MORTGAGE FINANCE REFORM: AN EXAMINATION OF THE OBAMA ADMINISTRATION'S REPORT TO CONGRESS

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MORTGAGE FINANCE REFORM: AN EXAMINATION OF THE OBAMA ADMINISTRATION'S REPORT TO CONGRESS

Tuesday, March 1, 2011

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

The committee met, pursuant to notice, at 10 a.m., in room 2128, Rayburn House Office Building, Hon. Spencer Bachus [chairman of the committee] presiding.

Members present: Representatives Bachus, Hensarling, Royce, Lucas, Manzullo, Biggert, Miller of California, Capito, Garrett, Neugebauer, McHenry, Campbell, Bachmann, McCotter, Pearce, Posey, Fitzpatrick, Westmoreland, Luetkemeyer, Huizenga, Duffy, Hayworth, Renacci, Hurt, Dold, Schweikert, Grimm, Canseco, Stivers; Frank, Waters, Maloney, Velazquez, Watt, Ackerman, Sherman, Capuano, Baca, Lynch, Miller of North Carolina, Scott, Green, Cleaver, Ellison, Perlmutter, Donnelly, Carson, Peters, and Carney.

Chairman BACHUS. This hearing will come to order.

In the interest of time, I will recognize three of our members for opening statements in the Majority. And, without objection, all members' written statements will be made a part of the record.

First, the gentleman from New Jersey, Mr. Garrett, is recognized for 4 minutes.

Mr. GARRETT. Thank you, Mr. Chairman.

Thank you, Mr. Secretary.

And I also want to thank you for your report, entitled, "Reforming America's Housing Finance Market." I read it over thoroughly. And while it might be a little light on some specifics in some areas, and without a single concrete position on a way forward, I believe that it does come to a number of conclusions that will be very helpful for members to grasp as we move forward with this debate.

So the first conclusion in it is that the Federal Government's housing policy did play a significant and leading role in the financial crisis of 2008, and the ongoing bailout of Fannie Mae and Freddie Mac is over $150 billion and counting, and that dwarfs any and all other bailouts that occurred during the crisis.

The second conclusion is that specific entities, Fannie Mae and Freddie Mac, must be terminated and should never come back to life. And this is important for everyone, from members to industry, community groups and taxpayers, to understand that point. So I agree with the Administration that these entities must be put on a responsible path to dissolution. And I will work closely with the Administration to see ensure that is accomplished.

The third point, and perhaps the most important conclusion in the report, is that a purely private mortgage finance market is very serious and an achievable goal. Many supporters of the status quo preach doom and gloom for the U.S. housing market without a government guarantee. They would have us believe that any discussion of a purely private mortgage finance market is completely without merit and would return the housing market to its Depression-era status. But I believe the Administration plan ends this argument once and for all, that no one serious in this debate believes our housing market will ever return to the 1930s. So I applaud the Administration for taking this ridiculous rhetoric really off the table.

So now that there is consensus on these issues, we need to decide what steps to take next. Here, I also see a number of areas of continued agreement between the Administration and myself.

The first is a gradual increase of the guarantee fees. This is an important component of bringing more accurate pricing into the market. But any increase in these fees must correspond with an increase in FHA premiums in order to not push greater risk over there. So, again, I look forward to working closely with the Treasury on specific legislation we may need to accomplish that goal.

The next area of agreement is on the need to reduce the portfolios of the GSEs. Currently at $1.5 trillion, these portfolios pose a significant risk to the American taxpayers and don't serve any real purpose anymore. So I believe these portfolios can be wound down at a fast pace without jeopardizing the fragile housing market. I look forward also to discussing this with the Secretary in greater detail on how we must best shape that legislation to achieve that goal.

A third area of agreement is on the Treasury's support for higher downpayment premiums. I don't believe that downpayments are the only factor that should be used to determine credit quality, but I am pleased to see that we both recognize the fact that they play an important role in the underwriting process.

Fourth, is an agreement on reducing the conforming loan limits. To be able to afford a house at $729,000, a couple must make, they say, on average, around $250,000. This is the same level that some in the Administration and some of my colleagues on the other side of the aisle describe as being someone who is rich, making that much money. So I am glad that the Administration has finally decided that the government should basically be out of the business of subsidizing those people who are rich in order to buy a house.

And, finally, an area that we have strong agreement on is a need to create a covered bonds market in the United States. I agree that is not a cure-all for the system, but a covered bond market could provide significant liquidity benefits and help bring private capital back into the mortgage market.

So, as Ranking Member Frank so eloquently stated repeatedly during the former Administration's tenure, when that was the case, I do find it a little bit odd that I am here now this morning defending the current Administration and their proposals on so many fronts from their own party. But I do believe that it is an opportunity for us now to try to reach a broad-based consensus on all these issues in front.

And, finally, one final point of agreement that I failed to mention above but that is probably the most important is that we must never put the American taxpayer on the hook again for the failures in the private mortgage market.

And, with that, I thank you, Mr. Secretary.

Chairman BACHUS. At this time, I recognize Ranking Member Frank for 4 minutes.

Mr. FRANK. Thank you, Mr. Chairman.

I am struck at what a difference an election makes. I agree that we should be moving forward, and I am interested that we do have these areas of consensus.

But I do have to note a great disappearance. Perhaps the Inspector General can track it down. A year ago, my colleagues on the other side knew exactly what they wanted to do with regard to Fannie Mae and Freddie Mac. A bill was introduced about a year ago, in March of 2010. We heard, during the year, constant criticism from people on the other side that the legislation we adopted on financial reform didn't cover Fannie Mae and Freddie Mac.

My own view was that since we had, by legislation that was adopted in 2007 and 2008, put them into conservatorship, that the losses had been largely stemmed, that we were dealing with a situation in which they were very different than they were before, and that had bought us some time to think about what to do.

But that was a position which, last year, when they were in the Minority, was rejected by the other side. Indeed, there was a bill filed in March, I believe, by the gentleman from Texas, Mr. Hensarling. And, again, we were told that should have been included in financial reform. At the conference committee meeting, that bill was offered. And that bill was ready last year.

What I guess is—we used to have this question, what did the President know, and when did he know it? My question is, why did the Minority know something last year that they don't know this year? They knew last year what to do. They were very critical of us for not doing it. They talked about the urgency. Lo and behold, being in the Majority has apparently induced a form of legislative forgetfulness. They say that power corrupts. Apparently, in this case, it hasn't corrupted; it has taken away memory or knowledge.

Because, again, I don't understand why the committee is not now dealing with—this is our second hearing, I believe, on the GSEs. And that bill that they were so insistent on passing last year and were so critical of us for not passing seems to have faded away, and it is no longer there.

I understand that position. My own view is that it was a more complicated subject than their bill assumed, that because we had put these two entities into conservatorship by legislation which we adopted in 2007 and 2008 that the urgency was gone, in the sense that the losses had been stemmed, that Fannie Mae and Freddie Mac are operating and have been operating since they were put into conservatorship on a bipartisan effort in 2008 in a very different manner, and that this year was the year in which we should begin looking seriously at it.

I did say, at the time, that it was my intention to file a bill last December to get us started. When control of the House changed, it seemed to me that the reasonable thing to do was to acknowledge the fact that the Majority was in control.

But, again, I have this question: Where is the bill? It was all ready to go last year. Last year, there was this insistence on passing something and a criticism that it wasn't passed. Today, we have a very reasonable attitude of working with the Administration.

I think the explanation is that this is a harder issue to deal with than the Majority thought when they were in the Minority. I think it is also the case that they don't have the votes for the bill that they were pushing last year. And it is one thing when you are in the Majority and have to get something done; it is another when you are in the Minority.

But I would say this: The urgency does appear to have ebbed a little bit, because the people who are now in control and who knew since early November that they were in control have decided not to go forward with the bill they had last year, which they were so insistent should be passed, and apparently, they are now awaiting the Administration.

I have thought very hard to think of another issue on which this particular group of Republicans has awaited the leadership of the Obama Administration, and I haven't thought of one yet, but maybe this is the beginning of a trend.

Thank you, Mr. Chairman.

Chairman BACHUS. Thank you.

Mrs. Biggert is recognized for 2 minutes.

Mrs. BIGGERT. Thank you, Mr. Chairman.

Welcome, Secretary Geithner, and thank you for joining us this morning.

Page 2 of your written testimony says that, "The Administration and Congress have a responsibility to look forward, reconsider the role government has played in the past, and work together to build a stronger and more balanced system of housing finance." And I couldn't agree with you more.

As for where we should start, it is very clear that, in its report to Congress, the Administration only laid out options for a reform but has chosen to avoid a very tough decision for setting a single course of action.

Having reviewed the Administration's report to Congress, it is clear to me that Option 1 most closely resembles the kind of plan that the taxpayers expect from us. And I ask that today you work with our committee to not only establish a clearer framework but put in motion reforms that facilitate private-sector re-entry, eliminate the taxpayers' risk, and generate a vibrant housing finance system that serves creditworthy Americans.

For many years, it seems like Republicans on this committee have pressed to reform Fannie Mae, Freddie Mac, and the FHA. So it is my hope that today you can confirm your commitment to work with us. Housing is one of the most important cornerstones of our economy, and we have to get it right.

So, with that, I yield back the balance of my time.

Chairman BACHUS. Thank you. You still have 33 seconds left, and I will claim that time.

I do want to say that former Chairman Frank, who was the leading advocate for Fannie and Freddie, just gave us a history lesson. But, in 2003, he said that neither of these GSEs were in crisis and they did not need more regulations. Two years later, he said they ought to be pushed to make more affordable loans—i.e., subprime loans—not less. So that part of the history lesson was missing.

And our time has expired.

Mr. FRANK. Two minutes, Mr. Chairman? I will take 2 of my remaining minutes.

Chairman BACHUS. Two additional minutes.

Mr. FRANK. We have just heard a serious distortion of the facts.

Yes, in 2003, I didn't think Fannie and Freddie needed reform. You want to get into the history? In 2005, the chairman joined then-chairman Oxley in passing a bill to reform Fannie Mae and Freddie Mac which Mr. Wallison derided as "wholly insufficient." And it then failed because the Senate Republicans rejected the House Republican bill.

In 2007, when the Democrats were in the Majority, we did pass a bill which Mr. Wallison, the Republicans' lead witness on this, said was a very good bill. And it was that bill which led them to being put into conservatorship.

I would then go back to the gentlewoman from Illinois. She said the Republicans have been pressing for reform. Yes, the Republicans press for reform when they are unable to achieve it. But when they are able to achieve it, they don't press for it. We have to get these in-phase.

They were in power from 1995 through 2006 and passed a bill in the House which Mr. Wallison and the President of the United States, Mr. Bush, derided as insufficient. Last year, when they were in the Minority, they pushed hard for a bill which they told us was the answer, and this year it has disappeared, and they are now waiting for the Administration.

And the gentlewoman from Illinois said the Administration has avoided making the tough choices. In that, the Administration, if that is the case, resembles the Republicans, who aren't making the tough choices either. She said they are ready to reform, so what is stopping them?

The fact is that, in November, it became clear that the Republicans would take control of the House, and I am still waiting to see the bill. We had a bill last year. I guess I want to understand, what happened to that bill? What flaws were discovered in it? Why is that not being put forward?

And, yes, the fact is that in 2003, I underestimated the need for reform. I was wrong. By 2007, we adopted the bill that resulted, at the Bush Administration's request, in their being put into conservatorship, and it is why we now have the time, which the Republicans are taking full advantage of now that they are in the Majority, to deal with.

I yield back.

Chairman BACHUS. We have 2 minutes left on our side. I will claim the time in opposition.

Mr. FRANK. If the gentleman would yield, you are no longer in opposition. You have to get used to that. You have to produce.

Chairman BACHUS. That is correct; in opposition to what you just said.

When Chairman Oxley and I and others pushed for a stronger regulator for Fannie and Freddie because we felt that it was a captive regulator, then-Chairman Frank opposed that bill, voted against it, and actually said that Freddie had an accounting problem but that the people responsible had been dismissed. As we found out, it was slightly more than that, and they continue to have a problem.

I yield my remaining time to Mr. Neugebauer.

Mr. NEUGEBAUER. Thank you, Mr. Chairman.

I think, over 2 years ago, Members of Congress were asked to prop up Freddie and Fannie. We were told we really would never have to advance any money, that we were going to just overwhelm the markets with the size of Congress' commitment. Oh well, there goes that plan.

One of the things that was articulated at that time and the question I asked was, what would be the exit strategy? And the answer again was, we don't need an exit strategy because we will never advance any of these moneys. But here we are, over 2 years later, and billions more mortgages have been originated by these entities, which means billions more in contingent liability for the American taxpayers.

I appreciate the Secretary's report. I wish they would have taken a little bit stronger leadership, with a recommendation rather than alternatives, but hopefully we can get into more details about that today.

But I think it is important to understand that it is time to get the American taxpayers off the hook. They are tired of making their own mortgage payments and being responsible for other people's mortgages, as well. The time to start is now, not later. The time to start is now, because, as I said, today, while we have this hearing, millions more mortgages will be originated at these entities, and millions more commitments will be outstanding, which will put the taxpayers on the hook.

An important part of this solution is getting the private mortgage market back to operating again. We need to take steps to make sure that happens, so that, ultimately, the goal here is to, as my colleague, the chairman of the subcommittee, said, never, never, ever have the taxpayers on the hook for mortgages again in this country.

Thank you.

Chairman BACHUS. At this time, I yield 15 seconds.

Mr. FRANK. Yes, the bill the chairman boasted about voting for with Mr. Oxley is the one the Senate rejected, the President said was way too weak, and Mr. Wallison derided as way too weak.

As to Mr. Neugebauer, the argument he gave, "we are going to overwhelm it with money," yes, that was an accurate quote from Secretary of the Treasury Paulson under the Bush Administration. And he was doing that pursuant to a bill for which Mr. Neugebauer voted after cosponsoring an amendment that somewhat weakened it, in Mr. Paulson's view, but went through anyway.

I would ask that my remaining time go to Mr. Scott.

Chairman BACHUS. Mr. Scott?

Mr. SCOTT. Thank you very much, Mr. Chairman.

Welcome, Mr. Secretary.

And I wanted to just make a couple of points on the options that were presented in the Obama Administration's report.

For one, it says that Option 1, particularly, on privatization, I think—and I would like to know if you are concerned about whether or not private capital can meet the needs of the housing market with any kind of sufficient liquidity. It seems to me to be unclear whether or not there is enough private capital willing to fund such a system.

Under this option, the report is running on the assumption that if government support for the housing market is eventually removed, then private money will replace it. That is what we hear from our friends on the other side. However, if there is no guarantee this will happen, how can this option be viable? Isn't there a risk that the amount of private funding for the mortgage market will be substantially lower than the demand for mortgage loans?

And the other option in the report, proposed in the report, calls for a government option priced far away from market rates that can begin to lend mortgages in a time of crisis where private capital disappears. If this backstop is implemented, doesn't it resemble a sort of bailout, in the sense that it would protect private market agents without asking for any financial support from them in return?

And, finally, the report states that the Federal support for the housing market must acknowledge that not all Americans should be homeowners and that any future system must also include support for the rental-housing sector. However, the plan does not identify a specific proposal for dealing with the GSEs' multifamily programs. So what does the Treasury plan do in terms of reforming existing GSE multifamily programs?

Thank you very much, Mr. Chairman.

Chairman BACHUS. Thank you, Mr. Scott.

At this time, let me say, without objection, all members' written statements will be included in the record.

Chairman BACHUS. Secretary Geithner has to leave the committee at 12:30, and that is a hard stop. So we are going to enforce the 5-minute rule on all members; just be aware of that.

At this time, Secretary Geithner, you are recognized for your opening statement. Without objection, your entire written statement will be made a part of the record. And you are recognized for a 5-minute summary of your written remarks.

STATEMENT OF THE HONORABLE TIMOTHY F. GEITHNER, SECRETARY, U.S. DEPARTMENT OF THE TREASURY

Secretary GEITHNER. Thank you, Mr. Chairman, Ranking Member Frank, and members of the committee.

Two weeks ago, we laid out our proposals for reforming the housing finance system. The written testimony I submitted summarizes that report.

I am going to talk about our proposals for reform, but before I do that, I want to just emphasize what I think everybody in this room knows, which is that the housing market of the United States is still in a very difficult state. The damage caused by this crisis is still deep and very broad. Millions of Americans are still at risk of losing their homes. Housing demand is still too weak to quickly absorb the excess supply in the market, particularly with unemployment so high. And even with the economy growing again, it is going to take a long time for us to repair the damage caused by the crisis.

The Administration, working with the tools the Congress gave us, has taken a range of steps to help stabilize the market and reduce avoidable foreclosures—not all foreclosures, but avoidable foreclosures. These programs have helped catalyze millions of loan modifications and refinancings, and helped keep mortgage interest rates low. And they were successful in preventing much, much greater damage at a much greater cost to a larger fraction of American families.

Over the next 10 years, our estimates on conservative assumptions show that the total cost to the taxpayer of our support for Fannie and Freddie will be well below $100 billion. I think the current estimates in the budget are about $75 billion, but that does not take into account our proposals to gradually raise the guarantee fees. So if we were to implement this plan, we expect the ultimate cost to the taxpayer to be lower.

This process of reform will take years, as I said. And as we debate these options, we have to be very careful that our actions to reform the market do not jeopardize either the housing market itself or the broader economic recovery now under way.

Our proposal aims to achieve three key objectives on a responsible timeline. First, we want to wind down Fannie and Freddie and help bring private capital back into the mortgage market.

As you know, in the wake of the crisis, private capital fled the market and has not yet returned, leaving the government now to guarantee more than 9 out of 10 new mortgages. That assistance was essential in stabilizing the market and giving Americans continued access to mortgage credit, but it is not a long-term solution. We believe that under normal conditions, under a reformed market, the private sector—subject to stronger oversight and better standards of protection for consumers and investors—should be the primary source of mortgage credit and bear primary responsibility for absorbing losses.

