?

Mr. ALLISON. Well, we are really not sure what proportion will end up in foreclosure.

Chair WARREN. You must have a projection. We all have looked at numbers. We have been looking at numbers now for a year in terms of what are called redefault rates, that is, people who get a modification and then it does not work. You must have a projection for this. Treasury has put this program forward. What is the projection you are using based on all the data you have read? I understand the programs are different. I understand there are lots of different studies that use lots of different information.

Mr. ALLISON. Right.

Chair WARREN. What is your projection?

Mr. ALLISON. Well, I think, again, what I can do is to come back to the panel with our best estimate on what that might be.

But I think, our goal is to get beyond the projections to reach real Americans who are in trouble and try to have as many of them succeed in this program as possible.

Chair WARREN. I am sure that is everyone's goal.

Mr. Silvers.

Mr. SILVERS. Assistant Secretary Allison, can you tell us what is the dollar amount assigned to the small business program you were discussing with Superintendent Neiman a moment ago?

Mr. ALLISON. Well, at this point, we are going to be working with the communities that are going to be helped by this program to try to estimate the potential eligible population for it. So we will be in a better position to estimate for you what the actual expenditure might be once we have completed that work because we are going to try to tailor the program as much as we can to the actual needs. Instead of designing the program in the abstract, finalizing every aspect of it, and rolling it out, we have announced the broad metrics of the program. Now we want to work with them to see how we can maximize the potential eligible population. Then we will be able to give you a better estimate.

Mr. SILVERS. We are using TARP money here. Right?

Mr. ALLISON. Yes, we are.

Mr. SILVERS. So it cannot be more than the amount of TARP money that is left.

Mr. ALLISON. That is absolutely correct.

Mr. SILVERS. Can you give me any further insight into your thinking as to what the range might be? I do not want to get into a 10-minute discussion of it, but I am interested. Can you scale it for me in any respect?

Mr. ALLISON. Yes. Well, it would be a fraction of the amount of remaining money. I would say it would be somewhere between $10 billion and as much as $50 billion.

Mr. SILVERS. That is very helpful.

Mr. ALLISON. And the answer could be somewhere in between. Again, we want to be responsible here when using taxpayers' money, by providing an accurate estimate as possible.

Mr. SILVERS. There have been some suggestions. I believe Senator Warner in particular suggested the idea of essentially, as we have done in some of the credit markets, just effectively bypassing the bank credit system and moving TARP money directly to small business with private sector managers. Can you explain to me why you appear to have decided to go this route instead of that route?

Mr. ALLISON. Yes. We have decided to go through the community banks. We think that is by far the most effective and efficient way of reaching large numbers of small businesses since these banks already have relationships with these companies throughout the country.

Mr. SILVERS. No, that is not the question. I think the proposal Senator Warner had was actually to go through those same banks. The way you are proposing to do it is you are going to give the banks some equity capital and then they are going to give you a plan for how they are going to lend, you assume, that money plus other money to small business.

Mr. ALLISON. If I may say, the program is structured in reverse. The banks are going to give us the plan. Then, we are going to give them the money.

Mr. SILVERS. All right. I was not implying an order.

You have to have a certain confidence that they are actually going to do that and not as you suggested—your concern might be that they were going to fill capital holes and the like. On the other hand, if you did what was done with TARP in more financialized markets, which was to go directly into the markets in the TALF program——

Mr. ALLISON. I see.

Mr. SILVERS. Right? Senator Warner was talking about going directly into the small business lending market, hiring the community banks to manage it for you, thereby ensuring that the money, in fact, ended up where you wanted it to end up.

I am just curious that you made a choice to use the bank's capital structure, not just their managerial capacity, but their capital structure.

Mr. ALLISON. Right, and the reason is because by providing capital, they can leverage the capital to do much more lending. Perhaps eight to ten times the amount of the capital can be lent out.

Mr. SILVERS. So your hope is that, for example—just a take a number—that if you put $25 billion into this, that you might be able to generate between $100 billion and $200 billion of net——

Mr. ALLISON. That is correct.

Mr. SILVERS. That is the hope. I think that is very thoughtful.

Mr. ALLISON. Thank you.

Mr. SILVERS. Let me shift back for a moment to big business. When our last round ended, you were telling me about the perception that Treasury believes in the growing strength of the large banking sector. I am curious. If each of Wells Fargo, Citi, and BofA showed up this morning with a check for the balance of their TARP funds, would you accept it?

Mr. ALLISON. Well, that is really a matter for the regulators to determine because they are responsible for the financial soundness of those institutions.

Mr. SILVERS. All right. I hope you would correct me if I am wrong. My perception is that at least Wells Fargo, of those three banks, has almost begged in public to be allowed to return the money, which suggests that they have got the check, and yet they are not being allowed to return it. Why in your view is that so?

Mr. ALLISON. Well, again, I would not speak for the regulators of Wells Fargo. So I would defer to them and their determination of whether Wells Fargo is ready to repay. Obviously, on behalf of the taxpayers, we would be delighted to receive our money back from these banks. But we also have to recognize that the money was put out there to enhance financial stability. The regulators are far better qualified than the U.S. Treasury Department as to when those banks will be able to repay.

Mr. SILVERS. If I can ask the indulgence of my fellow panelists just to express a final thought here.

It seems to me that you and the regulators are behaving wisely here, that this is the real test of whether or not we have repaired our large financial institutions, whether or not, in the privacy of whatever rooms that these decisions are made, people, fully informed individuals, presumably acting in good faith with the public interest in mind, are willing to allow these banks to return the money. And I think the evident fact that they have not returned the money suggests that in truth there is not a comfort level with doing that. I think that is very good. I would urge you not to submit to any kind of pressure to allow banks that are fundamentally not yet sound to return the money.

But I think it raises a larger issue which goes back to my concerns in my opening statement and to the backdrop to your views about the weakness of the small business lending market and to the backdrop to the sort of end game around mortgages, which is these institutions do not appear to really be healthy. And that is a very dangerous thing, given the size of those institutions. And it seems to me that that remains a continuing challenge.

Mr. ALLISON. Mr. Silvers, first of all, these banks have raised large amounts of capital, in some cases very large amounts of capital, since last spring since the stress tests. They are far better capitalized than they were then. So they are in a better position to begin considering, I think but the regulators have to be the arbiters of that. Of course, we are in dialogue with the regulators as well.

So I would not characterize these banks as being impaired today. They are far healthier than they were before. They have taken a number of steps to reduce risk on their balance sheets as well. So I think the day is nearing when they will be able to begin repaying. It is closer than it was last spring.

Mr. SILVERS. My time has far expired.

Chair WARREN. Mr. Neiman.

Mr. NEIMAN. So I had intended to use this round of questioning to focus on conversion rates from trial mods to permanents and redefaults. But considering the time we spent on that, I will just make a few points. In my additional views in the October report, I did note that in my opinion it was too early to calculate those conversions and because of the very low statistics, it could be skewed for a number of reasons.

However, I think those kinds of projections would be helpful, and there are already press reports. BofA—it has been reported in the New York Times that they have estimated a 50 percent conversion rate. So I was going to frame my question that it would be helpful to Treasury to provide its own guidance. And my question was going to be, when do you expect to be in a position to project conversion rates and redefault rates and ongoing volumes for HAMP?

Mr. ALLISON. We are trying to continually improve this program to increase the conversion rates. We are going to be, as I mentioned before, in a better position to estimate what the goals for conversion should be when we have further experience and have made further improvements in the program, and that should be early in the first quarter. And, I think we will be revising those estimates as we go forward.

Mr. NEIMAN. Now, also in the October report—and you responded briefly to the issue in your written testimony—we pointed out that the Administration's housing foreclosure prevention program was designed six to eight months ago, and unemployment has continued to grow since then and the crisis has certainly extended and foreclosures extended from subprime into prime.

So my question is really focusing on what is the Treasury doing on the issue of targeted foreclosure relief for the recently unemployed. I have suggested both in our last report and in other meetings with you and personally with the Secretary to explore Federal funding for State programs that are modeled after Pennsylvania's successful program, the HEMAP program, Housing Emergency Mortgage Assistance Program, that provides, in a sense, short-term secured bridge loans for people who are recently unemployed. A program of this nature could be funded either possibly through TARP or through legislation.

So my question is, is there a reason not to pursue this approach to explore whether TARP or legislative proposals, which my understanding is there are some that have been proposed on the Hill, should not be pursued as part of the Administration's program?

Mr. ALLISON. We are familiar with the Pennsylvania program, and we have high regard for what has been done in Pennsylvania. Also, a number of other States have initiated foreclosure prevention measures as well.

Let me mention again that our own program now allows people to qualify who have expected unemployment payments for at least nine months to come. We are still studying what more we might do in that area. We think that our program, as it is designed today, is the most efficient one to reach a large number of people while at the same time protecting taxpayer dollars.

But we are open to suggestions, as we have been all along. We are looking further at the Pennsylvania model as well to see what more might be done.

And let me also mention that there are, other federal programs underway such as for state housing finance agencies, for cities or other areas that are impacted more than average. Already these programs are in place. So we cannot look just at the HAMP program as the only federal program.

Let me also mention that outside of the TARP program, the Government-sponsored entities, Freddie Mac and Fannie Mae, also have their own program which is identical to ours to reach their borrowers as well.

Mr. NEIMAN. Well, to the extent that the analysis around that program continues and a decision is made one way or another, I would appreciate it if you would get back to our panel and provide us any analysis or decisioning around it.

Mr. ALLISON. Thank you. We will.

Mr. NEIMAN. Thank you.

Chair WARREN. I am going to start by following up on the previous two lines of questioning. I just want to make sure in following on Mr. Silvers' question, as I understand it, in the small business lending, you will be asking the banks to propose plans for using this money, which I think is a substantial advance over where we were a year ago. But I just want to make sure. Unlike the TARP funding for the big banks a year ago, this time will we be tracking the money?

Mr. ALLISON. Well, first of all, with the program that already exists, the Capital Purchase Program, we have voluminous information on our Web site, financialstability.gov, about the actual lending by all these banks. And we think it is very important that the public be able to see for themselves. What is very important is how much lending they are doing. We also have indications that this program has been quite successful in producing lending rates in the banks that are higher than they would have been without the program. So we think we are being quite transparent about actual lending activity.

Chair WARREN. That was not my question.

Mr. ALLISON. In terms of tracking how the money is being utilized, we are asking the banks to provide their goals, then we will look at their goals, and measure their performance, for instance, in lending, which is the main objective of the program, in a way that the American public can judge for themselves how each of these banks is performing.

Chair WARREN. So we will be verifying that they use the tax dollars for small business lending.

Mr. ALLISON. They will be verifying and——

Chair WARREN. We will look at their lending rates before they take the money.

Mr. ALLISON. That is correct.

Chair WARREN. And we should expect to see essentially either a dollar-for-dollar improvement in their lending or with leverage from private investment, a better than dollar-for-dollar improvement in small business lending.

Mr. ALLISON. Absolutely, we hope there is a better than dollar-to-dollar improvement. But I think that it is important to judge them against the plans that they submit as to how much additional lending they are doing, which should be more than the dollars we are putting into the banks.

Chair WARREN. All right, and we will be documenting that.

Mr. ALLISON. Yes.

Chair WARREN. That sounds good. That sounds very good.

Mr. ALLISON. Thank you.

Chair WARREN. Let me ask a follow-up to Mr. Neiman's question. We were talking about all these programs, the various programs, some obviously underway on mortgage foreclosure mitigation, some perhaps in the wings to try to deal with the problem.

I just want to ask about the other half. These are all questions about using taxpayer money in order to bail out homeowners and in particular the investors who bought those mortgages, who invested in those mortgages for high profits. How much are we talking about programs where the investors have to acknowledge their losses and come to the economically rational place in dealing with foreclosures?

I worry about two facts.

The evidence suggests that $120,000 is lost in every mortgage foreclosure. That would seem to me to be an enormous incentive for the mortgage lenders themselves, frankly, with no government help, to come in and modify those mortgages.

But the second part is for every dollar of federal money that goes in and ultimately makes it into the hands of the mortgage lenders, there is an increased incentive for them to sit on the sidelines and hope that more federal dollars are coming and not come to the table and negotiate with their homeowners.

So I just want to hear about the part of the program that encourages the lenders to acknowledge their losses rather than taxpayers having to pick that up.

Mr. ALLISON. As you point out, foreclosure is very expensive. It is expensive to everybody, to the homeowner, as well as to the original lender. We believe that our program, which is designed for situations in which there is a positive net present value to modifying the mortgage, has caused banks to take a hard look at whether they might be better off by modifying the mortgage.

As to principal relief, the Making Home Affordable program does allow for principal relief. It provides the same types of incentives. We also have now coupled the Hope for Homeowners program, which involves principal relief, into our waterfall of alternatives. And the individuals who run the Hope for Homeowners program are working on revised rules and guidance that will soon be rolled out. So, we should see more activity in the Hope for Homeowners program as well.