Our report recommends a combination of policy levers to wind down Fannie and Freddie such as increasing guarantee fees, reducing conforming loan limits, and gradually tightening underwriting standards. And, of course, we are committed to supporting the continued wind-down of Fannie and Freddie's investment portfolio. These actions will help shrink the government's footprint in the housing finance market and help bring private capital back.

But we are not going to get private capital to come back into this market unless we fix the very substantial fundamental flaws that still exist in the mortgage market as a whole. So a second key piece of our reform proposals is to put in place reforms that will help provide a better market for private capital.

And that means giving consumers the ability to make better decisions about mortgages and protecting them from unfair, predatory, and deceptive practices. It means requiring participants in the securitization process to retain risk, and to improve access to information, improve accountability and transparency throughout the securitization process.

It means requiring banks to hold more capital against the mortgages they hold. And that is important, to make sure that banks are in a position to better withstand the losses that can come from future recessions. It means addressing the chronic problems we still face in the servicing and foreclosure process by setting national servicing standards and improving the incentives for the participants in that market.

Our third objective is to more effectively target the government's support for access to low- and moderate-income Americans to sustainable mortgage finance and to rental-housing options.

We think it is important that the government continue to help Americans get access to housing that they can afford. This does not mean, however, that our goal can be for all Americans to become homeowners. We want all Americans that have the financial capacity, the desire to own a home, to be able to take that step. But at the same time, we need to provide a broader range of affordable options near good schools and near good jobs for the 100 million Americans who rent today, whether they do so by choice or by financial necessity.

With those three broad objectives in mind, we need to begin the process, working with you, to decide on the long-term solutions to replace Fannie and Freddie. This requires a thoughtful, careful discussion with Congress and all the stakeholders about what the appropriate role of government is over the longer term.

We have put forward three broad choices. We do reject two. We rejected—considered, and suggest Congress not embrace either what you might call the "full liquidation privatization option," or what you might call the "full nationalization option," as many have proposed. So the options we proposed lie in the middle of those more stark choices.

Each of the options we proposed would produce a market where the private sector plays the dominant role in providing mortgage credit and bears the dominant burden for losses. But each has different advantages and disadvantages, and those need to be carefully considered.

In the first option, the overwhelming majority of mortgages would be financed by lenders and investors and would not benefit from a government guarantee. We would limit the government's role to the FHA's current job of providing targeted support for affordable housing and more affordable mortgage credit.

In the second option, the government's targeted assistance through the FHA would be complemented by a government backstop, available only in crisis, designed to promote stability and access to mortgage credit only in crisis.

And as a third option, alongside the FHA, the government would provide a form of reinsurance for certain securities that would be backed by high-quality mortgages. These securities could be guaranteed by closely regulated, carefully regulated private companies under strict capital standards and strict oversight and reinsured by the government.

In providing this narrower set of options and a set of criteria for evaluating them, we are hoping to encourage a careful discussion with the Congress about the ultimate reform option. And I think you all recognize that this will require some tradeoffs and difficult choices. As I said, each has advantages and disadvantages, and there is no easy solution.

Our challenge is to find the right balance between making sure that low- and moderate-income Americans can have access to mortgage credit, that we have a more stable mortgage market, that the taxpayers are less exposed to risk, and that we have the capacity in the future to do a better job of limiting the broader damage to the economy that can come from financial crises like we saw in this crisis.

Each of these options would require legislation. And our judgment is, we should work together to try to pass legislation within the next 2 years. If we can move more quickly than that, we would welcome that chance. But we can't put this off indefinitely or leave the market with too much uncertainty. That will make it harder to get private capital to come in and replace the role the government is playing today.

So our hope is that the Congress will work with us to find a consensus on a long-term solution and to make sure that we have the authority in the transition—the FHA is the authority—we have the authority in the transition to make sure we implement a carefully designed transition program that phases out the government role without damaging the process of repair in the housing market.

We look forward to working with you on this challenge, and I welcome the chance to answer any of your questions.

[The prepared statement of Secretary Geithner can be found on page 60 of the appendix.]

Chairman BACHUS. Thank you, Secretary Geithner.

Secretary Geithner, you have said that now is the time to reform the mortgage housing finance market, and I take you at your word.

The White Paper actually proposes four things that the Republicans have also proposed, as well as many Democrats: first, increasing the guarantee fees, so I think there is agreement there; second, increasing downpayments; third, reducing conforming loan limits; and fourth, winding down investment portfolios.

All of those can be done without legislation, can they not?

Secretary GEITHNER. They can, yes.

Chairman BACHUS. Could that begin today or tomorrow? Is there any reason why at least some of those could not begin even before legislation passes?

Secretary GEITHNER. In fact, we have already started, and Fannie and Freddie and the FHA have already started to raise guarantee fees or to change pricing and to change the basic standards that apply to their programs. But, yes, we can move reasonably quickly on those initial steps.

I think the challenge is to make sure that we are doing it in a gradual way that doesn't hurt the housing market or hurt the expansion under way. And what we propose is that the FHA and the FHFA—sorry for these acronyms—the Federal Housing Administration and the oversight body of Fannie and Freddie—work together to put out a set of recommendations for how they would implement a gradual plan to improve pricing and strengthen underwriting standards to phase out the government's role.

Chairman BACHUS. I think if you are going to, as you say, crowd out the private markets, you are going to have to begin to do these things now.

The American Banker, this morning, says that Option 3 is Fannie by another name. And also, part of Option 2, you say here that the Federal Government should reserve the right to backstop the mortgage and housing market during times of market stress.

Secretary GEITHNER. "Could" reserve the right.

Chairman BACHUS. Could. How do you define "market stress?"

Secretary GEITHNER. That is an excellent question. And that is one of the risks in thinking about just a system where you only have the emergency capacity to come in, in a crisis. That is a hard thing to do because it takes time; it is hard to scale those programs up quickly, and hard to design them carefully in a crisis. And, of course, it is a matter of judgment, when market circumstances might require the government sort of stepping in.

And as you have seen and as you would want, you would want the government to be very reluctant to do that. Because you don't want the market operating with the expectation that the government would come in too quickly or too easily in the future, even in the face of a recession. So that is a challenge. Among the many challenges in designing an emergency capacity like that are those.

Chairman BACHUS. If you are talking about falling housing prices as a reason to intervene in the market, falling housing prices could actually be constructive, in that they would make homes more affordable. So, as long as you have that backstop, it is almost an implicit government guarantee, in my mind. Am I wrong?

Secretary GEITHNER. Yes, I think there is a risk in that, but—and this is worth spending some time on—I don't think it is quite right to think about these things as a stark choice between a purely private market and a market where the government, in crisis or in normal times, is guaranteeing mortgages.

If you leave all these mortgages in the banking system, like many countries do, the government is still there with an implicit commitment to back the banking system. So if you look at the model that Canada and many European countries have adopted, where, in contrast to our model, they leave most of these mortgages with banks, the government provides a lot of support for banks, is very reluctant in those countries to let banks fail in a crisis. So the support is there, but it is just implicit; it is not explicit. Banks don't have to pay for that support. But it is not quite the private-market ideal that many people seem to think.

It is not fair to say that Option 3 is an option that would recreate Fannie and Freddie. And just know that I would not support that. Even if this group of people in this room thought that was appealing, we would not support it. I think it is—

Chairman BACHUS. We would not think that.

Let me close by saying, when you talk about the government in times of stress intervening, I almost think that is what we—and I have said for some time, the American people don't like privatizing the profits. In other words, in good times, the financial services industry, the lenders make money, and then in the bad times, you socialize the losses. And the American people have—November was about ending that. The American people are tired of taking the loss. And I think you would agree.

Secretary GEITHNER. You do not want to run a system in which the taxpayer is going to be on the hook when things go bad. That is not a system—to some extent, that will be inevitable in severe crises, because banks get in trouble in crises and government will be exposed to loss and that kind of thing. But you want to avoid that, to the extent you can.

And you are right to say it is very hard to know what level of stress would motivate what level of assistance. That is a matter of judgment. But what you don't want to do is leave the country in a situation where you face a severe recession, like we did in this context, and you can't do anything to protect the innocent from the collateral damage.

Chairman BACHUS. There will be market stress, and apparently there may be government guarantees, and we oppose that.

Ranking Member Frank?

Mr. FRANK. Of course, the Majority has the power to pass a bill that does anything it wants, so they don't need to ask the Administration's permission.

I want to come—lest I appear too partisan—to the defense of the leisurely pace my colleagues have chosen now with regard to legislation here, as opposed to the great urgency that they felt last year when they were insisting that we pass the bill as part of financial reform.

And the point is this: We have had allusion to the losses, but my understanding is that those losses overwhelmingly, almost entirely predate the conservatorship which Secretary Paulson asked this Congress to give him and which we gave him and which he then used in 2008.

So is it the case that, in fact, essentially since the conservatorship, the activities of Fannie Mae and Freddie Mac have not been incurring new losses?

Secretary GEITHNER. That, I think, is an accurate view. The losses that the taxpayer will ultimately be exposed to will be only, I think, in a general sense related to the loans made before the crisis.

Mr. FRANK. And that means before the legislation, which was initiated in 2007, that Mr. Wallison praised very heavily and which eventuated in the conservatorship of 2008.

We have recently been told that there may, in fact, be some money recovered, that the pre-2008 losses that go from the 1990s into 2000s, that they may be less than anticipated. Is that accurate?

Secretary GEITHNER. Yes. The losses keep coming down. Of course, the future is uncertain, and it depends a lot on how the economy does going forward. But the loss estimates are now coming down, as I said in my opening remarks. In the budget now, the current estimate is around $75 billion—between $70 billion and $75 billion. But that does not take into account the fact that we proposed to raise the guarantee fees carefully going forward, so that overstates the likely ultimate loss.

Mr. FRANK. All right. I apologize. I had to step aside.

Let me then cover one other factor. One of the arguments we have had is, a lot of this problem came because people were trying too much to help low-income people. And my own view has been that we have erred, bipartisan, over time, by stressing too much homeownership for low-income people and not enough for rental opportunity.

Fannie Mae and Freddie Mac have dealt both with multifamily, as my colleague from Georgia referenced, and single-family. As you look at the losses, were the losses equally distributed, or proportionally distributed between multi-family activity and single-family, or were they more on one or the other?

Secretary GEITHNER. I have to respond more carefully to you in writing on that question, but my impression is that the losses are concentrated in single-family.

Mr. FRANK. That is my impression, too, or I wouldn't have asked you.

And I do think that is very important because, as we tighten up in the single-family area, I hope that will not lead—and this has been—yes, I have been quoted in the past actually as talking about my support for affordable housing. I may have not been explicit about what I meant. I have primarily been looking for help for affordable multi-family rental housing.

And I hope that out of whatever proposal the Administration comes forward with and ultimately passes the Congress, there will be some effort to do what we do with the Federal Home Loan Banks. The Home Loan Banks, since the late 1980s, under the chairmanship of Henry Gonzalez, have been empowered to make mortgage decisions based on business decisions. And a fairly small percentage of the revenue that is generated then goes to help subsidize affordable rental housing, so that you don't pollute the basic business decision.

The other point I would make is this: As we go forward, in terms of losses, there are two factors that I think give us some reason for hope. Namely, part of the problem was that mortgages were, I think everybody agrees, improvidently granted. People differ as to how much was the fault of the borrower and how much was the fault of the lender and whether it was this or that, but, clearly, mortgages were improperly granted.

We now have two pieces of legislation that change that: first of all, specific prohibitions on no-document mortgages, on pick-as-you-pay, etc., in the financial reform bill; and, second, a requirement of risk retention and securitization unless you hit the qualified residential mortgage, which would be maybe a 20 percent downpayment.

Is it the case that the substantive reforms that we have adopted in the mortgage market give us a little bit more flexibility as we design this system going forward?

Secretary GEITHNER. They do. And I think they are very important. I think that any system that is going to work better in the future is going to require homeowners to hold more equity against the value of their homes, against what they borrow. And banks are going to have to hold more capital against loans, retain more risk. And you are going to have to have more conservative underwriting standards.

And a lot of that is mandated by the financial reform law that you helped to author, and a lot of that is already in place and is coming to fruition.

Mr. FRANK. I think that is very important to note, because we are looking at a better set of mortgages, going forward, as one of the safeguards.

Thank you, Mr. Chairman.

Secretary GEITHNER. Can I just say, Mr. Chairman, quickly that we very much support the emphasis on rental multifamily. I think the government did a lot of things in the mortgage market, a lot of them badly, a lot of them reasonably well, but too much of the support we provided went to homeownership as opposed to rental. And too much of the support we provided to homeownership went to relatively fortunate Americans.

Mr. FRANK. And you are going to get us the breakdown on how the losses were proportionally between single-family and multifamily. Thank you.

Chairman BACHUS. Thank you, Mr. Frank.

Our subcommittee chairman, Mr. Garrett, is recognized for 5 minutes.

Mr. GARRETT. I thank the Chair.

And to the ranking member, it really is hard to predict the future, which is what I guess he is trying to do right now. But he tried to do that back in 2003, as well, when he said, akin to what he is saying right now, "Fannie and Freddie do very good work, and they are not endangering the fiscal health of this country." The ranking member also said, "I think it is clear that Fannie and Freddie are sufficiently secure, so they are no great danger."

So the same statements that he is making now about how well-run Fannie and Freddie are and how well the underwriting is of the loans that they are taking in right now going forward, in essence, are really what he said in this committee back in 2003 about the loans that we were taking out at that time. And we all saw they didn't really turn out so well.

I am sure the Secretary will agree that the loans that they are taking out right now have not had the opportunity to, what, season, if you will, and that in reality you have to look at loans a little bit down the road to really see what the loss ratios are going to be.

Is that a fair assessment?

Secretary GEITHNER. True. But if you look at the estimates people have made at FHA of the future losses associated with the guarantees they have been writing since conservatorship, the estimates they make are not just modest—

Mr. GARRETT. And I appreciate that. I appreciate that. But, of course, those were exactly—you weren't here at the time, but those are basically the same arguments that were being made and that the ranking member was making at the time, as well. If you looked at the projections back in 2003, as the ranking member was saying, things didn't look so bad.

But let me close where I began. It is always hard to predict the future. The ranking member didn't do a very good job of predicting the future back in 2003. We will see whether his predictions are good this time.

Secretary GEITHNER. We don't—

Mr. GARRETT. But to your report, one of the common arguments we hear from the people who are supporting a Federal guarantee is that if you don't do it, the cost for homeowners is just going to skyrocket, with regard to homeownership in this country, and people won't be able to achieve the American dream.

So, to that point—and you have done your whole report and what have you—did you run any quantitative analysis in any one or all three of your options to determine exactly what the overall impact would be on the monthly payments for a consumer in order to get those?

Secretary GEITHNER. Let me just start with the following observation, which is that, under any of these options, the cost of a mortgage is going to be higher in the future. It has to be, because the government substantially subsidizes—

Mr. GARRETT. What about the monthly cost, though, actually? Not just the mortgage, but the overall monthly cost—

Secretary GEITHNER. I am going to answer your question, but let me just say, under any of those options, they are going to be somewhat higher than they were before the crisis, and they need to be. That is sort of a fundamental reality we face.

We have looked at a range of estimates, at what the ultimate impact might be on these options on the cost of a mortgage. But it is very hard to judge until they are defined more clearly. You cannot know until you look precisely at what version of Option 1, 2, or 3 or which mix of those options you would do. You can't tell. You know they will be higher, I think modestly higher, but different degrees of increase, depending on the mix of those options you ultimately embrace.

Mr. GARRETT. I appreciate that.

Let me just refer you to an economic analysis that was done. This was done by—some would call him a liberal economist—Dean Baker of the Center for Economic and Policy Research. His report looks at a 30-year mortgage, which is what we are talking about here, under a purely private system, and he says that will be about 90 basis points, as you are saying, more expensive than under a similar mortgage system where you have the government guarantee. So what you are saying is true: a little bit higher cost in his projections.

But then he goes into it a little bit deeper. He says, what would the overall cost be if you combine it with the medium price of, let's say, a $170,000 mortgage? And this is what he comes out with. He calculates that the monthly payment for the mortgage, what you are talking about, under a hybrid system would be around $833. Okay? Then he calculates that a similar mortgage under a purely private system would have a higher financing cost, is what you are saying. But the overall price of the house, then, would be less expensive, and the monthly payment would be only about $8 more. Okay, so a little bit more under that scenario, with a purely private sector.

Next, however, he factors in the monthly taxes that you will be paying on that house. And because the house now, under the hybrid system, the guaranteed system, would be more expensive, housing prices would remain high, the property taxes would be greater. He then finds—the final calculation is that the monthly payments under a private system would be about $4 less than under the hybrid system.

So, overall, you add all of it together, the higher mortgage price, the lower price of the house, and then the lower property taxes, it comes in between—a difference of about $4. Okay?

But even if his numbers are off a few dollars there, doesn't the fact that the numbers are so close to each other indicate, then, that a hybrid system really doesn't outweigh the cost of a private system, with all the inherent risks that go with it to the taxpayer at the end of the day?

Secretary GEITHNER. I don't—just like you just said, we should be cautious about predicting the future. I don't think you can make any of those judgments without knowing the precise details of what the government role is in this context. And I think it is almost certain that the costs to the homeowner, all in—

Mr. GARRETT. Right.

Secretary GEITHNER. —would be higher under Option 1 and higher under Option 2 than they would be in Option 3.

But under all those options, it is going to be somewhat more expensive to borrow to finance a home than was true before the crisis.

Mr. GARRETT. Thank you.

Chairman BACHUS. Congresswoman Waters?

Ms. WATERS. Thank you very much, Mr. Chairman.