In addition, the Obama Administration has long advocated responsible reform of bankruptcy rules to encourage affordable modifications. That is, bring lenders together with borrowers to try to prevent bankruptcy, which is expensive to all sides.

Chair WARREN. Thank you.

Mr. Silvers.

Mr. SILVERS. I want to pick up on this line of questioning a little bit.

As Superintendent Neiman mentioned, we had a hearing in Philadelphia and your office was very helpful in providing witnesses. At that hearing, there was a great deal of focus on these two issues you just mentioned: the question of negative equity and the reform of our bankruptcy laws, on the one hand, and secondly, the issue of the unemployed.

In respect to reform of the bankruptcy laws—and I just draw this to your attention—it was acknowledged by our expert witness from the Federal Reserve Bank of Boston that really bankruptcy reform was the only way anybody could think of to target relief in the area of negative equity. There is a problem if you just throw money at negative equity, that it goes to lots of people who can actually afford to pay their mortgages. But with the bankruptcy process, there is kind of a gatekeeper mechanism there. Bankruptcy is unpleasant and has real consequences for the person going bankrupt, but you target the relief that way.

Secondly, I want to come back to unemployment. There was a near universal—I think actually universal view among our witnesses that the Treasury's programs did not adequately address the unemployment-driven foreclosure wave, and as Superintendent Neiman suggested, a deep interest in the HEMAP program, the Pennsylvania program. Do I take from your testimony that you are looking at further actions in this area. Am I hearing your testimony right?

Mr. ALLISON. We have been looking at a wide variety of actions, including to help people who are unemployed. As I mentioned, this program now makes it possible for people who have the prospect of another 9 months or more of unemployment insurance to take part in the program, and we will continue to look at what else we might do in balancing the interests of the taxpayers with the needs, the very serious needs, of people who become unemployed. And, we are looking at various models. I am not committing that we will be able to instigate any particular method at this point, but we——

Mr. SILVERS. I did not hear you commit.

Mr. ALLISON [continuing]. Are certainly actively looking at it.

Mr. SILVERS. But you are actively looking.

Mr. ALLISON. Absolutely.

Mr. SILVERS. I mean, I think you know this, but I would urge you to not just consider this as a balance between the interests of the taxpayers and the interests of people facing unemployment and foreclosure, but the systemic consequences of the unemployment-driven foreclosure wave.

Mr. ALLISON. The Obama Administration takes this very seriously. It has initiated a wide variety of measures, again, beyond the HAMP program. The entire economic stimulus program is intended to create jobs and to preserve jobs as much as possible during the most serious recession we have had in at least 50 years.

Mr. SILVERS. At least I personally am aware and supportive of much of that work. I think that the particular problem of unemployment-driven foreclosures is one that I think was underestimated through no one's particular fault early on in the development of the Making Home Affordable program. I am glad to hear that you are looking at what options are available. I would urge you to do that.

Mr. ALLISON. Thank you. And we certainly understand the importance of this issue.

Mr. SILVERS. Very good.

I want to then turn back to the small business piece for a moment. There is a tradeoff, it seems to me, between the potential of leveraging small business lending versus the certainty of a direct TARP pipeline, that you would be certain that that money was going to small business lending if you did it directly. I think that I would urge you to focus on our chair's comments about the need, given the choice you have made, to very closely monitor not just the plan at the front end, but the implementation of the plan at the back end from these banks.

Mr. ALLISON. Thank you, and we fully agree with you.

Mr. SILVERS. Very good.

I will stop here and pass it on to my colleague.

Chair WARREN. Mr. Neiman.

Mr. NEIMAN. Thank you.

I want to focus on the stress tests and pick up on commercial real estate lending, which we really have not touched on yet. The stress tests required that the largest banks carry and in some cases raise additional regulatory capital. When those tests were conducted last spring, many of the concerns revolved around the mark-to-market securities. Now it appears that those securities may have stabilized somewhat and now the concerns have really shifted to portfolio loans on bank balance sheets particularly commercial real estate.

Is your office looking at or considering any programs other than PPIP and TALF for CMBS programs, commercial mortgage-backed securities, or an expansion of those programs to address the particular issues around commercial real estate loans?

Mr. ALLISON. We have looked at many alternatives. This is a problem that is considerable across the country, both because the securitization markets are not as robust as they were before and because banks have a large amount of commercial real estate loans on their books. In fact, the smaller banks tend to have a larger proportion of commercial real estate on their books than do the bigger banks. That is another reason why we have launched this program aimed at community banks. A lot of their small business lending is connected with commercial real estate lending. So by providing them access to additional capital, we can help them to withstand a deterioration in the value of those assets on their books.

Now, we think that providing capital is more efficient and more effective than trying to directly intervene to support prices in the commercial real estate market, which would be very expensive and impractical. By providing capital, the banks are better able to deal with the problems on their books by, for instance, extending loans or modifying loans over time. And we think that already there is a lot of creativity in the commercial real estate market. Some investors are entering this market. We are seeing somewhat more activity in the securitization markets, and banks' earnings also can help them to withstand this problem over the next several years. So I think the banks are well aware of the problem, as are the regulators, and they are working actively to deal with it.

Mr. NEIMAN. Are there any proposals around addressing the commercial real estate problem that you could share with us, particularly projects that support affordable housing, multi-family housing?

They are a great concern in many urban areas, including New York. Large commercial lenders who use those funds to purchase low- and medium-income housing projects, now that they are facing possible default, are cutting back on maintenance and services and it is becoming a real community concern. Are there any programs that you can share with us today that may have some level of real interest to confirm that there are programs under consideration?

Mr. ALLISON. Well, we have been in dialogues with community leaders and also with housing finance agencies and others to look at this problem. So overall, there have been measures taken to support the housing finance agencies and to work with them on this problem. As you know, there are different situations for different housing projects, and in some cases, the banks are stepping in to deal with this or other new investors as well. So there are a variety of ways of dealing with that problem. But again, right now, our focus is going to be on providing capital to the community banks to help them with their widespread concerns about commercial real estate and to support small business. These two factors are intertwined in the communities across the country.

Mr. NEIMAN. Still on the stress tests, is there any consideration being given to rerunning any of those stress tests on large or regional banks with a particular focus on commercial real estate loans and to extend the time horizon on those tests out another year? In New York we have utilized stress tests on an ad hoc basis in situations where we feel a bank may have issues. But is there any consideration? We have recommended it in past reports that the Administration and the regulators consider expanding out either on an ad hoc or systemic basis the stress tests.

Mr. ALLISON. As you know, the regulators are well aware of these issues and they are the ones who determine how to administer stress tests to those institutions. And I am sure that they have had extensive dialogues with these banks to understand their current situation.

Mr. NEIMAN. Thank you. My time has expired.

Chair WARREN. I would like to ask some questions about the winding down. I was interested to see that on September 18th the money market guarantees were permitted to expire. Is the guarantee really gone?

The next time money market managers face big losses and the money market account breaks the buck, is there anyone in America who does not believe that the American Government will rush back in and support the money markets?

Mr. ALLISON. Well, the need for that program went away.

Chair WARREN. It has gone away for today. I am asking about tomorrow, the next time we hit a financial crisis. So do we have, in effect—the question I am asking—do we have a pre-guarantee out there? That is, we will not call it a guarantee in boom times and when there is a bust, then we will move in. So unlike FDIC insurance, for example, which you have to pay for all the time, it is just an insurance policy that you pay for only when you're sick.

Mr. ALLISON. Well, that is another reason why the Administration has been proposing comprehensive reform of the financial industry and also adequate disclosure by institutions about their financial situations. So I think you are asking whether there is a moral hazard with regard to the design here. The intention of the Administration's programs is to reduce drastically the need for Federal intervention going forward.

Chair WARREN. Through regulatory reform.

Mr. ALLISON. Absolutely.

Chair WARREN. Good.

So let me ask another one then. Will CPP, CAP, and TIP—I am learning the acronyms of Washington. Will those three programs be closed by the end of the year?

Mr. ALLISON. Let me just mention that is the Capital Purchase Program, the Capital Access Program, and the program for just a few banks.

Chair WARREN. And the TIP.

Mr. ALLISON. The TIP, Troubled Investment Program.

Those programs are, in effect, going away. They are being capped.

Chair WARREN. So they will be gone by the end of the year.

Mr. ALLISON. At the end of the year.

Chair WARREN. Are we planning any new programs to launch?

Mr. NEIMAN. The programs that are planned are the ones I have talked about today.

Chair WARREN. Okay. So that means that going forward, just if you could, describe what TARP will be starting in January. What is left?

Mr. ALLISON. Well, we have the homeowners program.

Chair WARREN. So the homeowners program will be ongoing. The new small business lending program.

Mr. ALLISON. The small business/small bank program, absolutely. We will still have the investments that we have made that have not yet been repaid.

Chair WARREN. But surely, we do not need a whole TARP apparatus to be——

Mr. ALLISON. Well, actually, we are going to need people who are looking after those assets, asset managers, as well as accountants and many other——

Chair WARREN. I am actually sorry to hear that. We are still not considering the panel recommendation to put those shares of stock in trust. I should say Treasury is still not considering the panel's recommendation to put the shares of stock of the auto industry and the large financial institutions in trust?

Mr. ALLISON. Most of our holdings are in preferred stock. We are common stockholders in a few companies.

Chair WARREN. And the recommendation is to take our common stock and put it in trust.

Mr. ALLISON. Under the EESA, the Emergency Economic Stimulus Act, the Treasury Secretary has the responsibility for overseeing those investments. He cannot shed that responsibility. Even if we put them in a trust or a limited liability company, the Treasury Secretary still has that responsibility under the law.

Chair WARREN. I am sorry. I am not quite understanding. Are you saying it is not lawful for the Secretary of the Treasury to put the shares of stock in Chrysler and GM into trust?

Mr. ALLISON. No, I am not. I am saying that even if they are put into a trust vehicle or a limited liability company, the Treasury Secretary still has the responsibility for overseeing those assets. It is possible to do that. The question is whether that is an efficient use of taxpayers' dollars to create that administrative infrastructure since the Treasury Secretary still has the responsibility for oversight.

Chair WARREN. Good. I am going to quit early this time.

Mr. Silvers.

Mr. SILVERS. Thank you.

I want to circle back to where we started on executive pay. Thinking about this, it seems to me that this week we have seen a fair amount of public anger about bonuses in the financial sector, most of which are actually not to top executives and most of which are across a number of firms not all of which will be subject to Mr. Feinberg's recommendations.

So what do you say to the public who are expressing the view that firms like JP Morgan, Goldman Sachs, Morgan Stanley are alive today because of the combination of CPP funds and Federal Reserve dollars, that they have now handed out vast sums to a relatively small number of people, sums that would simply not have been there absent government support? And they are not going to be affected by Mr. Feinberg's recommendations because they apply only to the banks we were discussing earlier. What do we tell the public?

Mr. ALLISON. Well, the Administration and the Treasury Secretary have been outspoken about the need for financial institutions to structure their compensation in ways that promote a long-term view for the health of those companies and responsible risk-taking. Obviously, the public is angry about the pay levels in the financial industry among some institutions, not all by any means. I am sure that the boards and the managements of those institutions must be aware of this.

We have also, as you know, imposed the interim final rule on the institutions receiving special assistance from the Federal Government and the results of those determinations will be out very shortly. Other banks that are still in the Capital Purchase Program, for instance, and these other programs that we mentioned are still subject to the rules that govern those companies on compensation as well.

What we need is comprehensive reform of financial institutions and the regulations that cover them. Boards have to be responsible in making sure that their pay programs are reasonable, that they are paying for real economic performance and not just spurts in market prices. In addition, they are creating incentives for their employees to think about the long term and to manage risks responsibly.

Mr. SILVERS. It seems to me that in respect to the bonuses that were just announced, the horse has left the barn. And my question is, would the Administration consider looking at tax policy as a way of roping that horse?

Mr. ALLISON. Well, I am sure that Congress and the Administration are equally concerned about this, but I cannot speak for tax policy.

Mr. SILVERS. With some of your colleagues at Treasury, you might want to have a chat together.

Mr. ALLISON. I am sure that others will have more to say about this in the future.

Mr. SILVERS. Let me move from that.

Earlier this week, Neil Barofsky issued his report as the Special Inspector General. He raised an issue. His report talked about a sort of confidence deficit or something of the like. I forget the exact term he used. And he cited particularly the statements made by your predecessors about the fact that all the banks that were getting CPP money were healthy and that that was clearly not true.

I have noted in the past that I think one of the achievements of your team and Secretary Geithner was to reverse that position, that the stress tests were effectively a reversal of that.

I would like you to address what other steps you are taking to, shall we say, reverse this confidence deficit, with particular reference to what plans you have to be forthcoming about the destiny of these large banks that were the subject of this misrepresentation, according to Mr. Barofsky, around their health.

Mr. ALLISON. Well, first, let me make clear that as we expressed in a letter that I sent to Mr. Barofsky some time ago, we fully share his concern that the Government operate with transparency and accountability. And that has guided us during this administration.