Secretary Geithner, you have three options that have been presented. And I guess what you are saying is, any of these three would be acceptable to Treasury?

Secretary GEITHNER. No, I wouldn't say that.

Ms. WATERS. Tell me about Option 1. Option 1, as I understand it, is complete privatization, except the FHA is available to medium-income families only. That is similar to the Republican plan, except the Republicans don't want any FHA.

In this plan, if you are slightly above medium income, likely there would be no 30-year fixed-rate mortgages. You would have higher downpayments, higher interest rates. And, of course, an adjustable-rate, short-term loan would be the norm.

What is your position on 30-year fixed-rate mortgages?

Secretary GEITHNER. I think under Option 1, if I understand your question, a 30-year fixed-rate mortgage would be more expensive and harder to get than would be true under some of the other variants you could consider.

Ms. WATERS. But it would be acceptable to you if we adopted Option 1?

Secretary GEITHNER. No, I would not say that. I think the disadvantage of just Option 1, just to be fair about it, is that you would leave the Government of the United States with a more limited set of tools to protect the economy and the innocent victims in the face of the next severe recession.

And that is a disadvantage of Option 1—unless, under Option 1, you allow the FHA in the crisis to dramatically expand what it does. And if you do that, then the taxpayer will be more exposed to loss. Because what the FHA does is they provide very high loan-to-value mortgages, very low downpayment—

Ms. WATERS. So I am to understand that this is not your choice? You are not saying that this could be as acceptable to you as any other option?

Secretary GEITHNER. I would say it has some disadvantages the other options do not have. And, again, you have to be careful that you look at all of those advantages and disadvantages.

And, again, I would caution people on this side of the aisle to say that it would be tempting to look at the FHA-only option and say, oh, the government control will be more limited in that context. But that is not necessarily the case, because what it means is that all the risk is with banks. The government does provide support to banks. The guarantee is then implicit. The government doesn't pay for it. The taxpayer is not necessarily better protected. And if your only option in a crisis is to have the FHA scale up dramatically, the taxpayer is much more exposed to risk on an FHA product than it would be in those other options.

So don't look at that as such an appealing option. It looks like it is a more private solution, but it may not be in the end.

Ms. WATERS. Let me just—I want to get something into the record here. The Financial Crisis Inquiry Commission examined loan performance and found that mortgages bought by Fannie Mae and Freddie Mac were more likely than privately purchased loans to require a significant downpayment when borrowers had weak credit and were less likely to default.

For instance, GSE mortgages with a downpayment of at least 10 percent had a serious delinquency rate of 5.7 percent in 2008, compared with a delinquency rate of 15.5 percent among mortgages in private-label securities, the FCIC found.

Do you agree with that?

Secretary GEITHNER. I think it is true that the underwriting standards in the private market were worse than the underwriting standards—

Ms. WATERS. Okay. Let me continue.

Mortgages originated for private securitization defaulted at much higher rates than those originated for Fannie and Freddie securitization, even when controlling for all other factors. Overall, private securitization mortgages defaulted at more than 6 times the rate of those originated for Fannie and Freddie securitization.

And I guess this is a study that was done—"Securitization and Mortgage Default: Reputation Versus Adverse Selection"—by the Federal Reserve Bank of Philadelphia in September of 2009. Are you familiar with that?

Secretary GEITHNER. I am not familiar with that study, but the general pattern is correct, which is that the quality of underwriting standards in the private market was, on balance, worse, less conservative, less careful, than was true on the Fannie and Freddie guarantee book.

Ms. WATERS. You have alluded to the exposure to the taxpayers under the systems as we know them now. And you have basically concluded that it would be better to have the private market rather than the government guarantee. And if this is true, what I just read, and you agreed with it, how is that so?

Secretary GEITHNER. No, I would say it a little differently. I would say, right now the government is doing 90 percent of new mortgages. That is unnecessary—it is necessary today, but it is not necessary in the future. It would not be desirable for us to preserve that system.

You want to have a system where the private market plays the larger, the more dominant role, not the only role, but—

Ms. WATERS. But it is a riskier role?

Secretary GEITHNER. No, not necessarily, because it depends a little bit—

Chairman BACHUS. The gentlewoman's time has expired.

Ms. WATERS. Thank you very much.

Chairman BACHUS. The vice chairman, Mr. Hensarling?

Mr. HENSARLING. Thank you, Mr. Chairman.

And good morning, Mr. Secretary.

First, I would just like to say for the record and the ranking member, who unfortunately is absent at the moment but who appears to be obsessing over the timing of the introduction of my GSE bill, that as soon as he produces the GSE bill that he promised in the last Congress, I would be very happy to coordinate the timing of the introduction of my own bill.

And I would just note, as a general practice, Mr. Chairman, I try to improve my bills before they are voted on instead of after.

Mr. Secretary, in response to the gentlelady from California, I want to make sure I heard what I thought I heard. I thought she asked you, "Do you support the three options that were just presented?" And I think I heard you say, "Not necessarily."

And if that is correct, we waited 2 years for this? Did I understand your answer correctly, that you are not necessarily supportive of the three options you have presented?

Secretary GEITHNER. No. She asked me if I supported Option 1.

Ms. WATERS. Option 1.

Secretary GEITHNER. I will say this in response to any question, and this is very important for people to recognize—

Mr. HENSARLING. Let me ask you this way: Will you support Option 1? If you are not necessarily supportive of Option 1 over Option 2 or 3, will you support Option 1?

Secretary GEITHNER. Congressman, we played out three options for a reason: because they each have advantages and disadvantages. And we want this—

Mr. HENSARLING. Are you willing to support each of them? Yes or no? It is not a trick question. It is just a yes-or-no question.

Secretary GEITHNER. But this is an important thing. Remember, we are living with a crisis caused by a legacy of bipartisan failures designing the role of government in the financial system as a whole. So how—

Mr. HENSARLING. Mr. Secretary, if you would answer the question, I would be happy to give you time to give it some context. But it is a simple question. You are presenting three options. Are you willing to support the three options?

Chairman BACHUS. Let me say this, without penalizing the gentleman. We do want the Secretary to have an opportunity to respond to the question. And in fairness, we had a question last week which was just a yes-or-no answer. And it is sometimes hard to simply give a yes or no.

But I will go back to the gentleman and add an additional 30 seconds to the gentleman's time.

Secretary GEITHNER. The reason I say this is because—and this is why we started with options—because it depends a lot on how Congress designs them. And you could do a mix of these things that might be better than any of them individually. You could design Option 1 in a way that would have a very substantial role for a government in crisis that would be worse than the other options. You could design Option 3 in a way where the government has much less exposure to loss in a crisis. It depends overwhelmingly on how you do this. And critically—

Mr. HENSARLING. So, Mr. Secretary, if you could—and forgive me. There is a limited amount of time here. You are not necessarily supportive of any option, depending upon how it is written? Is that a fair assessment?

Secretary GEITHNER. It all depends on the design of the specifics in each choice. That is why you can't know what the effect would be on—

Mr. HENSARLING. Okay. Let me move on to another question, if I could, Mr. Secretary. On page 2 of your testimony, you say it is "very important to wind down Fannie Mae and Freddie Mac at a careful and deliberative pace."

You and the experts at Treasury have now had 2 full years to study the matter. What is the careful and deliberative pace? Media reports seem to indicate that you have said 5 to 7 years. I do not know if the media reports are correct. So what is a careful and deliberative pace?

Secretary GEITHNER. It is a careful and deliberate pace. I have said it will probably take somewhere in the range of 5 to 7 years. And that is based on the judgment that we need to move carefully because, by any measure, the housing market is in a state of substantial stress still.

But, of course, that judgment about pace, if you leave it to the government, will be designed by the FHA and the FHFA. It is not something that I can design. It is their authority to design.

Mr. HENSARLING. Mr. Secretary, in speaking of Options 2 and 3, I am still concerned about the ability of the government to be able to accurately price for risk.

Acting FHA Director DeMarco, before this committee in September, said, "The presumption behind the need for an explicit Federal guarantee is that the market either cannot evaluate and price the tail risk of mortgage default, at least at any price that most would consider reasonable, or it cannot manage that amount of mortgage credit risk on its own. But we might ask whether there is reason to believe that the government will do better."

Already, we know that the National Flood Insurance Program is $19 billion in debt. The Federal Crop Insurance Program has cost the Federal Government about $40 billion. PBGC has a reported deficit of $23 billion at the end of Fiscal Year 2010. Barclays believes that the FHA has dramatically underpriced its risk and could face losses of up to $128 billion. And we know that recently there has been pressure on the Deposit Insurance Fund of the FDIC.

Why should we have any confidence that government can accurately price the risk on Option 2 or 3?

Secretary GEITHNER. I share your concern about this. It is an excellent question, and it is one reason why you have to be very careful in embracing any of the three options on the table.

And you want to remove that decision about how you price the guarantee, if you have a guarantee, from any interference by the Congress. You want to keep it as independent of politics as you can. And one of the reasons why the government's record is so terrible in those programs is because you have subjected those judgments, which are very difficult, to excess political interference by some of the stakeholders in the system.

I will give you a few other counterexamples so that you don't lose hope completely in this context. If you look at the FDIC guarantee program in the crisis, all of the Fed's programs to prevent the financial system from collapsing, the government's investments in the banking system authorized by Congress, all those investments all had a form of guarantee, had risk in there, and were priced in a way that the government had a very, very substantial positive return.

It is not impossible. It is difficult to do, but if you are going to have a chance, you have to remove the judgment as much as you can from political influence.

Chairman BACHUS. Mrs. Maloney?

Mrs. MALONEY. Thank you.

First of all, I would like to welcome the Secretary and thank you for your leadership and your service. You have helped navigate us through one of the worst recessions in my lifetime and through one of the most significant reforms of our financial system in generations. I know it has been difficult. Thank you for your service and for the report that you have put before us.

I would like to ask, in one of your policy proposals you note the importance of retaining access to any future secondary markets by lenders of all types and sizes, particularly the community banks and the credit unions.

Could you elaborate on this issue and provide the committee with your recommendations on how to ensure access in the future system? Some people have written to me that they are concerned that it may concentrate the market in very, very few hands and would create more problems in the future for the financial security of large institutions.

Secretary GEITHNER. That is a very important question. I think you are right to say that there is a credible argument that if Congress were to embrace something more like Option 2 or 3, that would leave the mortgage market banking system too concentrated and create an unlevel playing field for community banks. That is one factor you have to look at very carefully.

What we want is a system where you have a better designed securitization market existing alongside banks, and we want to have a banking system that is not materially more concentrated than the one we have today. I think the fact that we have a system with 8,000 community banks and thrifts is a great strength of our system. We want to make sure they can play a very active role in the mortgage market going forward.

Mrs. MALONEY. But specifically, what would the Administration's proposals do to the ability of smaller lenders such as community banks to compete in the mortgage market and regional banks? Currently, small lenders are able to participate in the mortgage market by selling loans to Fannie and Freddie without having to go through one of the larger banks to accumulate enough loans to create a securitization pool. So how do you answer that challenge?

Secretary GEITHNER. That is one of the reasons why Option 3 is laid out the way it is. That would preserve the capacity for community banks to originate mortgages and then sell them into a market. It is harder for us to do that in either of the other two options. It is not impossible, but it is a little harder.

Mrs. MALONEY. Okay. Your policy proposals mentioned the development of a revenue neutral funding source to provide resources for assisting extremely low-income residents. Can you elaborate on what these recommendations involve and how would you envision them functioning?

Secretary GEITHNER. That is something we have to work with Congress on, but let me say the basic objectives. Where the government provides support to help low- and moderate-income Americans afford housing, we want the support to be transparent and on budget, carefully designed. We think it is appropriate for the government to find a financial means to provide support for homeowners through downpayment assistance who need it and for better options in the multi-family rental area.

There are a variety of different ways you can do that to raise revenues. That is something we have to work with Congress on. There are some examples out there that work reasonably well, some examples other countries have tried. That is something we have to work with you on.

Mrs. MALONEY. Also, as you testified in answer to Ms. Waters' question, the performance of Fannie and Freddie during this crisis has been good. They have had very few losses. But during this crisis, many private investors have fled the housing market because of weaknesses in the private CMBS market, and Fannie and Freddie's share, actually they have been expanding and helping us get through this crisis.

What guarantee do we have that the private sector will step in and provide the same support to expand housing opportunities here in our country, and could you elaborate on that challenge?

Secretary GEITHNER. There is no guarantee, and for it to happen again, you have to do two things. One is you have to gradually phase out the government's role, phase down the government's role, but you also have to make sure you have a clearer set of rules of the game in place for the private market, because investors won't come back in unless they know there is clarity on what the capital requirements are, the risk-retention requirements, what type of underwriting standards will prevail, what type of standardization procedures will apply, and what level of transparency there is going to be so investors can see into the risk in those mortgage pools. All of those things have to happen.

The financial reform bill lays out a framework for that to happen, and the regulatory community is gradually laying out those rules. But until we have a chance for those rules to be defined and to be in place, the private market is not going to come back in.

Mrs. MALONEY. Thank you very much. My time has expired.

Chairman BACHUS. Mr. Royce?

Mr. ROYCE. Thank you. Secretary Geithner, how are you? It is nice to see you.

There was in 2008 the agreement for the senior preferred stock purchase agreement that was worked out between your predecessor and the conservator at the time who worked on behalf of Fannie and Freddie. My concern is that if you took a step that would violate that agreement, the original terms of it, it would deprive the Treasury of obligated funds, it would unnecessarily absolve the two institutions that I think were really at the heart of a lot of the problems in the collapse of the housing bubble, and I think that there is an opportunity here to stay the course.

But I read yesterday in the Wall Street Journal that executives from Fannie and Freddie were trying to reduce the size of the dividend that is paid back down to 5 percent, and I was going to ask you if you were aware of any conversations between Fannie and Freddie or their conservator and any Treasury officials on that subject, and I was also going to ask you if the Administration would support a reduction or elimination of the dividend payment because I frankly think that would be the wrong message to send.

I say that because Fannie and Freddie had such a powerful lobby up here, and you and I have talked about that before. I know that the Fed felt the same way, that they were leaning in and basically pushing policies that in many cases created systemic risk. There was that perception. And that it was impossible really to counter the weight of Fannie and Freddie here in the Congress.

So, if they are now communicating again to change an agreement, and that at least was the report in the press, I would want to know and I would also want your reaction to it, Secretary Geithner.

Secretary GEITHNER. I will tell you what we are going to do, but, of course, we have to work with the conservator over at the FHFA in this context, which is the body Congress gave the authority to oversee these institutions. We are going to make sure that we wind these institutions down and that we do everything we can to minimize the ultimate losses to the taxpayer. Those things are going to guide our decision. We will look at any suggestion from the FHFA through the prism of does it support those two objectives. So any proposal that is designed to keep them in existence for the long term, we will resist; any proposal that carries the risk of increasing the ultimate loss to the taxpayer, we will resist.

I think you are right to highlight the risks that we saw in the system where you had this combination of private equity holders able to benefit from a guarantee, able to prevent effective regulation, and that is something that we are not prepared to preserve for the future.

Mr. ROYCE. I appreciate that. I will go to a second question I have, and that is, as you look at the financial crisis we found ourselves in, you have recognized that there was excessive investment in the mortgage market which helped facilitate, as I think you said, speculation: 30 percent of the homes at one point were people basically speculating on homes, flipping homes.

Do you believe there was a perception by investors in addition to that, that the housing market was too-big-to-fail basically at the time?

Secretary GEITHNER. I don't know. I think government policies encouraged distorted investment decisions, encouraged too much investment in housing, and I think that the market operated absolutely with the perception that Fannie and Freddie were too-big-to-fail.

The market as a whole—banks, credit rating agencies, investors—did not make decisions on the expectation that housing prices would fall materially over time, and that mistake pervaded private decisions across the country as a whole. Nobody expected or planned for the possibility that there would be a crisis where housing prices would fall this much, and that mistake itself was what caused the crisis.

Mr. ROYCE. We concur. But it sounds like from your testimony your preference would be basically to not have government intervention, or if you had a limited level of government support in good times, you could be in a situation where you would have in place a mechanism to expand and support the market in times of stress.

My concern about that is, if you believe there was a perception that the government would prevent the housing market from a downturn pre-bubble, why would we take steps to compound that perception going forward? You see, it does send that message again.

Secretary GEITHNER. I think there is a risk of that, of course, and I think that is one reason why you have to be very careful in defining any role for the government, even in crisis. Because, again, the risk is you create exactly the same types of problem that led to excess risk-taking in the boom.

But again, just living with the scars of this crisis, look what we faced in this crisis. You have to have the capacity in extremis to protect the economy from broader damage caused by a catastrophic financial failure. You have to do that. It is the obligation of government to do that. And one reason why this crisis was so deep and so traumatic was we came into this crisis without the tools necessary to protect the innocent in this context.

So whatever we do, we have to make sure we are preserving ultimately a better set of tools to again protect the economy, all businesses, the innocent victims, from the collateral damage that a severe crisis can come. Of course, if you do that badly, you will make future crises more likely, and that is why this is so complicated.

Chairman BACHUS. Thank you.

Ms. Velazquez?

Ms. VELAZQUEZ. Thank you, Mr. Chairman. Welcome, Secretary Geithner.

You discussed with Mr. Frank the fact that while Fannie and Freddie lost billions on securities backed by single-family mortgages, they actually turned a profit in their affordable multi-family portfolios. What lessons did we learn in terms of the multi-family portfolios, and what will that tell us regarding a proposal to reform the housing system and should this approach, this type of financing differently?

Secretary GEITHNER. I think the most important thing is in any reform proposal, we have to make sure we have a well-designed capacity for the government to help support multi-family housing and rental options. We have to do a better job than we did in the past. But, as you said, Fannie and Freddie give us a model for how to do that well and carefully and prudently, and that role would have to be assumed by the FHA at least.

But I think you are right to say there are a lot of examples of how to do that well, and how to do it not so well. We will take the best model available.

Ms. VELAZQUEZ. Mr. Secretary, for New York City, multi-family preservation transactions and special needs housing are particularly important. Can you give us more detail on the type of role that the new housing finance system should play in this market?

Secretary GEITHNER. Again, we have to respond in more detail in the coming weeks and months. But I want to say that we are committed to and I think it is very important to the Congress to provide a capacity for carefully designed but significant support for multifamily. Again, if you look back, too much of the support we provided went to single-family ownership options and much of that support went to people who were relatively fortunate in this country. So when the government provides support, we want to make sure that support is more targeted to low- and moderate-income families and more of that support goes for rental, not just for ownership.

Ms. VELAZQUEZ. Would you say that the FHA has the capacity to absorb the multifamily?

Secretary GEITHNER. I think the FHA does an excellent job in a lot of things, but they would have to do more in this area if they were going to provide the role, the substantial role we think is important. So they would have to take on some of the work Fannie and Freddie have been doing in multifamily.

Ms. VELAZQUEZ. If all the Administration's proposals for reforming the housing system are intended to greatly reduce the government's role in housing finance, how can we begin to withdraw government support from homeownership without placing undue stress on our financial system?

Secretary GEITHNER. You have to move very, very carefully. And we have started to move, but we are doing so carefully, because, again, we cannot afford to take too much risk that we jeopardize what is still a very fragile system, because as we all know, unemployment rates are very high and you have millions of homeowners who are still at risk of foreclosure, you have millions of communities where house prices are still under stress, and again, the huge amount of damage to the innocent victim in this context, and we have to be careful as we go forward.

Ms. VELAZQUEZ. Mr. Secretary, the Administration has proposed to let the larger conforming GSE loan limits expire in the next 6 months. In regions like New York City where the average home cost routinely exceeds the lower-limit threshold, can private sector lenders continue lending without vital liquidity from Fannie and Freddie?

Secretary GEITHNER. That is an important question, and you can't be sure. But in my judgment, at this stage, based on what we know, it is reasonable to expect the market to be able to absorb the impact of that reduction in conforming limits.

I will give you an example of why we think that is the case. I think it is true that in 2010, only 5 percent of the mortgages issued in that context were within that temporarily raised conforming limit threshold, so it is a relatively small share of the market. The market is coming back in that area. You can't be certain, but I think based on what we now know, we think the market is likely to be able to absorb that.

Ms. VELAZQUEZ. And if that doesn't happen?

Secretary GEITHNER. That is something Congress would have to reflect on. Congress would have to legislate actions to prevent those limits from falling. But we have to watch carefully. And, again, one reason why we have been so careful not to lock in a path for phasing out the government's role is, there is no certainty in this context and we have to be careful again not to do damage to the recovery.

Ms. VELAZQUEZ. Thank you, Mr. Chairman.

Chairman BACHUS. Ms. Biggert?

Mrs. BIGGERT. Thank you, Mr. Chairman.

Secretary Geithner, in my opening statement, I said that we have been looking at Option 1 on this side of the aisle. It seems that is what taxpayers want. Would you work with our committee on Option 1 to establish a clear framework, put in motion reforms that facilitate the private sector?

Secretary GEITHNER. Of course, we will work with you. But, again, I would be careful not to be too enthusiastic about that option because you want to recognize that the consequences of that could be more concentration in the mortgage market, less level playing field for community banks, and in a crisis, you might face the risk that in the end, your only option is a model in the FHA where the taxpayer may be more exposed to losses. And although it seems like a more private option, that risk will be in the banking system, and what that means is there will be a general implicit guarantee there the taxpayer doesn't get paid for, so there is risk in that option too.

That is why you have to look at them a little bit more carefully, and I would caution you from being too enthusiastic about the stylized versions of even that more limited option, even if you want a market that is more private than public.

Mrs. BIGGERT. I think it is a starting point, but I think when you are talking about the FHA, there has to be work at the same time with the FHA to make sure that the market goes right to FHA. So this probably would be an increase in the costs for FHA as the premiums increase for Fannie and Freddie so that we get the private sector in there. But there seems to be then a contradiction between the regulators and HUD as far as how this is going to work, because—or the Administration seems to be saying we have to reduce the role of FHA. But the regulators have what seems to be this restrictive QRM that will limit the opportunity for borrowers, especially I think the first-time borrowers, and things like having a 20 percent downpayment is really going to cause some problems.

Secretary GEITHNER. You made two points which are very important points. One is that you want Fannie and Freddie and the FHA to move together as they try to phase out the government's role. That is important and we are committed to doing that. They are going to commit to work together in that context, because, again, you don't want one moving and the other not moving and the business just shifting to the other.

But you are right, as you design these new rules of the game for risk retention for the private market, you also don't want to create a situation where you increase the incentives for the government to take on more of that role. You are right to emphasize that, and I think we can achieve that balance.

But I think if you look forward in the private market, I think we should return, as an objective return to a system where homeowners borrow less against the value of their house and have to put a higher downpayment. That is a very important protection. It is not the only thing you need to look carefully at, it is not the only determinant of loss rates, but it probably leaves the country in a better position if there is a bigger cushion of equity in people's homes.

It is their most valuable financial asset. People need to be able to move when they change jobs. If they can't move because they don't have the equity cushion, it is very damaging to the overall economy, and it could be very damaging to other people in their community. And so I think for the broader market, we want to move to a situation where people put more equity down in their homes.

Mrs. BIGGERT. I ran into former Treasury Secretary Paulson a couple of weeks ago, and he mentioned GSEs and said you better fix this, and what about being a public utility? I don't think that was too popular. But that is another thing. Did you ever consider that as one of the options?

Secretary GEITHNER. There are variants of Option 3 which people describe as having a public utility feature. Again, I would say the following things are true: If the government is going to provide a guarantee through FHFA or alongside FHA, you want it to be explicit, you want the government to charge for the risk of loss, you want there to be private capital ahead of the public capital so that private investors absorb the loss ahead of the taxpayer, and you ultimately want the taxpayer to be exposed to less risk of loss.

But what you don't want to do is have a system where there is this implicit guarantee or a guarantee that is not appropriately priced. Those are the things we have to avoid. But when people say the word "utility," again, you could have options—versions of Option 3 which would have that characteristic. You could avoid that characteristic in Option 3. It depends on how you do it.

Mrs. BIGGERT. Thank you. I yield back.

Chairman BACHUS. Thank you. Mr. Watt?

Mr. WATT. Thank you, Mr. Chairman.

Mr. Secretary, I guess I have accepted the notion without arguing that the private sector is going to be a lot more involved in providing mortgage financing and homeownership for upper-income people, and it seems to me that all three options, 1, 2, or 3, are really directed at how you structure that. What troubles me in this, what, 28, 29, 31 pages, is that there doesn't seem to be much attention to how low-income people can achieve homeownership. A lot more attention, with all due respect to Ms. Velazquez and her line of questioning, to how they would become renters.

But as I found it, I found one sentence in the whole report that holds out a hope for low- to moderate-income people to be homeowners. That sentence is on page 21. It says that the Administration would support downpayment assistance and counseling to help qualified low- and moderate-income home buyers in a form that does not expose them or financial institutions to excessive risk or cost. Nothing else in this report that I can find addresses low-income people having homeownership.

So the question is, how are you going to give—just give me some ideas about how you give content to that one sentence which is hedged at the end with the three options, or let's just be transparent that low-income people are going to become renters in this country, there is not going to be any homeownership at the low-income level. If that is where we are, I would rather know it and have the Administration say it up front.

Secretary GEITHNER. That is not our proposal. I am grateful for you to give me a chance to clarify this. Under any of these options, we want to make sure that the FHA is able to play the very important role of making sure that Americans with low to moderate income can have the opportunity to get a government-guaranteed mortgage with a very modest downpayment. So we think that is very important under any of those options.

Mr. WATT. I didn't see that in any of the descriptions.

Secretary GEITHNER. Central to each of these options, in any option, in our view, the FHA has to have the ability, should have the ability, Congress has to decide whether it will, to provide with a very modest downpayment the ability to low- and moderate-income families to borrow to finance a house. That is very important. There is a very good public policy case for that. So when we say that we have to do a better job of rental and multifamily, we don't mean at the expense of that critical role.

In addition to that, as you said, there is an important public policy question about how much equity, how much should you be required to put down, how much money should you be required to put down for an FHA-guaranteed mortgage. Right now, FHA will guarantee, I think, above 97 percent of the value of the house.

There are people who argue that even for the low- and moderate-income family, they are better off if they have to put a somewhat larger fraction of their income down at the time they purchase their house, so, again, if they have to change jobs or if there is a crisis, they have some cushion there for savings. That is why we propose that there be a targeted program funded by the government to provide downpayment assistance to people who really need that assistance, and it is that combination of proposals that are at the center of this reform proposal.

So thank you for giving me the chance to clarify that.

Mr. WATT. I am glad you clarified it, because I, for the life of me, didn't find any of that in these 31 pages. While I know you are walking a very, very delicate line here of not trying to agitate my colleagues on this committee, if we are going to have an honest discussion about this, I think we have to put those things on the table and be explicit about them and we can't finesse them or hide them or pretend that—that has to be done as a part of this process, not as a separate step, because if it is done as a separate step, it won't ever get done. Rich people will have homeownership and poor people will have—and rich people will make money on apartment rentals, but we will be a renter nation for low-income people.

I yield back.

Secretary GEITHNER. I agree with that, and you are right to emphasize it. And, let's just, again, to be fair, we did not do a good job in helping low-income Americans get access to sustainable housing finance options. We left them with a system where it was easy for them to be taken advantage of and they had none of the basic protections we think people need to be able to operate safely in a very complex business. So we did not serve them well in our current system. And a lot of the support the government provided went to much more fortunate Americans.

So we have to get that balanced better. But you are right to emphasize again, as we try to do, that you want to have a balance of support for homeownership and a balance of support for affordable rental options. Right now in the country, about two-thirds of Americans own their homes, and about one-third rent. But we put much more financial assistance into those who want to own their home than we do for those who choose to rent. We have to get that balanced a little bit better.

Chairman BACHUS. Thank you, Mr. Watt.

I would also ask all the members to look at pages 20 through 22, because I think including rental, affordable rental, because I think at least a quarter of our low-income families spend over half their income on rental income, and I do think there has been a failure in that regard, and the FHA, whether they have the capacity, I think that would be a goal of any reform to focus on low-income people in both rental and ownership.

Mr. WATT. I am glad to hear the chairman say that. I haven't heard much of that from your side of the aisle, Mr. Chairman. I appreciate that.

Chairman BACHUS. I think it needs to be part of the discussion. I think, as the Administration says, only about 32 out of 100 low-income families can afford homeownership, so you have to consider, as Chairman Frank said, affordable rental income, too. I can tell you, I think it will be part of the discussion.

Mr. Neugebauer?

Mr. NEUGEBAUER. Thank you, Mr. Chairman.

Mr. Secretary, thank you again for coming. This is a very important discussion. I am a little confused. I was kind of excited when I saw your report come out where you embraced—maybe it wasn't your number one, but it was the first recommendation was more of a private market solution. I heard you say we need to phase out Freddie and Fannie and we can do that with raising the risk premium so that the marketplace can create space in there. You lower the conforming loan limits, you create more space in there.

So along those lines, with Option 2 or 3 you have to go create something before you start that process, whereas—it says under Option 2, the government would also have to develop a backstop mechanism. Number three, it envisions a system where there is an explicit guarantee of catastrophic risk, and so you have to go establish some other mechanism in the system. Whereas in Option number 1, basically you are just creating space for a market that has been there before, and many of us think we can bring back. So to me that kind of delays moving down that road.

Secretary GEITHNER. Let me clarify that. We believe we have the authority, and the chairman said this at the beginning of the hearing, "we" being the FHFA and the FHA, the authority to gradually phase down the role of the government over the next several years while we work with the Congress to figure out which mix of options we want for the future. You don't need to delay that process until you lock in the ultimate design of what is going to replace Fannie and Freddie. You don't need to delay that. You can move ahead.

What determines the pace at which you can phase them out are really these basic questions about the gradual process of the repair of the housing market and our success in clarifying the rules of the game so that private capital will come in. That is what will determine the pace.

Mr. NEUGEBAUER. But, Mr. Secretary, you are going to send a very mixed signal to the private sector then if you say hey, we are ratcheting down, we are going to create space for the private sector, and, by the way, while we are doing that, we are going to set up these new mechanisms. I think the private market says, I think we will wait until you get the new system set up. So I think that is a road that you go down.

I think one of the things that the mortgage market needs now, because I have talked to a number of people all the way through that chain, is they need some certainty. So, I think as you start down that road, you have to make that commitment.

I think one of the things that I would ask you in order to create that certainty is, do we need a definitive date where the switch is turned over? Because at some point in time you have to say it, at this point in time, the taxpayers are not guaranteeing these mortgages.

Secretary GEITHNER. I understand the risks you are saying and I think you said it very thoughtfully. That is one reason why you can't delay indefinitely legislation that would define the ultimate solution. It is important to recognize that if we do nothing, if we don't legislate, Congress doesn't legislate, then we are left with authority under what is called HERA that in many ways would recreate Fannie and Freddie at the end of the process, in a slightly different form, with many of the risks in that context, and we don't think that would be prudent.

So you are right to say that you want to provide as much clarity about the endgame as possible, as quickly as possible, but to do that in a sensible way does require legislation. So it is a good reason to try to move. That is why I have suggested that this is something Congress wants to do within the next 2 years. You don't want to wait 3 to 5 years to do that.

Mr. NEUGEBAUER. One of the primary functions that Freddie and Fannie play is the aggregation, being able to bring the mortgages in and provide securitization. What about the idea of at some point in time just letting them, as of this wind-down, continue the aggregation function, but at some point in time, eliminate the guarantee and let them continue to act as aggregators and sell those securities to the private market?

Secretary GEITHNER. I think there is something to that and you can envision that being part of any long-term solution. There is a lot of talent in those institutions and there are a lot of very valuable systems that make that process work better. There is a lot of economic value in those systems. So you are right to say that depending on where Congress goes with this, you might want to find a way to preserve what is still very valuable in both the people and those systems.

Mr. NEUGEBAUER. Is one of the ways, in other words, the portfolio that Freddie and Fannie have, they are supposed to be reducing those. What we understand is that is kind of a tricky situation. They are selling off, they are rolling off some of that, but actually they are bringing loans out of some of the securities and bringing those in and reworking those by repurchasing them.

Is there merit in letting Freddie and Fannie sell off some of their portfolio in a non-guaranteed portion? What I worry about is they have the interest rate risk, so obviously when they sell those securities, that interest rate risk goes on. But if they sell them with a guarantee, then basically the risk is still there, and I am looking for ways to minimize the taxpayers' exposure here.

Secretary GEITHNER. I agree with you. You are right, as you said in the beginning, that by gradually winding their role down, and there really is no alternative to doing it, they are still issuing guarantees, so there is some risk of exposure to the taxpayer in that process. But we just see no alternative to that. You can't flip a switch today and have the private market come in and take over 90 percent of the market again. It is just not realistic, as you know. So there is no real option except for them to be issuing guarantees, but more conservatively underwritten, more expensive over time, through this transition process.

You are right that their retained portfolio includes a lot of their own guaranteed mortgages, so if they sell those into the market, they are still guaranteed in that context. I just don't see a better way to—I don't see a way to solve that basic problem. We are living with that. That is the price of the mistakes of the past. Our job is to make sure that, again, we wind them down in a way where we reduce the risk of loss to the taxpayer ultimately over time, and I think we are doing a very good job of bringing down those losses, those estimates, carefully over time. But we are going to stay at it, and it depends a lot on the quality of the judgments that the FHA makes, and the FHFA makes.

Chairman BACHUS. Thank you. Mr. Ackerman?

Mr. ACKERMAN. Thank you, Mr. Chairman.

Thank you, Mr. Secretary.

You have stated that the GSE loan limit is going to be lowered from its current elevated level of $729,000 to $625,500 starting in October of the current year. In my district, which is in New York City and Long Island, the median home price is about $500,000. That doesn't mean that a person having a home that costs them $600,000 is living in some extravagant home. Home prices are based on a number of things, including the cost of the actual construction and the location and cost of living. That same $600,000 house in my district, which would be a fairly modest house, would cost under $300,000 in a lot of other places in the country, so these aren't necessarily people who are living extravagantly.

This is going to affect my constituents tremendously and they are going to be among the first to feel the effects of the larger role of the private mortgage market.

What can people like that or my constituents and other people in other parts of the country expect in terms of credit availability and interest rates, given the fact that private capital has been largely absent over the past few years and that the GSEs have been a participant in over 90 percent of the loan originations? In your view, is the private market ready to come back and do they actually want to play a role or will the trauma of the past few years make them hesitant to lend or hesitant to lend at least at what most people today consider reasonable rates?

Secretary GEITHNER. That is a very important question. The way the law of the land is written now, without action by the Congress, those limits do come down, but they still preserve the capacity for differentiation. So they will still be higher in parts of the country where home values are much higher than they will be in other parts of the country.

Mr. ACKERMAN. You are talking about the rates?

Secretary GEITHNER. When the conforming limits, if they are allowed to revert or come down in October, without action by the Congress, that is what happens, they still are differentiated to reflect the very different factors driving home values. And I think the private market now is not—

Mr. ACKERMAN. You are saying that there would be a regional cost-of-living adjustment?

Secretary GEITHNER. There is a differentiation in the way the law is written now, and I think that is very important to preserve. I think, again, for this transition process we are going through, you need to have more differentiated limits to reflect the very different factors that affect home values throughout the country. That is very important.

You asked whether the private market is coming back yet for those higher-value mortgages, and I would say not that much yet. It is a very slow, gradual process. And one of the reasons why we want to proceed so carefully is because we want to be careful not to again jeopardize the recovery, jeopardize the prospect for growth and repair of the housing market.