And we have published voluminous information about the TARP program on our Web site, financialstability.gov, about the lending practices of the banks, about every transaction that we have done, and about the models we use in valuing warrants and valuing our investments. We are going to be reporting a full accounting of the value of these investments by the end of this year so that the public can see for themselves what the returns have been on the money they have invested through TARP. So we are trying to be as open as possible.

I have dialogues with Mr. Barofsky every week and sometimes more than once a week. For example this week we met several times. We, I think, share the same goal: to try to protect the interests of taxpayers while also promoting financial stability. We have adopted at least three-fourths of the Special Inspector General's recommendations, as we have your own recommendations, which we welcome, the GAO, and the Financial Stability Oversight Council. So, we are trying to be as open and responsive as we can possibly be, and we understand our substantial responsibility to the American public.

Chair WARREN. Mr. Neiman.

Mr. NEIMAN. Thanks.

To give you a heads up for our future reports, in our December report we are going to look back over the last 12 months and really look at how effective—what are the measurements, what are the metrics that we should be looking at, what measurements that the American taxpayer should be looking at to see the state of the economy and the effectiveness of the Treasury's program. And credit availability will be an important part of that analysis.

As you know, though, measuring credit availability in this environment is very complex, and we know that credit contracts in a recession as banks and consumers deleverage, and we know that underwriting standards become tighter as banks strive to conserve capital.

So I am looking to you as we grapple with this question. How should the American taxpayer be assessing the effectiveness of the Treasury's programs to promote bank lending? Should they be looking at credit spreads or bank origination levels or portfolio holdings? What would be helpful and meaningful for the American taxpayers?

Mr. ALLISON. Thanks for your question. Actually we do a lot of thinking and work on that subject. We have many different measures that we use to assess the effectiveness of these programs as well as the activity in the financial markets. We would be glad, by the way, to sit down with members of your staff to go over our metrics, as you produce your own report.

But I have to say that for all the measures of debt spreads and prices capital ratios, what is important to the American public is whether the job market is getting better, can I afford to stay in my home, and are businesses able to get credit. And even though these programs have helped to alleviate these problems, we are not by any means satisfied. We have to keep on striving to make these programs as relevant and as useful to the American public and produce real results.

That is why we are altering the thrust of the TARP program today from having helped the large financial institutions survive, which was important to the financial system given their role, but now get into what is happening with the American public. Can the small businesses get capital? Can small banks be helpful, and can people stay in their homes? So that is where we are focusing our effort today.

We can give you the financial metrics, the more sophisticated measures that we use, but I think ultimately these programs will be judged by their impact on the American economy as felt by the American public.

Mr. NEIMAN. Are there any plans to expand the monthly lending snapshot? I know you have extended it beyond the largest 19 to include 200 banks, though it is a monthly snapshot. I have been recommending for a while that it should include trend information, comparisons to earlier periods such as 2006 when credit was running high and even the fall of 2008 when credit markets were frozen. And I think those kind of trends would provide perspective for the American public as to where we are in comparison to where we were.

Mr. ALLISON. I think that is a great suggestion and let us see what we can do there.

Mr. NEIMAN. Great.

Mr. ALLISON. Thank you.

Chair WARREN. Assistant Secretary, thank you very much. Thank you for your time. Thank you for your service.

Mr. ALLISON. Thank you.

Chair WARREN. We appreciate your coming here today.

The record will remain open for additional questions from the Panel and from our members who could not be here today. With that, this hearing is adjourned.

[Whereupon, at 11:30 a.m., the hearing was adjourned.]

QUESTIONS FOR THE RECORD
FOR US DEPARTMENT OF THE TREASURY
ASSISTANT SECRETARY HERBERT M. ALLISON, JR
CONGRESSIONAL OVERSIGHT PANEL
October 22, 2009

Questions for the Record from Elizabeth Warren, Chair, Congressional Oversight Panel

1. **As Treasury designed the Making Home Affordable (MHA) programs, what assumptions did you make regarding the direction of housing prices? Specifically, what percentage appreciation or depreciation in prices did you assume for each of the next ten years? Did you factor in local or regional variations in price recovery? What was the basis for these assumptions? Should your assumptions prove to be wrong, what will that mean for the likely success of MHA? How much tolerance does the model have for variation from your housing price assumptions? Should your assumptions prove overly optimistic, what do you project will happen when HAMP modifications begin to reset after five years?**

   - The initial modeling of HAMP used home price projections to estimate the cost of the Home Price Decline Protection incentive. The House price projections were based on a national home price trajectory that was consistent with the home price assumptions used in the Budget. More refined projections of HPDP costs used subsequent to the initial program design phase and used for setting caps, are based on home price changes at the MSA level and capture expected regional variation in price changes.

   - Overall, the price assumptions described above imply a cumulative decline in the near term, and then rising house prices cumulatively over the 10 year window. In general, as housing prices stabilize in the projections HPDP incentive payments will be lower resulting in a lower program cost.

   - It is difficult to predict home prices 5 years out because of uncertainty regarding key housing metrics such as house prices and mortgage rates, as well as the broader macroeconomic environment including household incomes and unemployment trends. If, as is most likely, there is moderately steady house price appreciation coupled with improved labor market conditions, then many households should be in an improved home equity and affordability position in 5 years.

2. **Mortgage modifications under the HAMP program must complete a three-month trial period before they can become permanent. Thus far, the conversion rate for trial modifications made at least three months ago has been very low. What conversion rate did Treasury assume in designing HAMP? What is your goal for the program's conversion rate, and how soon do you expect that rate to be achieved? Should your assumptions prove wrong, what will that mean for the likely success of HAMP? What options do you have should modifications fail to convert to permanent status in sufficient numbers?**

- In the initial modeling of HAMP we did not make an explicit projection of trial to permanent modification rates, the transition from trial to permanent modification was assumed to follow the same process as modification payment default. We did not make specific assumptions about the ability of households to complete and submit required forms. The assumed default rate for the first year was higher than for subsequent years.

- In setting caps, a conversion rate of 84% was computed for Phase III Cap purposes, based on historical OCC data at the aggregate level. This estimate will be adjusted based on actual program performance.

- Our goal is to convert as many borrowers as possible, who are in sustainable mortgages. One important purpose of the trial modification period is to ensure that homeowners are in sustainable loan modifications before taxpayer resources are used. We differentiate borrowers failing to convert due to payment problems from difficulty converting due to documentation. Our goal is for every eligible borrower to complete the documentation process in a timely manner.