Mr. ACKERMAN. Is there a rate card or a scale that is available?

Secretary GEITHNER. There is, but I don't have it with me. I would be happy to share it with you.

Mr. ACKERMAN. Thank you very much.

Chairman BACHUS. Thank you, Mr. Ackerman.

Mr. Miller?

Mr. MILLER OF CALIFORNIA. Thank you, Mr. Secretary. It is good to have you here today.

We tend to be focusing very specifically on Freddie and Fannie, and yet when you look at the housing downturn, it has been global. But the problem I have is I don't think we are looking at the problem in the marketplace. And we keep talking about Freddie and

Fannie's default and the failures they have had and the money they have lost.

As I see it, the GSEs, Fannie's seriously delinquent loans are about 4.2 percent. That is not a good number. Freddie's is about 3.1 percent. That is not a good number. Subprime ARMs delinquent that are not agency loans, 38.7 percent. Subprime loans delinquent, non-agency, 26.5 percent. Even in your prime loans, private sector loans, just delinquent is 5.4 percent. There is a problem here. We are shining a light on Fannie and Freddie, but we are not saying there is something seriously structurally wrong with the entire market.

Looking at all the numbers I have seen, you keep talking about your affordable housing goals. Freddie and Fannie, in 1998 and 2000, basically started trying to compete with the private sector, became very lenient in their underwriting standards, to raise their percentage of the marketplace. It was like a race to the bottom. Yet if you look today, they are outperforming the marketplace, and they are basically performing their goal, they are providing liquidity in a stressed marketplace: FHA, VA, Freddie and Fannie, 92 percent of the market.

We are not addressing the problem. The loans you are making today through Freddie and Fannie are performing very well. Yet the loans that are performing the best in high-cost areas you are wanting to completely eliminate. So let's eliminate the high-cost areas where people likely are able to perform in and just take that sector out.

My concern is we are saying we are going to bring the private sector dollars into the marketplace. Where were they at in 2005–2006 when the market was heated? You had Countrywide selling junk to the marketplace. The only bundled securities you had that were any good were the GSEs. All of those mortgage-backed securities by the private sector are worthless, in many cases.

So we are not addressing the serious problems in the housing industry. We are saying we are going to get the government out.

But another problem I have is when the TARP funds were issued to the private sector, you were charging 5 percent. You are charging Freddie and Fannie 10 percent. Are they paying it?

Secretary GEITHNER. As you know, in a sense—

Mr. MILLER OF CALIFORNIA. My question is, why would we charge them double if we are trying to not create more of a problem than we are charging anybody else? We are not paying 10 percent for money, the Treasury. When you sell notes, you are paying very little. Yet you are saying Freddie and Fannie are seriously distressed today, so let's charge them 10 percent interest on the money we forward them. How much sense does that make?

Secretary GEITHNER. If it makes you feel better, in effect the taxpayer is paying that. It is one hand paying the other.

Mr. MILLER OF CALIFORNIA. But you are going to get the money back from them.

Secretary GEITHNER. No. As I said, we are not going to recover fully the amount of investments the taxpayer put in. It is not possible. But it is going to be substantially lower than anybody thought it would be.

Mr. MILLER OF CALIFORNIA. What do you think it would be?

Secretary GEITHNER. In the budget, we estimated somewhere around $75 billion, but that doesn't take account of the fact that we are going to raise the guarantee fees gradually over time. So it will be less than that. That is an extraordinary amount of money.

Mr. MILLER OF CALIFORNIA. $75 billion is a lot of money. If Freddie and Fannie had not been there in 2007, 2008, 2009, 2010, what kind of a hit do you think housing values would have in this country when there was nobody to make the loans? Because you can't tell me the private sector was there, because they are not.

Secretary GEITHNER. I don't think we are disagreeing as much as you think. You are absolutely right—

Mr. MILLER OF CALIFORNIA. You are talking trillions of dollars.

Secretary GEITHNER. It would have been much, much more devastating than anything we faced, much more devastating.

Mr. MILLER OF CALIFORNIA. If 61.5 percent of all the taxpayers in this country own a home, and we allowed the values of their homes to go down by trillions of dollars—

Secretary GEITHNER. I agree with you completely.

Mr. MILLER OF CALIFORNIA. Who is getting hurt worse?

Secretary GEITHNER. I agree with you completely. That is why I say that as you examine the future options, be careful to make sure you preserve some capacity for the government.

Mr. MILLER OF CALIFORNIA. Why don't you give—

Secretary GEITHNER. To protect the economy and the innocent victims from the kind of crisis we went through.

Mr. MILLER OF CALIFORNIA. You have to have the numbers. Why don't you go back and tell us what year they started to make the loans that had a higher propensity of default rates and why that occurred. I looked at Freddie and Fannie. They ratcheted up in 1998 and 1999 and specifically 2000, completely ratcheted down their underwriting standards. Those two went in different directions. This did not have to occur.

Secretary GEITHNER. It was preventable. They pulled the market down, I agree with you.

Mr. MILLER OF CALIFORNIA. Before we make a huge mistake, would you get us the data that says why they went wrong and when and where so we can analyze the problem rather than throwing the baby out with the bathwater? Because Fannie lost money in 1985. Freddie never lost a dime in their history until recently. Let's go and find out why they lost money, rather than just saying they are the bad guy while they are outperforming the rest the marketplace. I would love to have an hour to talk to you.

Secretary GEITHNER. Don't let them off the hook, because they made a lot of mistakes and did not hold capital against those losses, and Congress made it possible for that to happen.

Chairman BACHUS. Your time has expired.

Mr. Sherman?

Mr. SHERMAN. Yes. I would like to build on Mr. Miller's questioning.

There is this view that lenders lost money because they made bad loans. That was true at the beginning. But then with housing prices declining, lenders lost money when they made good loans, because if you make 100 good loans, with at least some of them, you are going to have a divorce, you are going to have some guy who loses his job, somebody is going to die, you are going to have a health crisis. And in the old days, pre-2007, that would happen a typical amount of times, and they would sell the house at a profit.

Anybody who invested in good loans, prime, people who really documented their income, still lost money. I don't know. To what extent are Fannie and Freddie's losses due to their subprime and Alt-A lending, which was a small part of their overall portfolio, and how much of their losses are due to losses on prime loans where you just had an unexpected level of default and yesterday's profitable sale is today's short sale.

Secretary GEITHNER. I would be happy to give you the numbers in more detail, but since most of their book is prime, most of the losses are on the prime. But still, they lost a substantial amount of money in what they did in Alt-A.

Mr. SHERMAN. And yet if the most pristine and conservative banker started his bank in late 2008 for the purpose of making the most prime of loans, I am sure they lost money on the loans they made in 2008 and 2009.

Secretary GEITHNER. For the reasons you said, but also because when unemployment goes from 5 percent to 10 percent, people lose their jobs and that huge shock to income, you are going to see a big increase in default rates.

Mr. SHERMAN. The issue before us short term is the conforming loan limit. In Los Angeles, it is easy to get a $20 million loan to buy a home in Malibu, because if you are buying a home in Malibu, you either know your banker or you are the banker. But it is almost impossible to get a loan in the $800,000 range.

What could happen to this economy if we precipitously allow that $729,750 that applies to roughly 10 major metropolitan areas, including Gary's and mine, what happens if that were to precipitously drop? What is the effect on housing prices in Los Angeles and New York?

Secretary GEITHNER. As I said several times, I think you need to be very, very careful as you look at what to do with conforming limits with guarantee fees, with underwriting standards, that we not magnify the pressures on a still very delicate market. Again, the failures we produced, that this government produced, were, just to be fair, they were bipartisan failures, and we have to be very careful as we try to fix what is broken, we don't make this crisis worse for people. I think that is a responsibility everybody shares here. So we have to be careful as we do it.

But I do believe that it would be prudent based on what we now know today for Congress to let those conforming limits fall modestly, as they are scheduled to do at the end of this year.

Mr. SHERMAN. Speaking for those who are trying to buy and sell homes in Los Angeles, I don't know if you create a double-dip recession nationwide, but you certainly do in many areas, including the second largest metropolitan area. I would point out that the failures of Fannie and Freddie are bipartisan, but they are unicameral. The House of Representatives passed a bill that was carried through this committee under Republican leadership that former

Chairman Oxley explains would have prevented this crisis, and it was over on the other side of the Capitol where others blocked it.

Finally, if we go bad bank-good bank, then the new GSEs' profits belong to someone else rather than those profits being used to pay what we hope is less than $75 billion in losses. Doesn't it make sense to make sure not only that future operations are profitable, but that those profits are used to repay the taxpayer?

Secretary GEITHNER. I agree. And I don't think—I haven't seen a good bank-bad bank version that would achieve the objective of minimizing risk of losses to the taxpayer.

Chairman BACHUS. Thank you.

Mr. Campbell?

Mr. CAMPBELL. Thank you, Mr. Chairman.

Mr. Secretary, in your comments you talked about the continuing wind-down of Fannie and Freddie's investment portfolios at a rate of no less than 10 percent annually. Some of that is wind-down. Some of that, however, will be selling into the marketplace, which we have discussed before.

What has been done in that regard thus far, and does this mean that we are going to be selling off 10 percent of Fannie and Freddie's portfolios into the marketplace in the balance of this year?

Secretary GEITHNER. I can't tell you precisely the mix between natural runoff and what would be an actual sale, but I can say that based on the experience so far, the market has been able to absorb the wind-down on that pace. I am happy to provide more details to you on that.

You can't be certain how the market is going to evolve in the future, but we think that it is reasonable and prudent to adhere to that path.

Mr. CAMPBELL. And you do expect to be selling—obviously with interest rates where they are, some of this can be sold off at a profit?

Secretary GEITHNER. I want to be careful how I say it. I can say for the Treasury portfolio that would be the case.

Mr. CAMPBELL. Okay. I suspect you know this, but in terms of the three options of where we go in the future, there is not unanimity here.

Secretary GEITHNER. That is my impression.

Mr. CAMPBELL. On either side of the aisle. So I will confess that I am a public utility model type guy. It sounds like you don't particularly like that term, so let's—I guess it falls within Option 3 in your set of options. Let's call it instead something where there is a guaranteed or Federal reinsurance that is available to multiple entities that is, as you suggested, explicit and limited, as opposed to the Freddie and Fannie model where the guarantee was implicit and unlimited.

What is your reaction to that sort of model going forward?

Secretary GEITHNER. I think it has a lot of merit. But, again, you want to be careful to design it in a way that makes sure you meet those tests. Again, I want to emphasize something that Mr. Hensarling suggested earlier, which is if you are going to have the government provide a guarantee, through the FHA or through some hybrid mechanism like you described, what you need to make sure is that it is priced to cover risk of loss, the taxpayer is substantially—the taxpayer is behind a bunch of private capital in that context, not ahead of it, and you want to make sure that you leave politics out of the setting of the basic fee. That is very important. And you can't create a system that is going to be vulnerable to your successors and lobbyists and other stakeholders trying to put pressure to underprice those guarantees in the future.

Mr. CAMPBELL. I couldn't agree with you more on those points. If we don't do something like that, if we do something that has less involvement, my concern, the housing market is such a huge portion of the economy, as we witnessed in 2008, if left without some stability provided by the government, you will have vicissitudes as banks, which they often do, they get all excited and all of a sudden they want to loan everybody in the world money for a house, and then after they have some losses, all of a sudden they don't want to loan to anybody for a house. This happens in other segments of the economy and it affects those segments, makes them very volatile, but it doesn't have that huge an effect on the overall economy because they are not that big. But the housing market is so big if we subject it to those vicissitudes, I am afraid that we will have some significant additional volatility in the overall economy. Do you agree?

Secretary GEITHNER. I think there is that risk, and you state it very well, and that is why I want to emphasize over and over again that when you look at alternative models that look like they have more of what people say is a private character to it, a more purely private character to it, most of those systems out there involve banks holding all of that risk. And, as you know, the history of financial crisis is largely a history of banks and real estate together, and the government ultimately is there, it is just behind the banks with this implicit support that they don't charge for. So it still leaves the taxpayer exposed to loss.

So, again, the really difficult challenge is to try to make sure you have a system where you have more conservative standards for underwriting, homeowners hold more equity in their homes, banks hold more capital against risk. The government is very limited.

Mr. CAMPBELL. Let me sneak in one final question here. You talked about how we may have higher downs, that will require higher downs, and that there may be higher costs for mortgages for moderate-income people, etc. How can we reconcile that, taking rental aside, but for low-income people then saying no, we are going to have modest downs and perhaps no more increase? In other words, how can we tell moderate-income people that it is going to be harder to buy a house, and for lower-income people, it is going to be easier?

Chairman BACHUS. Let him answer the question.

Secretary GEITHNER. That is an excellent question. Again, that is the kind of judgment Congress has to make. But my own view is that there is a good public policy case for the government providing some assistance for low- and moderate-income Americans so they can afford that first house. I would want to try to preserve that, carefully design it in any system going forward. But that objective is consistent with returning our system to a system where the private market plays the major role in housing finance, and if we get better oversight, better capital requirements, better underwriting standards, we will have a more stable system.

Chairman BACHUS. Mr. Capuano?

Mr. CAPUANO. Thank you, Mr. Chairman.

Mr. Secretary, this is all very interesting, but I think we are mixing a lot of apples and oranges when we are talking low- and moderate-income housing and Fannie. The truth is we are not even talking today for some reason about HUD or about tax credits or all of the other things that go into low- and moderate-income housing. And I have to tell you, Option 1, Option 2, Option 3, I feel like asking, can I get a salad instead of soup? It is hard for anybody to follow.

Secretary GEITHNER. Would you like the salad and the soup?

Mr. CAPUANO. I would love to, if I could, but I don't think we can afford that. For me, I look at housing as we all do. We all come to the table with our own experience.

I live in my first and only owner-occupied two-family home. I don't know if there is anybody else on this panel or in this room who lives in their own two-family home. I bought it because I couldn't afford a single family home. My children went to college on the basis of remortgaging that home. If I didn't have that home, my kids could not have gone to college. Even with that, they came out with significant loans.

So, for me, I really want to get to the bottom line. When we are done, I would like to know the Administration's goal on numbers. When anybody I know walks in to get a mortgage, they don't care who it comes from. They probably don't even know, Fannie Mae, FHA, private. They just want to know how much, what is it going to cost me, and will you give it to me.

And for me, I come from one of the markets like most of the people in this top row, I come from a very expensive market. Most of the people in my district probably would never or seldom qualify for a Fannie loan. They just don't, because the houses are too expensive even with the new numbers. Some do, but not many.

But we have a lot of young people in this room today, many of whom I am willing to bet do not own a home, and if I were them, I would be asking, when is it my turn? If a young couple, two good jobs, good education, making $100,000 together, paying rent, probably paying student loans off, paying one or two auto loans off, trying to put something aside for everything else, what do you think is a fair amount to ask them for a moderately priced home? Again, that number changes. Mr. Ackerman is 100 percent right, Mr. Miller is right. A moderately priced home in my district is a castle in some of the other places for the numbers.

But a moderately priced home, what do you expect them to pay? Do you expect them to pay 20 percent down? Do you expect them to pay 7 or 8 or 10 percent? How are they ever going to be able to get this together and how will they ever hope to afford to send their children to college?

Secretary GEITHNER. That is an excellent question, and let me just say it again, we think it is very important to make sure that the FHA, which is HUD through the FHA, still has the capacity to provide mortgages at reasonable cost to people who cannot afford to put a lot of money down on their house.

Mr. CAPUANO. I want to be clear. I am not talking at the moment about people who have a lower education or have limited income. I am talking about the people in this room. All of the ones that I know are very well educated, very intelligent, making decent incomes, and have probably a reasonably decent future. But as they are living their daily lives, it will be almost impossible for them to put aside, on top of rent and student loans, $60,000, $70,000, $80,000 for a downpayment and then qualify for that, especially for young women who may want to have a family someday.

How are they going to be able to do that if we don't address the long-term goal? How much are they going to pay? What is that goal?

Secretary GEITHNER. Again, in this system today, and I think we would want to preserve part of this, you would be able to go to the FHA, you would have to go to a bank and get an FHA-guaranteed mortgage and only have to put down a very small fraction of the value of your house, and I think that is appropriate to try to maintain for people of low and moderate income.

Where Congress defines those lines is a choice for Congress to make. For the rest of the American people, we want to have a system where the private market provides that finance, and we think that is possible.

Mr. CAPUANO. I think I am talking about the vast majority of the American market. I am not talking about the lower end. Maybe I am wrong, but all the young people I know in this room are very intelligent people. They are going to have a great future. They are not the low end of the socioeconomic scale. They are going to have a great future. How are they going to get in?

Secretary GEITHNER. I said low and moderate, but, again, this is the fundamental choice and you are right to raise it, which is the way to ask the question is, is it fair to ask all Americans to put their money at risk to help subsidize access to housing for more fortunate Americans? Where you draw that line is a judgment Congress has to make. You are right to say that if you put it too low, it will still be unfair.

Mr. CAPUANO. For me—and I guess that we all have to ask ourselves that question—I am not interested in pulling up the ladder because I got lucky enough to get my house. I have children; I want them to be able to afford a home someday, a reasonable home in a reasonable neighborhood, as I do everybody else in this room.

And I have to think—I agree with you, those are the questions we have to ask ourselves. It is also the question the Administration has to ask. And as we go forward, though I appreciate all the esoteric academic exercises we have to go through, in the final analysis, it is about how much. How much are we going to ask for them?

And I think this Administration has to do a little bit more—

Chairman BACHUS. Thank you, Mr. Capuano.

Mr. CAPUANO. —than this White Paper to help us answer this question.

Thank you, Mr. Chairman.

Chairman BACHUS. Mr. Pearce?

Mr. PEARCE. Thank you, Mr. Chairman.

Thank you, Mr. Secretary, for being here.

I am still trying to get my hands wrapped around the comment that you made that we just need the tools to protect the innocent. With all due respect, when you have a policy of "too-big-to-fail," then you have a policy of "too-small-to-succeed." That is the State I represent, New Mexico. So when you all—you, the regulators—suspend prompt corrective action for all the big banks, all the small banks still have to comply with prompt corrective action. And it is very punitive on the small banks.

You indicate on page 3 that you are worried about sufficient capital. When Basel II was agreed to back in 2003 or 2004, we allowed the big banks to determine by models their own capital requirements. So are the big banks still allowed to determine the capital requirements under Basel II, or is that something that you have changed? Is that one of the tools that you have—

Secretary GEITHNER. I want to make it clear, I would never support a system where you allowed banks to choose how much capital they hold against risk.

Mr. PEARCE. Am I incorrect that Basel II basically allows them to set their models and declare their own capital requirements? Is that a mistake on my part?

Secretary GEITHNER. Because Basel II took so long to put in place, it actually never applied in this context. Under Basel III, banks have to hold more capital against risk, and they don't get to decide.

Mr. PEARCE. But Basel III is not in effect yet.

Secretary GEITHNER. No, but it will be.

Mr. PEARCE. Oh, okay. That is—as long as it is not in effect and II is.

What about the mark-to-market? When I was—back in my district, in about 2008, I had Indian hotel owners who dominate in New Mexico—it is a small market, kind of low margins—and they were being told they had to come up with $750,000 in new capital for a $2 million or $3 million facility because of the re-evaluation of the mark-to-market rules.

So is that, sort of, protecting the innocent there when the—

Secretary GEITHNER. You are not going to find me disagreeing with you that you want to have a system where you don't create these perceptions of too-big-to-fail. And I believe very strongly that large institutions need to be forced to hold more capital against risk than relative to small institutions. So if that is your view—

Mr. PEARCE. If I could catch you right there, you believe that those institutions should hold more capital, and yet—

Secretary GEITHNER. Relative to risk.

Mr. PEARCE. —institutions were complained about to—the SunTrust institution was complained—when it was trying to put more reserves as capital requirements. Then they were penalized for adjusting their earnings.

And so, in good times, banks are prohibited from putting more capital aside; and in bad times, they are punished for not putting capital aside. And so where does all this stuff—

Secretary GEITHNER. I am tempted to say—

Mr. PEARCE. So the innocents out there are wondering, when are you going to worry about us?

Secretary GEITHNER. I agree with you about that. And I am tempted to say to you, it is so much worse than you think.

You are right to say that the accounting system we had in place made it harder for banks to put more reserves aside during the boom against loss than would have been appropriate. I agree with you about that.

Mr. PEARCE. So if we scooted over, then, to the size of the problem, the estimates at the end of 2006, where we had $1.24 trillion in subprime loans, only $300 billion of those, 0.3, were held in FDIC-controlled banks. If you give them 75 percent—75 percent of those were performing at that point, which means $75 billion nonperforming. And if you took a 50 percent write-down on those, you get somewhere in the neighborhood of $38 billion real risk associated with the subprime.

And then if you take another 25 percent of all the performing loans, write them down, you get another $56 billion or $58 billion. So you get about $100 billion of exposure. And we had a $12.3 trillion total in assets in the banks at that point, $1.4 trillion in equity, $150 billion in earnings.

So the total exposure in the subprime market appears to be in the $100 billion range, and yet we took very dramatic, dramatic actions. That, to me—I question whether or not we took the right actions after the fact.

Secretary GEITHNER. You mean in terms of the reform legislation Congress passed or in terms of the actions—

Mr. PEARCE. No, in terms of the responses. The responses—I was sitting here in Congress at that period—appeared to be ad hoc. They appeared—

Secretary GEITHNER. You think we overreacted?

Mr. PEARCE. I—

Secretary GEITHNER. The government overreacted?

Mr. PEARCE. They appeared to be ad hoc.

Secretary GEITHNER. Oh.

Mr. PEARCE. And we let Lehman Brothers fail. Then we, the day after, 2 days after, supported AIG; 2 days before, Freddie and Fannie. And so—

Secretary GEITHNER. I would be happy to respond to—

Mr. PEARCE. —we were sending mixed messages.

Secretary GEITHNER. I would say that this country came into this crisis without the tools not just to prevent crises safely but to respond when crises happened. And that is one reason why the crisis was so deep and severe, and it is one reason why Congress had to legislate in a panic at particular stages of the crisis. That should never happen again.

And one of the most important things that the financial reform legislation does is give the government better tools in an emergency to wind down these institutions without the taxpayer being exposed to the loss. It is just for that reason.

But you are right to say that the tragic mistake this country made was to build a system where the government could not come in and protect taxpayers, protect the economy from the mistakes that large institutions made.

Chairman BACHUS. Thank you.

Mr. PEARCE. Thank you, Mr. Chairman.

Chairman BACHUS. Mr. Lynch?

Mr. LYNCH. Thank you, Mr. Chairman.

And thank you, Mr. Secretary, for helping the committee with its work.

I want to look forward here. I know we could argue about who did what when, but I think it is important here that we try to figure out a way to wind down Fannie and Freddie, as you have suggested.

And I think on your point, as I look at Option 3, there are more tools, if you would, within that framework to influence the markets and to provide some relief when necessary.

I think that the idea that this government reinsurance would only apply to certain securities, mortgage-backed securities, that comply with very strict underwriting standards, I think that could offer a great incentive to getting the type of product we would approve of and that would be sound, especially when looking at what happened in the previous crisis, when you had Standard & Poor's and Moody's stamping "AAA" on everything. If you had those tight requirements on underwriting, I think that could stabilize the market.

As well, I think that having the loss allocation placed on these private guarantors also provides that first-dollar risk that would be absorbed by the private sector instead of the government. And I like those ideas.

However, having been here for a few years, I know there are some constituencies out there, such as the banking industry, such as the housing industry, that would want to have as many products comply and get reinsurance as possible. And these private guarantors would also want to have the backstop as close as they could so that their losses were minimized and the public losses were probably maximized.

How do you deal with that issue, where you have these constituencies and they are pushing against what you are trying to do? And my fear is that, as we get out of this crisis and we get more toward a period of normalcy, that we don't have the robust oversight of these private guarantors, and we may end up back in the same place because of a lack of oversight, and the taxpayer ends up at risk again.

Secretary GEITHNER. I think you have figured this out. You have it exactly right. I think that is exactly the mix of advantages and risks in designing some variant of Option 3. So, for Option 3 to work, it is very important to make sure that you have to have these basic conditions.

Absolutely, you have to have the capacity to make sure you set capital requirements and oversee those types of mortgage guarantors. That would be an absolutely necessary condition. Absolutely, it would be necessary to make sure you had the freedom, independent of politics, removed from politics, to set very conservative, very strict eligibility requirements for what would be eligible for a guarantee. It is absolutely important to make sure that that guarantee is priced on what is an economically sensible estimate of potential future losses, independent of political influence.

And one reason why we have been a little careful not to commit is to say that, fundamentally, whether you like Option 3 or Option

2 or Option 1 or some mix of those things, it depends a lot on whether Congress is willing or able to design a system that is less vulnerable to political influence from people who would like to benefit from the subsidy from the government.

Mr. LYNCH. Mr. Secretary, the other thing I wanted to ask you about is, the definition of "catastrophic" would seem to be agreeing that the government should step in to prevent—at that point of catastrophic loss, I guess.

And my guess is, I know what we just went through was catastrophic, so I know that much complies or comes within your definition. But, also, in reading through this and the President's proposal and the report of the Administration, it would appear that the other definition would be, "after the private guarantor is wiped out."

Does that trigger "catastrophic," or is there a reinsurer beyond that?

Secretary GEITHNER. You are talking about in the context of Option 3, variants of Option 3?

Mr. LYNCH. Yes, please.

Secretary GEITHNER. One way to do it is to say you have no exposure to the taxpayer until the guarantor has failed. That would be one way to design it to make sure there is enough risk ahead of the taxpayer.

And you are right to say that where you set those lines is what is important to the economics of the whole arrangement. It is very hard to do, but it is not beyond our capacity to design a system that works dramatically better than the system we had.

Chairman BACHUS. Thank you.

Secretary GEITHNER. So I am actually more optimistic you can design something in that area that is not nearly as vulnerable as the system we had with the GSEs to the types of failures we saw.

Mr. LYNCH. Thank you, Mr. Secretary.

Thank you, Mr. Chairman.

Chairman BACHUS. Mr. Posey?

Mr. POSEY. Thank you, Mr. Chairman.

Thank you for being here today, Mr. Secretary.

In your testimony, you indicate that your objective is a healthier and more stable housing finance system with a broader goal of helping our economy recover. A part of stabilizing our economy is to ensure there is adequate capital in our financial institutions so that money is available for lending for housing, construction, and commercial purposes. You have indicated it is one of your goals, and I assume it is part of the Fed's goal for QE2.

Given that goal, I wanted to call your attention to a recent proposed regulation from the Internal Revenue Service that could have a devastating effect on the capital in U.S. financial institutions. This rule proposed by the IRS could lead to several hundred billion dollars leaving the United States and fleeing to low-tax jurisdictions.

It is my understanding that for the past 90 years, our national policy has been to encourage foreigners to put their money in our banks. That money goes to work in the United States economy in exchange for those individuals earning some interest. And they have the assurance that their money is safe and sound. They also have the assurance that corrupt governments don't have access to that information. I think that is a win-win situation, and you are shaking your head "yes." I think you do, too.

The proposed IRS rule would force banks to hand over interest payment information to the IRS. There would still be no tax on the interest earned, but the IRS would, in turn, have this information to turn over to a foreigner's own country.

This was a bad idea when it was first proposed in 2001, and, wisely, the Administration and Congress rejected it. It was a bad idea then, and I think it is a bad idea now. And I look forward to working with you so that we can maybe do that again this time around.

The flight of between $200 billion and $400 billion from U.S. banks, as apparently would happen if this regulation were put into place, would be devastating to our economy, I think. Furthermore, it would raise safety and soundness issues for our bankers and have significant deposits from nonresidents—affect those.

Do you agree that this is a bad idea and that it has come at a bad time?

Secretary GEITHNER. Congressman, I am not completely sure I know which draft regulation you are referring to. I think I do. And if I am right, I don't think it has the risks that you are suggesting. But I would be happy to spend some time and talk to you about it and see if we can figure out a way to address your concerns.

Mr. POSEY. I would greatly appreciate that, because I think we are going to need your support here.

Again, do you think the housing market has bottomed out yet?

Secretary GEITHNER. It is very hard to know. We have unemployment between 9 and 10 percent. And although the economy is growing and though you have had a big, big adjustment in house prices—housing is much more affordable now—I think, by any judgment, you still have a lot of damage for the market to absorb over time. And that is going to take a fair amount more time.

Mr. POSEY. Yes. And I think we all know that. I just wondered about your personal opinion, yes or no, if you thought it has bottomed out. And I won't go in there—

Secretary GEITHNER. I am a very careful person—

Mr. POSEY. I won't be insensitive. I apologize for seeming insensitive sometimes and being impatient when the people I represent have been ripped off for billions of dollars. People have died over this issue, or this economy. It is really serious outside the Beltway to real, live people.

I am not sure, just as a comment I wanted to make, that a larger downpayment for FHA is going to help anything. I know for over 30 years, most people bought their first homes with 3 percent FHA downpayments, and they paid them back. There are a lot of zero-downpayment VA loans paid back without problems.

We never had a problem until Congress got involved and invoked its will on Fannie Mae and Freddie Mac under the impossible dream that everybody should have a home if they wanted it, whether or not they had a job, whether or not they had income, whether or not it was worth the loan amount.

I think if we just get people back to doing their jobs, the 3 percent downpayment is going to work out just fine for this country.

And you and I talked before about regulators who were taking performing loans and classifying them as nonperforming loans because, in their esteemed opinions, they shouldn't have been performing loans. The standard to determine a performing loan, historically, has been whether or not the loan is performing.

Can you give us any kind of help on the ground, back in our districts, to take this arbitrary and capricious treatment of our—or to make the arbitrary and capricious treatment stop by some of these out-of-control bank regulators, who are apparently overreacting for their failures to do their job in the first place?

Secretary GEITHNER. If you gave me authority to do that, I might be able to do it. But that is their authority.

What I can do is—I share your concern. And I know that if you have talked to Chairman Bernanke and Chairman Bair and the head of the OCC, that they are worried about this problem, too. And they are working to try to make sure their examiners bring a careful and balanced approach to those judgments and they don't overdo it after, perhaps, being a little bit accommodating in the boom.

I agree with that concern. And I have passed on those concerns to them every time I hear them, as I am sure you have. And they are working on it.

Chairman BACHUS. Thank you, Mr. Posey.

Mr. POSEY. Thank you.

Chairman BACHUS. Mr. Miller?

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

Mr. Secretary, in your prepared testimony, you said that the Administration is committed to a housing finance system in which the private market, private capital is the primary source of mortgage credit. And you said that that would be subject to strong oversight, strong consumer and investor protections.

It is pretty clear that private capital has not come back in this market. There has been one issue of $236 million in the private-label mortgage-backed securities market, which is an asterisk compared to what it had been before.

In response to questions by Ms. Waters, you elaborated some and said that we needed more standardization in the market and better disclosure so investors know what they are buying, which is consistent with what I have heard from investors.

But they say that the first effort by the SEC does not quite get there. SEC 193 allows greater disclosure of due diligence, but it is due diligence still by the issuer or a third party hired by the issue. They want to have the ability to do their own due diligence, to sample the pools, to see what they are buying.

And more important, they say it has to be enforceable. They actually have made—more than one has made the comparison of this mortgage market to doing business in Russia now and trying to sue an oligarch. There is a problem with rule of law, and contractual rights are simply very difficult to enforce.

Will the Administration proposal—would you support, in the structural changes to the private market, more disclosure, including direct due diligence by investors, allowing them the opportunity to see themselves, not take anybody's word for it, what they are buying; servicing requirements, so they know what happens if a mortgage goes into a default; and, third, that there be clear remedies?

There have been stories in the last week or so about some of the bigger banks advising their shareholders that they may face liability. There has been kind of a peevish tone to it, that their ankles are getting bitten by lawyers and by regulators. But that strikes me as a fairly basic rule of law.

Will the Administration's proposal support those three things?

Secretary GEITHNER. Absolutely share those objectives, and happy to talk to you in more detail about how best to achieve those objectives. And, again, any concern people have about the market, as about these draft rules, we will look carefully at.

And I think you are right to emphasize that for this to work better, you do not just need clarity on capital rules and things like that, risk retention, but you need better disclosure standards, you need servicer standards that can be enforced. And those are part of the solution. And I think until that happens, it is going to be harder to get private capital to come in.

But I would be happy to talk to you about how best to do that.

Mr. MILLER OF NORTH CAROLINA. On the servicer requirement point, there have also been stories about private negotiations going on now between regulators and States' attorneys general and the various servicers, as well as risk-retention rules, whether servicing requirements will be part of that.

Why is that not within your authority now? Why do you need them to agree?

Secretary GEITHNER. Treasury's authority?

Mr. MILLER OF NORTH CAROLINA. These are all subsidies of banks that are regulated by the OCC. The OCC does not have an appointed director now. It has a temporary director that you could replace at any time. Why is the OCC not requiring better behavior by servicers?

Secretary GEITHNER. Again, we are trying to take the authority that is in the financial reform legislation and apply that carefully in a way that will apply to all participants in the market, whether they are banks or non-banks, and make sure that there is a consistent, clear set of rules of the game that investors can benefit from more generally. And we are trying to do that on a careful, integrated basis.

It is taking a little more time than we thought. But we have to be careful to get it right. And I am not sure how much longer it is going to take, but it is going to take a little bit longer than we initially expected.

And we can't achieve those objectives just using the existing authority we have or the OCC has itself. You have to have a broader—so there is a level playing field across the market as a whole.

But we are moving in the same direction. And I very much share the directives you laid out. It is just a question of getting the details right.

Mr. MILLER OF NORTH CAROLINA. I am sorry. Do you not have existing authority with Dodd-Frank?

Secretary GEITHNER. No, with Dodd-Frank we do.

Mr. MILLER OF NORTH CAROLINA. Okay.

Secretary GEITHNER. But that is what we are putting in place. We are laying out the basic architecture through draft rules that the market can comment on that would give the comprehensive reforms that you laid out more substance and traction.

And, again, the way our system works is, we do have a lot of entities involved that have a piece of this. But we want them to move together and we want them to put out draft rules so people can comment, we get feedback on them, get them right.

Chairman BACHUS. Thank you, Mr. Miller.

Mr. MILLER OF NORTH CAROLINA. Thank you.

Chairman BACHUS. Mr. Luetkemeyer?

Mr. LUETKEMEYER. Thank you, Mr. Chairman.

Secretary Geithner, this morning I haven't heard a whole lot with regards to Federal Home Loan Banks. And it is in your testimony, and it is in the report.

Can you elaborate just a little bit on where you feel their role would be—I know there have been a few problems, but generally not a lot of problems with them—and where you think that we could go with that?

Secretary GEITHNER. There are a few examples we pointed to in the current system which we think deserve attention and reform. I will mention those again, although they are in the paper.

These entities were allowed, like Fannie and Freddie were, to accumulate an investment portfolio, which we don't think is necessary. And they took on a lot of risk in that context and didn't have—some of them took on some risk and didn't have capital to back that. That is something we should avoid in the future.

We have also created a system where we allow large banks to be members of multiple Home Loan Banks. And that is something we have to take a look at again, again, to make sure the system doesn't have too much risk.

There are other things people have suggested, and we will look at every credible idea. And I think, although you are right to say that the problems there were not nearly as bad as we saw both in the private market and in Fannie and Freddie, there are some things we have to take a careful look at.