- While not all eligible borrowers will convert to permanent modifications, it is too early to estimate a failure rate, diagnose causes, and predict future success rates. The conversion rate to date isn't necessarily indicative of likely default rates during the trial modification period. Based on a recent survey of large servicers, over 73% of borrowers are current in their trial plan payments.
- We've extended the trial period to give homeowners more time to assemble required paperwork and to allow servicers to process applications.

- We are developing a set of initiatives designed to encourage conversion that will be rolled-out publicly very shortly, building on efforts we've already taken to drive conversion. We will continue to address issues related to streamlining and simplifying document collection.

- Smaller than expected conversion obviously means fewer modifications. There are alternative programs in place such as our short sale and deed in lieu initiatives designed to transition the borrower out of the home with minimal financial burden.

3. **Both from the taxpayers' point of view and from the homeowners' point of view, a mortgage modification program should produce sustainable modifications- not simply postpone the inevitable. In designing HAMP, what redefault rate did you assume? Please give an average redefault rate assumption across all loans, as well as specific redefault assumptions by LTV and DTI at one-year, three-year, and five-year points, as well as over the life of the loans. What is your goal for HAMP's redefault rate? Should your redefault rate assumptions prove wrong, what will that mean for the likely success of HAMP, as well as for taxpayers? At what point will you evaluate HAMP's redefault rate for possible changes to the program, and what options do you have should you determine changes are necessary?**

- There are two sources of redefault assumptions for HAMP, one used in initial modeling of the program during the policy development phase and another drawn from the NPV model. Actual HAMP redefault will only be known through observation of the program experience.

- If our redefault rate assumptions prove wrong, that will mean a greater or lesser number of successfully completed modifications. As we learn about the actual program redefault rate, we will use that to assess potential program changes and modifications.

Description of default estimates:

Initial Policy Modeling Estimates

- The initial 40% redefault rate was an estimate of the probability that a modified loan would become 90+ days past due at some point during the five year life of the HAMP modification. The initial estimate looked at general re-default experience for modified mortgages.

- For cost estimates, the redefault assumption applies to all loans, regardless of LTV. There is no differentiation in default assumptions between trial and permanent modifications; there is simply a single assumption that represents the likelihood of a loan failing sometime during the five year period of the HAMP modification, inclusive of the trial period. Moreover, the budget projections do not look beyond the 5 years of the modification on any given loan.

- This estimate was based in part on a review of previous modification efforts and the FDIC assumptions used in the Indy Mac modification program. In developing this assumption we took into account that previous modification efforts often did not result in payment reductions, as is the case under HAMP, and in fact sometimes resulted in higher payments as overall mortgage debt was not reduced and past due amounts were capitalized into the unpaid principal balance.

- In contrast, under MHA, the monthly payment reduction for five years represents the cornerstone of the program, which should lead to a lower redefault rate than for programs that often resulted in higher payments.

NPV Model

- In developing the NPV model a more sophisticated approach was taken to estimate the default probability (for non-modified loans) and the redefault probability (for modified loans). An interagency group led by Freddie Mac was tasked with developing an econometric model that took into account the key drivers of default and redefault behavior.

- There is not a single redefault estimate used in the NPV, rather default and redefault are estimated using individual borrower characteristics.

- The key drivers of default include
  - Existing delinquency state of the borrower (current, 30, 60 or 90 days past due) – higher delinquency state increases the default probability
  - Mark-to-market first lien LTV – higher LTV increases default probability
  - Current FICO – higher FICO lowers default probability
  - Current front end (mortgage related debt only) DTI – higher DTI increases default probability
  - For redefault only – the difference between the initial and modified DTI.

- The key drivers of re-default include all of the above factors, plus one important addition – the *change* in DTI between the pre-modification level and a DTI value of 31, the target for which combinations of interest rate reductions, term extensions and principal forbearance are used to make the mortgage affordable.

- In contrast to the budget projections, the NPV model calculations take the full remaining term of the loan into account, though cash flows in the later years have a relatively smaller impact on NPV values because of discounting.

- The specific parameter estimates are available for COP review and can be derived from the publicly available NPV White Paper.

<u>Questions for the Record from Richard Neiman, Member, Congressional Oversight Panel</u>

1. **You and I discussed whether Treasury is reviewing specific foreclosure mitigation programs targeted to the situation of the recently unemployed. I mentioned the successful Pennsylvania program that since 1994 has provided temporary secured bridge loans for the unemployed and suggested the possibility of federal or TARP funding for similar state programs. You indicated that Treasury is looking at a variety of options and would be able to respond to the Panel regarding this review. Please indicate what options are being reviewed and what the results of that review are.**

   HAMP has been designed to allow unemployed borrowers to participate in the program. Unemployed borrowers who have 9 months or more of unemployment insurance (UI) remaining are eligible to include UI in their income for consideration in the NPV calculation. Unemployed borrowers are also allowed to include other sources of passive income like rental income as well as income from an employed spouse, which will qualify some borrowers for a modification. We recognize, however, that some unemployed borrowers will have trouble qualifying for a modification because their income is insufficient to pass the NPV test.

   Treasury is aware of a number of policy proposals that have been advocated to further assist unemployed borrowers, including the model provided by Pennsylvania's Homeowners' Emergency Mortgage Assistance Program (HEMAP), the Foreclosure and Unemployment Relief Plan proposed by academics at the University of Wisconsin, proposals put forward by economists from the Federal Reserve Bank of Boston, and other ideas. While our key focus is on helping as many borrowers as quickly as possible under the current program, Treasury recognizes that unemployment presents unique challenges and is still actively reviewing various ideas and suggestions in order to improve implementation and effectiveness of the program in this area. We have not yet concluded this review, and would be happy to schedule time to discuss our evolving insights on the issue on unemployment and HAMP at your convenience.

2. **In the context of the difficult problem of measuring the levels of bank lending and credit availability in a deleveraging environment, I asked whether OFS has any plans to expand its Monthly Lending Snapshot data. For example, it would be very helpful and informative to move beyond month-to-month data and present trend information with comparisons to earlier periods, such as 2006 when credit was running high, and the fall of 2008 when credit markets were frozen. You indicated that this was a very promising idea and would get back to the Panel. Your response would be appreciated.**

   Treasury is continuing to look for ways to evaluate the effectiveness of all TARP programs, including the CPP. Expanding lending beyond what would have occurred without this program is a critical question, but as you stated, a difficult one to answer. To that end OFS has developed a Quarterly CPP Report that lays out the changes in a number of balance sheet and performance ratios among different groups of TARP recipients and non-recipients. This analysis is being further expanded and refined to get a better picture of what the difference is in lending, capital ratios, and ability to write down assets of similar banks that received or did not received TARP capital. The first Quarterly CPP Report also includes a paper written by the Federal Reserve which shows that the decrease in lending during the current recession was not out of line with similar decreases in other recessions. http://www.financialstability.gov/impact/CPPreport.html

   In terms of looking at the Monthly Lending Snapshot data and extending that analysis to earlier time periods, that specific analysis is not possible. The data that is collected in this report is new data that have never been collected before, so there are no other time periods with which to compare it. However Treasury does track other lending series, such as the H.8 release from the Federal Reserve that details loan balance levels of the largest bank holding companies, though it is not differentiated by TARP recipient.

3. **You stated in your testimony that Treasury will begin to disclose an expanded set of foreclosure servicer performance metrics starting in December. We would appreciate learning:**

   (a) when and what specific new measures will be disclosed (ideally including reasons for denials, reasons trial modifications not made permanent, and redefault rates, in addition to others);

   (b) whether the metrics will include HAMP and HARP servicers; and

   (c)what details about the borrower and modification characteristics of trial and permanent HAMP loan modifications will be provided.

Treasury is working to collect and then report an expanded set of metrics such as reasons for denying borrowers a modification as well as related servicer operating metrics. The metrics will principally be collected for loans considered for HAMP. The biggest current focus for Treasury is on converting trial modifications to completed modifications; though the payment relief for borrowers starts the day they enter a trial modification, transitioning homeowners to permanent status is essential to keeping these homeowners in their home in the long run. When the number of permanent/completed modifications achieves a critical mass, we will be publishing data on borrower characteristics (such as income and credit score) and modification characteristics (such as the size of the payment reduction).

By way of specifics on collecting information about reasons for denials, servicers are required to begin collecting the following reasons by December 1st, 2009:

- Ineligible Mortgage
- Ineligible Borrower - Current DTI Less than 31%
- Property Not Owner Occupied
- Other Ineligible Property (i.e. Property Condemned, Property >4 units)
- Investor Guarantor Not Participating
- B/K Court Declined
- Negative NPV
- Offer Not Accepted by Borrower / Request Withdrawn
- Default Not Imminent
- Previous Official HAMP Modification
- Loan Paid off or Reinstated
- Excessive Forbearance
- Request Incomplete

By way of specifics on collecting metrics about servicer performance, Treasury is developing a set of required servicer operating metrics, which will require servicers to report on operating performance. The metrics will include measures of how quickly servicers answer borrowers' calls, the number of contact attempts made by servicers to at-risk borrowers, and how quickly servicers are making decisions about a modification request after contact by a borrower.

Treasury will begin to include subsets of these metrics in public reports as soon the data is deemed reliable and covers a population large enough to reach conclusions about underlying program and servicer performance.

4. What approximate percentage of projected foreclosures does Treasury expect:

(a) can be resolved by the remedy provided by HAMP;

(b) can be resolved by remedies that factor in broader economic conditions such as rising unemployment; and

(c) cannot be resolved because not every foreclosure is preventable.

- We project that more than 3 million homeowners will be offered assistance through HAMP. We are hopeful that many of those borrowers will avoid foreclosure through the assistance of HAMP, although we recognize that some borrowers will not be successful even in a modified loan.
- It is true that not every foreclosure is preventable either because the household simply does not have sufficient resources, or the borrower does not meet HAMP qualifications. In these cases we believe we can also provide assistance through our short sale and deed in lieu foreclosure alternatives.

Questions for the Record from Paul Atkins, Member, Congressional Oversight Panel

1. **Has Treasury made any decision in terms of extending TARP? When does Treasury plan to announce its decision regarding the extension of TARP?**

   A decision about whether or not to extend TARP must be made by the end of this year, and no decision has yet been made. That decision will be made with the following objectives in mind: We must ensure that we have the tools to support the basic stability of the financial system. We must also consider the need to support credit flows in specific areas, most importantly housing and small business. Finally, we must protect taxpayers and, to the extent possible, limit fiscal expenditures for financial stability.

2. **From your testimony at the hearing, it is my understanding that Treasury intends to let the CPP, CAP, and TIP expire at the end of the year. Is this correct? What other programs do you intend to let expire at the end of the year? If these programs are allowed to expire then what will TARP look like going forward? What will TARP look like on March 15, 2010? What is Treasury's plan?**

   One year ago, we faced one of the most severe financial crises of the past century. Action taken last fall by Treasury, the Federal Reserve, the FDIC, and other government agencies averted a catastrophic collapse of our financial system. When the Obama Administration took office the financial system was still extremely fragile and the economy was contracting sharply. The Administration's financial and macroeconomic policies have helped to shore up confidence in the financial system, facilitate private capital replacing public capital, and redirect support from the largest financial institutions to households, small banks, and small businesses. As a result, credit is flowing again to consumers and businesses.

   Our progress to date in stabilizing the financial system, bringing down the cost of credit, and opening up capital markets has enabled us to begin terminating and winding down many of the government programs put in place last fall. In September, we ended the Money Market Mutual Fund Guarantee Program, which guaranteed at its peak over $3 trillion of assets. Issuance under the FDIC TLGP program for bank debt declined from a peak of $113 billion last December to $12 billion in September. The last day to issue debt under the program was October 31, 2009. Credit extended under Federal Reserve programs that provide liquidity to banks and non-bank financial institutions has also declined significantly as market conditions have improved. In addition, banks have repaid more than $70 billion of capital investments made with EESA funds, and we expect another $50 billion of repayments over the next 12-18 months.

We did not need to make any investments under the Capital Assistance Program (CAP), which has now expired. No new investments will be made through the CPP after the end of 2009. We do not expect to make any new commitments to provide capital through the Targeted Investment Program (TIP). Further, we do not expect to expand commitments to AIG, General Motors, GMAC, or Chrysler, other than as needed to complete the post-SCAP capital needs of GMAC up to the amounts previously described in May.

Looking ahead, a decision about whether or not to extend TARP must be made by the end of this year. That decision will be driven by the following considerations. The process of terminating crisis-related programs must be done in a measured way that maintains confidence and the strength to respond so that exit does not undermine progress toward economic recovery. Credit losses in some parts of the system are still accelerating, and bank failures, which tend to lag economic cycles, are still increasing. At the same time, many of the Federal Reserve and FDIC programs that have complemented TARP investments are ending. This creates a financial environment in which new shocks can have outsized effects. As we wind down many of the government programs launched initially to address the crisis, it is imperative that there be complete confidence that we have the tools, strength and capacity to respond if financial conditions worsen. Maintaining such confidence and flexibility is a critical ingredient in mitigating the potential for new risks to financial stability.