Mr. LUETKEMEYER. During the course of your putting together the report, did you look at other countries and other programs around the world and what the good points of those may have been, what worked in other places, and see if they were appropriate for us? Could you elaborate just a little bit on that?

Secretary GEITHNER. We did. We did a very careful look, actually. And it is a very good question, because if you look at the experience of other countries, a lot of countries did a lot better than we did in this crisis.

But I think the biggest difference you can point to is, in most of those systems, banks are the overwhelmingly dominant source of credit. And there is not nearly as large a role for the securities markets. It is true for corporate debt. It is also true for mortgage finance and consumer finance.

In our system, we have a better balance between credit provided by banks and credit that is provided by the broader markets, broader investor community, both in terms of asset-backed securities, like real estate, like mortgages, but also just direct corporate credit. And we want to try to preserve that kind of balance. We think the system would be more stable in the future if you have that kind of balance.

In those systems in housing finance, as I said earlier several times, in countries where the government does not provide the kind of guarantee that we did through Fannie and Freddie, banks hold really the overwhelming bulk of risk, but those governments generally guarantee their banks. They don't let their banks fail in a crisis. In that context, as you saw in the crisis, the taxpayer is still exposed to loss, and it is just that the guarantee isn't explicit. The taxpayer isn't protected in that way.

So I wouldn't look to that model as a particularly appealing example of a more private system. As you know, in many of those countries, the banks are much more close to the government. The governments don't let them fail; they don't allow failure. And so, in a sense, you are still socializing losses and risk in that context, too.

Mr. LUETKEMEYER. Okay. One of the comments you made a while ago was that it is an obligation of the government to protect the economy. Can you tell me at what level you believe that is where we need to go with that?

Secretary GEITHNER. That is an excellent question. And, of course, that is something people will disagree on in the moment. And, again, the basic paradox of this challenge is, if you build in protection against the extreme crisis, you might make the crisis more likely in the future. That is why governments get these things wrong over time. It is very hard to get that right.

But, again, if you look at what happened in this crisis and what helped get us out of it, you have to have the ability in extremis to reduce the risk of collateral damage that can push the economy off into the kind of deep recession we saw. That is very important, to have that capacity. And I think we can do it in a way that doesn't, again, magnify moral hazard or magnify the risk in the future to taxpayers. But it is hard to do.

Mr. LUETKEMEYER. What you are saying, though, is at some point, the government is going to be the backstop?

Secretary GEITHNER. But it should be in a much more limited way, and I think we can do it in a way where it is much, much more limited, much less risk of loss to the taxpayer.

And, again, here is the—and not to make it overly simple, but if you require banks to hold more capital against risk, if you require homeowners to, in general, hold more equity in their homes, if you make sure that underwriting standards are more conservative in that broad context, then you will do a lot of good in making sure the system is more stable, even in a deep recession.

That probably won't be enough, but that will take you a long way to it. You still may need the flexibility in an emergency to come in and provide a little more protection.

Mr. LUETKEMEYER. Okay.

And, with that, I will yield back my time. Thank you, Mr. Chairman.

Chairman BACHUS. Thank you.

Let me say this. The Secretary has to leave in 5 minutes. So we will have one more—Mr. Scott will be the last—unless you can stay an additional few minutes. And I think the agreement—you extended from 12:00 to 12:30 as part of negotiations.

Secretary GEITHNER. Can I offer the following commitment, which is, again, I would be happy to respond in writing to any questions.

Chairman BACHUS. That is fine.

Secretary GEITHNER. I know you will have a subsequent chance to have me up here.

Chairman BACHUS. What we will do—

Secretary GEITHNER. You could invert the order of your questions.

Chairman BACHUS. I would ask unanimous consent that the hearing that starts at 2:00, the Secretary Donovan hearing, that those members in the room on both sides who did not get a chance to ask a question will go first at that hearing.

And, hearing no objections, Mr. Scott is recognized. He will be the last. I apologize to the other members.

Mr. SCOTT. Thank you very much, Mr. Chairman.

And I am glad I got squeezed in, because, Mr. Secretary, I am very worried. I am very worried about unintended consequences here. And granted, there is a lot wrong with Fannie and Freddie; we certainly need to reform this situation. But there is a role for government here, and I think we need to be very clear on this.

We are examining this issue at a time of great volatility, of record, record numbers of people who are losing their homes, largely through no fault of their own but because of our problem up here in Washington. And I am concerned about this rush to judgment here and the tendency to be throwing the baby out with the bathwater.

We had Fannie and Freddie for a very serious purpose. And granted, there are some problems with them, but they provided a very useful tool to put us in the position where we are in. There are still problems facing minorities in the housing market, that—just the rush to bring in—say, "Get this out of the way. Bring the private capital in, and that solves the problem." That does not solve the problem of the pangs of color shock many of these folks suffer simply because they are African American, because of the color of their skin.

We have other burgeoning problems on the income levels of individuals. Now, we have another problem with many of our returning soldiers, which is heartbreaking, who are coming home after leaving here, going, fighting on the battlefields of Iraq and Afghanistan, and they come back and they are on the street, they are under the viaduct.

No matter what we do, bringing private capital in and saying, "That is the answer," is not the answer.

So I want to stress that Treasury and this Administration move with a very jaundiced eye on this and understand that, in my review of your report, probably the best option, given the volatility of the situation we are in, given the sensitivity, would be to look at Option 3 as a base from which we can work.

I think it has the attributes in here. It has a degree of certainty. And even members of the financial services community—the banks, the mortgage companies—realize that private capital isn't coming in at any price. There is a need in our housing market for there to be some sort of Federal Government guarantee, some way to be able to come down in these catastrophic situations, some way for us to be able to be there in the event of another financial crisis.

And so I would like for you simply to respond and give us—I am not going to ask you which one you like. But do you not agree that, given the difficulty of the situation we are in, the vagaries of the different needs that I mentioned in my remarks, that there is a need to move more from a position of Option 3 than the other two?

Secretary GEITHNER. I agree with much of what you said. And you are very right to emphasize, as I tried to do, that we have to be very, very careful we don't do more damage as we try to get the system to a better place.

And you could envision, in fact, a mix of those three options as being the best place to land this, ultimately. But you have to be very, very careful. And, again, I would caution you—and I think you know this better than anybody—that if banks and real estate companies together are in favor of something that involves a guarantee, you have to be kind of careful. And they will always be in favor of something that involves a guarantee by the government, in this case. You have to be very, very careful about that.

But, as I have said many times, I think there are ways to design Option 3, alongside a substantial role by the FHA, that would be a very dramatic improvement in our current system. The test is whether we can design it in a way that doesn't have the same kind of risks that we ultimately saw in Fannie and Freddie.

Mr. SCOTT. Yes, I meant the safeguards of that.

But I want to yield 10 seconds to my friend here, if I may, quickly.

Mr. GREEN. Mr. Secretary, quickly, the impact, please, if you will, of terminating the HAMP program, the FHA refinance program, the NSP program, and the Emergency Mortgage Relief Program? Do you have any opinions, please?

Secretary GEITHNER. Oh, it would be, I would say it would cause a huge amount of damage to a very fragile housing market and leave hundreds and hundreds of thousands, if not millions, of Americans without the chance to take advantage of a mortgage modification that would allow them to stay in a home they can afford.

So I think it would cause a lot of damage, and I would recommend against it.

Mr. SCOTT. Thank you very much, Mr. Chairman.

Chairman BACHUS. Thank you.

That concludes our hearing.

Let me say, Secretary Geithner, Congressman Posey posed a question to you, I think, which is immensely important. And he was referring to a draft proposal by the IRS, the IRS nonresident alien deposit rule, which just doesn't seem to go away. But I think, as he stated, it could cause hundreds of billions of dollars to exit our banks, particularly our banks in distressed areas in Florida, in Texas, in California, in Arizona. So it is a real problem. It is REG-146097-09.

So, with that, the Chair notes that some members may have additional questions for this witness which they may wish submit in writing. Without objection, the hearing record will remain open for 30 days for members to submit written questions to Secretary Geithner and to place his responses in the record.

This hearing is adjourned.

Thank you, Secretary Geithner.

[Whereupon, at 12:36 p.m., the hearing was adjourned.]

A P P E N D I X

March 1, 2011

Congressman Gary Ackerman's Statement

March 1, 2011

"Mortgage Finance Reform: An Examination of the Obama Administration's Report to Congress"

Thank you, Mr. Chairman,

Secretary Geithner, I think we all share many of the same goals for the future of mortgage finance in the United States. There is, I would imagine, unanimous agreement that we all want a system that actually works and doesn't contribute to bringing the American consumer and the American economy to the brink ever again. I think a system that functions and serves homebuyers would be vastly preferable to the Wild West of the last decade. I am sure you will agree.

Congress must create a new system that protects consumers from exploitation. A system in which consumers are offered loans at rates they can actually pay, with terms they can actually understand. The new consumer finance protections must be stringently enforced. For too long the game was rigged against the people it was supposed to serve and that's going to change, it must change. It is critical that in this future system money flows to credit-worthy borrowers in both good times and bad. Most of all, long term, fixed-rate financing must continue to be an affordable option for homebuyers. And, if an investor wants to buy a mortgage security, that investor should feel confident-in fact be certain-that they are not buying a AAA-rated pile of garbage.

So far, the questions regarding GSE reform have been theoretical. The mortgage finance system of the future will not exist theoretically. It is not going to exist in a think tank; it is going to exist in people wallets and the homes that it will provide will be our neighborhoods. It will be a reality and when we discuss mortgage finance it is crucial that we frame the issue properly: This is the largest and most important investment most American families will ever make. It's critical that we get this right and it is critical we protect the American consumer. I appreciate your efforts towards creating a system that works.

When the federal government embarks on a project as large as the GSE's, it's only natural for taxpayers to want a scorecard reported back to them. This is especially important when you consider the magnitude of the bailout for Fannie Mae and Freddie Mac. $150 billion dollars and counting have been poured into these two entities, and when we consider what we've gotten in return, there isn't much to be excited about: Home prices and the breadth of home sales is still sluggish in a lot of areas around the country; the homeownership rate in our country is back to the same level it was in 1998; and the United States now ranks *seventeenth (17th)* in homeownership rates amongst developed countries. Indeed, the American taxpayer has gotten a terrible deal out of this.

For years we've been told by GSE advocates that government guarantees, affordable housing requirements, and implicit taxpayer backing were the only ways the housing market in our country could

conceivably function. It is true that if some of these requirements were not in place, there may be some families today that otherwise wouldn't be homeowners. But it's hard to imagine an outcome worse than what we've already experienced coming from this toxic mix of public and private accountability.

Everyone in this deal lost – The GSE's, homeowners, neighborhoods – and especially, the taxpayer.

I look forward to hearing from Treasury Secretary Geithner today on the administration's plan for ending this taxpayer bailout.

I would like to thank Secretary Geithner for taking the time this morning to join us in this important discussion of the future of housing finance in this nation.

Last month, as required under the Dodd-Frank Act, the Treasury Department submitted a report to Congress which laid out a plan to change the structure of housing finance. Although this report is a step in the right direction in providing insight to how the administration sees the future of housing, this is a discussion that should have begun last Congress as we considered the sweeping financial regulatory reform. It is impossible to have true comprehensive reform of the financial system without addressing mortgage finance.

As Chairman Bachus has stated several times, reforming the housing finance market is a top priority for this committee and I echo those sentiments. I am happy Treasury recognized the need for a stronger private market presence in their report and presented options to shrink the investment portfolios of Fannie Mae and Freddie Mac. These are ideas which I believe can be used as a foundation to work towards comprehensive reforms to our housing market. The failure to deal with these issues last Congress has taxpayer's already bearing a burden in excess of $150 billion and only a stable housing finance system will ensure taxpayer's are protected in the future. That can only happen with a real plan in place.

Now is the time for us to work towards the shared goal of substantive reforms in housing finance. I look forward to hearing how the administration sees the role both the private sector and government support will play in the future housing market. Thank you Chairman Bachus for holding this hearing and thank you to Secretary Geithner for your testimony.

Congressman André Carson
March 1, 2011
Hearing – Full Committee
"Mortgage Finance Reform: An Examination of the Obama Administration's Report to Congress"
Statement

Thank you Mr. Chairman for holding this important hearing.

As we look at the enormous challenge of GSE reform, we must ensure homeowners of all backgrounds are protected in the new system we create.

This includes ensuring that the system that emerges from these discussions meets the needs of low-wealth people seeking affordable and sustainable housing.

Homeownership remains the primary means of building wealth for many Americans. That is why it is imperative that a new housing finance system must also support access for communities that otherwise would have been overlooked.

As the private sector takes on a larger role in maintaining liquidity in the mortgage market, we must make sure that it doesn't ignore the needs of low-wealth borrowers and economically distressed communities. We need private securitizers to uphold their obligations to our neighborhoods so that all communities--not just the wealthiest ones--have access to the capital they need for families to build assets and make their neighborhoods stable, attractive places to live.

United States House of Representatives
Committee on Financial Services
Mortgage Finance Reform: An Examination of the Obama Administration's Report to Congress
March 1, 2011

Congressman Ron Paul
Statement for the Record

Mr. Chairman,

Thank you for holding this hearing to discuss the Administration's report to Congress on mortgage finance reform. The problems with Fannie Mae and Freddie Mac are nothing new, as Congress over the years has known about them and consistently failed to deal with them.

For years the federal government has made it one of its prime aims to encourage homeownership. Various federal mortgage programs through the FHA, Fannie Mae, and Freddie Mac distorted the normal workings of the housing market. The implicit government backing of Fannie Mae and Freddie Mac provided investors an incentive to provide funds to Fannie and Freddie that otherwise would have been put to use in other sectors of the economy. Combined with the Fed's loose monetary policy, the net result was a flood of money rushing to Fannie and Freddie that helped to fuel the housing bubble.

Low interest rates influenced marginal buyers, those who were undecided on purchasing a house, and encouraged them to take on a mortgage that they otherwise would not. Even when interest rates were raised, no one expected them to stay high for long, as there was always pressure from politicians and investors to keep rates low, as no one wanted the cheap credit to end.

This resulted in a housing bubble which has now burst and helped to drag the economy down with it. The solution is simple, the complete phaseout of government intervention and a return to a completely private market for housing and mortgages. There is no need for government intervention to provide a fully functioning housing market, government intervention can only harm homeowners.

Unfortunately, even abolishing Fannie and Freddie entirely would not bring about a free market in housing. The Federal Reserve still has over one trillion dollars in Fannie and Freddie debt on its balance sheet, and no limit on how much of this debt it could continue purchasing in the future. The Fed's mortgage-backed securities purchase program works in the same way as its bailout facilities, by purchasing bad debt in order to keep it from being liquidated. But until these bad debts are liquidated and malinvested resources are shifted into productive sectors, the economy will never improve.

EMBARGOED UNTIL DELIVERY

Written Testimony by

Timothy F. Geithner

Secretary of the Treasury

before the

House Committee on Financial Services

Tuesday, March 1, 2011

Chairman Bachus, Ranking Member Frank, and members of the committee, thank you for the opportunity to testify this morning.

Two weeks ago, we released a report outlining our vision of the next steps for reforming the housing finance market. My testimony today summarizes the content of that report.

There is little dispute that the financial crisis was partly the result of fundamental flaws in the housing finance market. The consequences of those flaws, and the losses Fannie Mae and Freddie Mac have inflicted on taxpayers, make clear that we must build a healthier, more stable market that will work better for American families and our nation's economy.

For decades, the government supported incentives for housing that distorted the market, created significant moral hazard, and ultimately left taxpayers responsible for much of the risk incurred by a poorly supervised housing finance market. In more recent years, we allowed an enormous amount of the mortgage market to shift to where there was little regulation and oversight. We allowed underwriting standards to erode and left consumers vulnerable to predatory practices. We allowed the market to increasingly rely on a securitization chain that lacked transparency and accountability. And we allowed the financial system as a whole to take on too much risk and leverage.

These were avoidable mistakes. Their convergence, as we all know, resulted in a financial system vulnerable to bubbles, panic, and failure. Reforming our country's housing finance market is an essential part of our broader efforts to help ensure Americans will never again suffer the consequences of a preventable economic crisis.

Our proposal for reform breaks sharply from the past to fundamentally transform the role of government in the housing market.

We believe the government's primary role should be limited to several key responsibilities: consumer protection and robust oversight; targeted assistance for low- and moderate-income homeowners and renters; and a targeted capacity to support market stability and crisis response.

The Administration is committed to a system in which the private market – subject to strong oversight and strong consumer and investor protections – is the primary source of mortgage credit.

We are committed to a system in which the private market – not American taxpayers – bears the burden for losses.

And while we believe that all Americans should have access to affordable, quality housing, our goal is not for every American to become a homeowner. We should provide targeted and effective support to families who have the financial capacity to own a home but are underserved by the private market, as well as a range of options for Americans who rent.

As the housing market recovers and the economy heals, the Administration and Congress have a responsibility to look forward, reconsider the role government has played in the past, and work together to build a stronger and more balanced system of housing finance.

Reducing the Government's Role in the Mortgage Market

In the wake of the financial crisis, private capital has not sufficiently returned to the mortgage market, leaving Fannie Mae, Freddie Mac, FHA, and Ginnie Mae to insure or guarantee more than nine out of every ten new mortgages. Under normal market conditions, the essential components of housing finance – buying houses, lending money, determining how best to invest capital, and bearing credit risk – should be private sector activities.