In addition, we must continue to provide support where it is needed. Housing markets are still overwhelmingly dependent on government support, and foreclosures are high. Many homeowners are struggling with mortgage debt that is greater than the value of their homes, and unemployment remains elevated. The Administration's Making Home Affordable Modification Program addresses those challenges. The Administration is also evaluating other ways to stabilize housing markets and help American families
In addition, despite recent improvements in credit conditions, small businesses still face credit constraints amidst lower demand as a result of the recession. Those constraints threaten job growth and financial stability in thousands of communities. We will continue to implement initiatives designed to improve the flow of credit to small businesses. These initiatives will focus in part on small and community banks that provide a significant share of such credit.

History suggests that exiting too soon from policies designed to contain a financial crisis can significantly prolong an economic downturn. We must not waver in our resolve to ensure the stability of the financial system and to support the nascent recovery that the Administration and the Congress have worked so hard to achieve. In addition, we must reform our financial regulatory system to address the structural weaknesses that the crisis revealed. I look forward to continuing to work with you to achieve these goals.

3. **In your testimony from October 22, you noted the following: "The work we have done under our Financial Stability Plan helped avert a collapse of our financial system. As such, the Treasury is now in a position to begin winding down TARP**

programs that helped put large banks and the auto companies on a sounder footing."

I understand that Treasury is negotiating a third round of capital infusion for GMAC. Secretary Geithner testified before the House Financial Services Committee on October 29, that this round would likely be less than $5.6 billion.

Does the possible failure of GMAC present a systemic risk to our economy? If so, please describe the ongoing systemic risk that requires Treasury to provide more capital to GMAC.

Also, how does providing another $5.6 billion in new capital for GMAC qualify as "winding down" of TARP programs? What did you mean by winding down? Do you expect any of the auto-related TARP taxpayer exposure to be paid back soon? If so, how much do you expect will be paid back? When will it be paid back?

At how much does this total exposure currently stand? Please provide a breakdown of this exposure, and a schedule as to when Treasury expects to be paid in full for each of its parts.

Over the past year, the contraction of credit in the auto finance markets has helped drive our auto industry into a historic crisis. Treasury's investments in GMAC have helped to provide a reliable source of financing to both auto dealers and customers seeking to buy cars. Alongside Treasury's efforts through the TALF program, a recapitalized GMAC has offered strong credit opportunities, helped stabilize our auto financing market, and contributed to the overall economic recovery. The additional investment in GMAC was already contemplated in May and will follow through on the stress test process described below.

U.S. federal banking supervisors believe it to be important for the largest U.S. bank holding companies (BHCs) to have a capital buffer sufficient to withstand losses and sustain lending even in a significantly more adverse economic environment than is currently anticipated. In keeping with this aim, the Federal Reserve and other federal bank supervisors engaged in the Supervisory Capital Assessment Program (SCAP), or the stress tests, with each of the 19 largest U.S. BHCs, including GMAC. 18 of the 19 BHCs were shown to have no additional capital need or have now fulfilled their need in the private market. Only one institution, GMAC, has indicated a need for capital from Treasury and their capital need is expected to be lower than anticipated at the time the SCAP results were announced last May. GMAC is expected to access the Troubled Asset Relief Program (TARP) Automotive Industry Financing Program to meet its capital need, and is in discussions with the Treasury on the structure of its investment.

The release of the stress test results has provided important information about the condition of major U.S. financial institutions during a period of high stress and uncertainty, and helped to increase public confidence in the banking system and reduce the threat of systemic risk.

We have noted previously that Treasury will exit its investments as soon as practicable and while being a responsible steward of taxpayer money.

The loans to GM and Chrysler have prepayment terms and maturities that will trigger payments in the future. The loans used to finance the Auto Supplier Support Program must be repaid within a year, unless extended. Treasury expects these loans to be fully repaid by or before April 2010. The GM loan was recently amended to require quarterly mandatory prepayments of $1 billion from existing escrow amounts in addition to the obligation for such funds to be applied to repay the loan by June 30, 2010, unless extended. In addition, the loan matures in July 2015. A portion of the Chrysler loan also matures in December 2011 and Chrysler has recently announced that it plans to repay the loan fully prior to maturity in June 2017.
Treasury will periodically evaluate both public and private options to exit the equity investments under the AIFP. For GM the most likely exit strategy is a gradual sell off of shares following a public offering. For Chrysler, the exit strategy may involve either a private sale or a gradual sell off of shares following a public offering. Our goal is to exit the government's interests in GMAC as soon as practicable. The government will commit itself to sell down, and ultimately sell off completely its interests in GMAC in a timely and orderly manner that minimizes financial market and economic impact. At the same time, we cannot control market conditions and have an obligation to protect taxpayer investments and maximize overall investment returns within competing constraints.

The Auto Team evaluated many scenarios during its diligence process of GM and Chrysler. These scenarios are obviously dependant on various factors including assumptions around the overall market, the economy, and the recovery of the auto sector. Under certain of these scenarios, GM will be able to return a high percentage of the total funds advanced by the taxpayers and Chrysler will return the money invested as part of the restructuring. Other scenarios, which in Treasury's view are more likely, show much lower recoveries for the initial loans made to GM and Chrysler, but also indicate a reasonably high probability of the return of most or all of the government funding for GM and Chrysler that was advanced as part of the restructurings. Such analyses are obviously sensitive to the overall market and the economy.

The total exposure is outlined in the EESA section 105 transaction report. Auto program exposure and repayment terms are both described in the Congressional Oversight Panel's September report, using information provided and obtained in meetings with Treasury.

4. **I asked Secretary Geithner the following question for the record with respect to the Panel's September 10th hearing: "Does Treasury plan to include TARP in its review as required by the Government Performance Results Act? If not, why not? If so, how detailed will this review be? To what extent has Treasury been working on this review?"**

   Secretary Geithner provided the following answer:

   "OFS/TARP will be included in the overall Treasury review of its performance as required by the GPRA. OFS has drafted five overall goals and 15-20 corresponding

performance indicators. Currently these goals and indicators are being vetted through the standard Treasury process, and following this will be sent to OMB for approval. Concurrently, OFS is creating the data set that will allow us to track performance of these indicators. Our plan is to include these baseline results in Treasury's Fiscal Year 2009 Performance Summary."

What are the 15-20 corresponding performance indicators? Can Treasury provide the Panel the results of these 15-20 performance indicators? Will these indicators be made public? If so, when will they be made public? When will Treasury publish the results of its Fiscal Year 2009 Performance Summary?

The OFS will be publishing these performance indicators with the overall Treasury PRA report that will be released in February 2010.