We will work closely with the Federal Housing Finance Agency to determine the best way to responsibly reduce Fannie Mae and Freddie Mac's role in the market and ultimately wind down both institutions. This objective can be accomplished by gradually increasing guarantee pricing at Fannie Mae and Freddie Mac, as if they were held to the same capital standards as private institutions; reducing conforming loan limits by allowing the temporary increases enacted in 2008 to expire as scheduled on October 1, 2011; and gradually increasing the amount of private capital that risks loss ahead of taxpayers through credit loss protections from private entities and gradually increased down payment requirements. We also support the continued wind down of Fannie Mae and Freddie Mac's investment portfolios at a rate of no less than ten percent annually.

I want to emphasize that it is very important that we wind down Fannie Mae and Freddie Mac at a careful and deliberate pace. Closing the doors at Fannie Mae and Freddie Mac without consideration for the pace of economic recovery could shock an already-fragile housing market, severely constrain mortgage credit for American families, and expose taxpayers to unnecessary losses on loans the institutions already guarantee. It is ultimately in the best interest of the economy and the country to wind down Fannie Mae and Freddie Mac in a responsible and prudent manner.

The Administration is fully committed to ensuring Fannie Mae and Freddie Mac have sufficient capital to perform under any guarantees issued now or in the future, as well as the ability to meet any of their debt obligations. Ensuring these institutions have the financial capacity to meet their obligations is essential to maintaining stability in the housing finance market and the broader economy. During the transition, it is also important that the operations of Fannie Mae and Freddie Mac continue to serve the market and the American people, including retaining the human capital necessary to effectively run both institutions.

As we decrease Fannie Mae and Freddie Mac's presence in the market, we will also scale back FHA to its more traditionally targeted role. We support decreasing the maximum loan size that qualifies for FHA insurance – first by allowing the present increase in those limits to expire as scheduled on October 1, 2011, and then by reviewing whether those limits should be further decreased going forward.

We will also increase the pricing of FHA mortgage insurance. FHA has already raised premiums twice since the beginning of this Administration, and an additional 25 basis point increase in the annual mortgage insurance premium is included in the President's 2012 Budget and will be levied on all new loans insured by FHA as of mid-April 2011. This will continue ongoing efforts to strengthen the capital reserve account of FHA and align its pricing structure in a more appropriate relationship with the private sector, putting the program in a better position to gradually return to its traditional and more targeted role in the market.

The Administration also supports reforms at the Federal Home Loan Banks (FHLBs) to strengthen the FHLB system, which provides an important source of liquidity for small- and medium-sized financial institutions. These reforms include instituting single district membership, capping the level of advances for any institution, and reducing the FHLBs' investment portfolios.

We also believe it is appropriate to consider additional means of advance funding for mortgage credit as a part of the broader reform process, including potentially developing a legislative framework for a covered bond market. We will work with Congress to explore opportunities in this area.

Addressing Fundamental Flaws in the Mortgage Market

Winding down Fannie Mae and Freddie Mac and implementing reforms at FHA and the FHLBs, however, is only one side of the coin. These steps alone will not give rise to a housing finance market that meets the needs of families and communities, nor will it guarantee that private markets can effectively play a predominant role. We must also pursue reforms that restore confidence in the mortgage market among borrowers, lenders, and investors.

The Administration supports the strong implementation of reforms to help address pre-crisis flaws and rebuild trust and integrity in the mortgage market. Taken together, these reforms will improve consumer protection, support the creation of safe, high-quality mortgage products with strong underwriting standards, restore the integrity of the securitization market, restructure the servicing industry, and establish clear and consolidated regulatory oversight. The Dodd-Frank Act laid the groundwork for many of these reforms. We will implement its provisions in a thoughtful manner to protect borrowers and promote stability across the housing finance markets.

Treasury is currently coordinating critical reforms to the securitization market that will require originators and securitizers to retain risk, including coordinating an interagency process to determine the parameters for Qualified Residential Mortgages (QRM) under the Dodd-Frank Act. This summer, the Consumer Financial Protection Bureau will assume authority to set new rules to curb abusive practices, promote choice and clarity for consumers, and set stronger underwriting standards. Federal regulators will require banks to increase capital standards, including maintaining larger capital buffers against higher-risk mortgages that have a greater risk of default.

Treasury is also actively participating in interagency efforts to design and implement near-term reforms that will help correct chronic problems in the servicing industry, which has proven especially ill-equipped to deal fairly and efficiently with the sharp increase in the number of families facing foreclosure. Right now, we are working together to design national servicing standards that better align incentives and provide clarity and consistency to borrowers and investors regarding their treatment by servicers, especially in the event of delinquency. Our work includes identifying ways to reduce conflicts of interest between holders of first and second mortgages and improving incentives for servicers to work with troubled borrowers to avoid foreclosure.

Alongside these efforts, Treasury, the Department of Housing and Urban Development, and the Department of Justice are coordinating the Administration's interagency foreclosure task force, which is comprised of eleven federal agencies and also works closely with the state Attorneys General. In light of reports of misconduct in the servicing industry, the task force is currently reviewing foreclosure processing, loss mitigation, and disclosure requirements at the country's largest mortgage servicers. Those that have acted improperly will be held accountable.

Providing Targeted and Transparent Support for Access and Affordability

Low-and moderate-income families and communities account for a large proportion of all home purchase mortgages, and 100 million Americans are renters. The Administration stands strongly behind our obligation to support an adequate range of affordable housing options and access to fairly priced, sustainable mortgage credit for all communities and families – including those in rural and economically-distressed areas, and those with low- or moderate-incomes.

Although homeownership is not the best option for everyone, affordable opportunities should be available to Americans with the financial capacity to own a home. Part of our efforts to reform the housing finance system will focus on helping ensure FHA is a sustainable, efficient resource for creditworthy first-time homebuyers and families of modest incomes. We are working expeditiously with the FHA to plan and carry out reforms so its programs are more efficient and responsive to changing market conditions. To improve and streamline other government initiatives, the Departments of Housing and Urban Development, Agriculture, and Veterans Affairs – which all operate targeted housing finance programs – will establish a task force to explore ways to better coordinate or consolidate their efforts.

We will also consider measures to help ensure secondary market participants – securitizers and mortgage guarantors – provide capital to all communities in ways that reflect activity in the primary market consistent with safety and soundness. In addition, we will focus on making sure all mortgage market participants comply with antidiscrimination laws, and work with Congress to require greater transparency for data that tracks where and to whom mortgage credit is flowing.

Our approach should also encourage greater balance between homeownership and rental opportunities. That means improving support to the one-third of Americans who rent their homes, and especially to low- and moderate-income families. In the near term, the Administration will begin work to strengthen and expand FHA's capacity to support both lending to the multifamily market and adequate financing for affordable properties that private credit markets generally underserve. As part of our efforts, we will explore innovative ways to finance smaller multifamily properties, which contain a third of all multifamily rental units but the housing finance system has not adequately served.

Addressing long-standing problems in housing finance, like rental supply shortages for the lowest income families, will require a dedicated commitment, but it is one that can be made in a budget neutral way. We look forward to working with Congress and other stakeholders to discuss this and other avenues for improving access and affordability in a targeted, transparent way.

Options for the Long-Term Structure of Housing Finance

In the paper the Administration released last month, we laid out three potential ways to structure government support in a housing finance market where the private sector is the predominant provider of mortgage credit.

In each option, government support would be transparent, explicit, and limited. Each would make private markets the primary source of mortgage credit and the primary bearer of mortgage losses. Each would preserve FHA assistance and similar government initiatives that assist targeted groups, such as low- and moderate-income families, farmers, and veterans.

The first option would limit the government's role almost exclusively to these targeted assistance initiatives. The overwhelming majority of mortgages would be financed by lenders and investors and would not benefit from a government guarantee.

In the second option, targeted assistance through FHA and other initiatives would be complemented by a government backstop designed only to promote stability and access to mortgage credit in times of market stress. The government backstop would have a minimal presence in the market under normal economic conditions, but would scale up to help fund mortgages if private capital became unavailable in times of crisis.

The third option broadens access for creditworthy Americans and helps ensure stability in times of market stress. Alongside the FHA and targeted assistance initiatives, the government would provide reinsurance for certain securities that would be backed by high-quality mortgages. These securities would be guaranteed by closely regulated private companies under stringent capital standards and strict oversight, and reinsured by the government. The government would charge a premium to cover future claims and would not pay claims until private guarantors are wiped out.

The report we released last month discusses the advantages and disadvantages of each approach in additional detail, and also encourages Congress and the public to evaluate each option in light of four common criteria: access to mortgage credit, including the future role of the 30-year fixed-rate mortgage; incentives for private investment in the housing sector; taxpayer protection; and financial and economic stability.

Part of our intention in providing this narrow set of options and key criteria by which they should be judged is to encourage an honest conversation about the merits and drawbacks of each approach among the Administration, Congress, and stakeholders. We are faced with difficult choices that will involve real trade-offs. The challenge before us is to strike the right balance between providing access to mortgages for American families and communities, managing the risk to taxpayers, and maintaining a stable and healthy mortgage market.

In choosing among these options, care must be given to designing a system that maximizes the benefits we are seeking from government involvement in the mortgage market, while minimizing the costs. We should also be sure to consider how to utilize the existing systems and assets in our housing finance system, including those at Fannie Mae and Freddie Mac, as best as possible for the benefit of the taxpayer and the American people.

Each of the longer-term reform options we have outlined will require legislation from Congress, and we hope to work together with you and your colleagues to pass comprehensive legislation within the next two years. Failing to act would exacerbate market uncertainty and risk leaving many of the flaws in the market that brought us to this point in the first place unaddressed. We look forward to continuing the dialogue with consumer and community organizations, market participants, and academic experts as we work together to build a housing finance market that is stronger and more stable than it was in the past.

I want to conclude with one important point. Housing is a critical part of our economy and we will proceed with our plan for reform with great care. Our objective, after all, is a healthier, more stable housing finance system. While we are confident that the steps we have laid out follow the right path, haste would be counterproductive – possibly destabilizing the housing finance market or even disrupting the broader recovery.

I'd be happy to take your questions now and, again, thank you for the opportunity to be here today.

INDEPENDENT COMMUNITY
BANKERS *of* AMERICA

Statement for the Record

By the

Independent Community Bankers of America

Before the

Congress of the United States
House of Representatives
Committee on Financial Services
Subcommittee on Financial Institutions and Consumer Credit

Hearing on

"Mortgage Finance Reform: An Examination of the Obama Administration's Report to Congress"

March 1, 2011
Washington, D.C.

On behalf of its nearly 5,000 member banks, ICBA is pleased to submit this statement for the record for this hearing on "Mortgage Finance Reform: An Examination of the Obama Administration's Report to Congress."

Community bank mortgage lenders have a great deal at stake in the future of housing finance in this country. Community banks serve the mortgage credit needs of rural areas, small towns, and suburbs across the nation, and the secondary markets are a significant source of capital in support of this lending. Our members need a financially strong, impartial secondary market that provides equitable access and pricing to all lenders regardless of size or volume. We're grateful to Chairman Bachus for convening this hearing.

With regard to the Administration's recent report to Congress, "Reforming America's Housing Finance Market," we were encouraged to see the Administration recognize that smaller lenders and community banks serve their communities more effectively than larger lenders. Access to credit for these communities, along with the related imperatives of preserving a competitive market for credit and minimizing consolidation, are all criteria the Administration uses in evaluating proposals for remaking the government's role in the secondary mortgage market. In this respect, we support the analysis provided by the Administration.

The Administration's report considers three broad approaches to secondary market reform:

- Nearly complete privatization of the housing finance system, with government assistance for targeted groups of borrowers;
- A privatized system with a government guarantee that becomes effective only during times of crisis, supplemented by government assistance for targeted groups of borrowers; and
- A privatized system with catastrophic government reinsurance buffered by private capital, in addition to government assistance for targeted groups of borrowers.

Even the third catastrophic reinsurance option would entail a more circumscribed role for the government in the housing market, emphasizing private capital as the primary source of mortgage credit and the first to bear losses. The Administration report has effectively shifted the debate; the spectrum of viable options ranges from narrow government involvement to virtually full privatization. Government's historical role in housing is off the table. The administration's report also indicated that it will reduce the conforming loan limits, raise guarantee fees to allow private-sector securitizers to be more competitive and raise down payment requirements, among other steps to shrink the government's role in housing that don't require congressional approval. Wherever we end up, it will look significantly different than the pre-crisis Fannie and Freddie. ICBA welcomes this new reality as an appropriate response to the moral hazard and taxpayer liability of the old system. Our members are prepared to adapt and thrive in an environment of limited government involvement.

A housing finance system with a smaller government footprint, properly designed, can preserve the vital role of community banks. The worst outcome, for community banks and consumers, would be a system dominated by a few large, too-big-to-fail banks, with community banks forced to the sidelines.

Such an outcome would simply replicate the moral hazard that prevailed under Fannie Mae and Freddie Mac. To allow a small number of large banks to dominate the secondary mortgage market would create a new variety of moral hazard, just as pernicious as the old variety. These dominant lenders, driven by quarterly earnings and dividends to unacceptable risk taking, would become too-big-to-fail because the market would know full well that the government would bail them out (as it did in 2008) rather than let the housing market collapse. These lenders would in effect become privatized "Fannies" and "Freddies," with all the benefits and the risks that come with TBTF status. Privatization is not enough to cancel out moral hazard, which lies in the concentration of risk, and especially risk in the housing market because it occupies such a central place in our economy. These same TBTF banks are also the largest mortgage servicers and are responsible for much of the foreclosure mess, including the mishandling of America's military families. Any solution that fuels this consolidation is only setting up the financial system for an even bigger collapse than the one we've just been through.

To address these concerns, ICBA has set forth its own proposal for reform that would replace Fannie Mae and Freddie Mac with lender-owned cooperatives. We believe that this proposal would protect taxpayers from another bailout, ensure equal access and pricing for lenders of all sizes, deter further consolidation, ensure liquidity during periods of market stress, preserve the significant benefits of the "to-be-announced" (TBA) market, and minimize disruption in the market by providing for the direct transfer of Fannie Mae's and Freddie Mac's infrastructure to the new co-ops.

ICBA Proposal for Secondary Mortgage Market Reform[1]
Cooperative governance would ensure broad access and deter excessive risk taking

Fannie and Freddie would be restructured as cooperative entities owned by mortgage originators who purchase stock commensurate with their loan sales to the co-ops. This is similar to the capitalization of the Federal Home Loan Banks (FHLBs) and provides a capitalization source that can be adjusted based on market conditions and risk profile and performance of the co-ops' book of business. Members would have an incentive to transfer only soundly underwritten loans to the co-ops because any losses would adversely affect their capital investment.

The co-ops would be governed on a one-company-one-vote basis. Big banks would not be allowed to dominate the new co-ops. Further, directors would be appointed to represent

[1] ICBA's cooperative model is similar to a proposal favorably analyzed by the New York Federal Reserve and the Government Accountability Office. It is also similar to a proposal put forth by the National Association of Realtors.

various sizes and classes of members, while a minority number of seats would be reserved for outside independent directors with financial expertise.

The advantage of this form of governance is that all co-op members would enjoy open and equal access and benefits in terms pricing, regardless of their origination volume. This would prevent industry consolidation and preserve access to credit for the millions of small town and rural borrowers served by community banks. The housing market is best served by a large and geographically-dispersed number of lenders. The co-ops would be required to provide liquidity to all home mortgage markets on a continuing and equitable basis. Guarantee fees and reinsurance fees would be set by the co-op boards and would be the same for all members. However, mortgage originators with substandard loan performance would be subject to additional surcharges and restricted access until their loan performance improved.

A limited scope of conservatively-underwritten products would be eligible for sale to the co-ops

The co-ops would guarantee a limited range of conservatively underwritten products: 15- and 30-year fully amortizing mortgage loans that meet the definition of "qualified residential mortgage" (QRM) and adjustable rate mortgage loans that meet the QRM definition, would be exempt from risk retention requirements. Loans that fall outside of the QRM definition would require risk retention by the originator and additional risk to the co-ops would be priced accordingly. These provisions would shield the co-ops from excessive risk.

The co-ops would only be engaged in the secondary market and would be barred from operating in the primary market. They would not unfairly compete with mortgage originators.

A privately-capitalized guarantee fund would insulate taxpayers

Mortgage-backed securities issued by the co-ops would be guaranteed by a fund capitalized by co-op members as well as 3rd party guarantors. Resources would be set aside in good times to prepare for challenging times. The government would provide catastrophic loss protection, for which the co-ops would pay a premium. This guarantee, fully and explicitly priced into the guarantee fee and loan level price, would not only provide credit assurances to investors, sustaining robust liquidity even during periods of market stress, but – a point less often noted – it would enable the co-op securities to be exempt from SEC registration and trade in the "to-be-announced" (TBA) forward market.[2] Without the TBA market, which allows lenders to sell loans forward before they are even

[2] In a TBA trade, participants agree to exchange a given volume of mortgage backed securities at a specified date and at an agreed-upon price. This allows lenders to sell mortgages forward before they are even originated. Because it facilitates hedging of interest rate risk, the TBA market also allows lenders to offer borrowers an interest rate "lock" for as long as 90 days. TBA trades are based on an assumption of homogeneity among the securities that will actually be included in the MBS. This assumption is facilitated by standardization in the underwriting of mortgages and by a government guarantee, implied or explicit.

originated and to hedge their interest rate risk during the rate "lock" period, the 30-year fixed rate loan as we know it and on which our housing market is based will become a rarity. Though the co-ops would be ultimately backstopped by the government, private capital from members and private reinsurers would absorb all but catastrophic losses; government reinsurance funds and ultimately the taxpayer would be well insulated.

Easy transition from Fannie Mae and Freddie Mac

The infrastructure of Fannie and Freddie – including their personnel, systems, automated underwriting engines – would transfer to the new co-ops. This is an essential feature of the proposal as it would minimize disruption in the market and reduce the cost of the transition to the new system.

The outstanding debt and securitizations of Fannie and Freddie would maintain the current guarantee.

Strong supervision

The Federal Housing Finance Agency (FHFA) would regulate and supervise the co-ops. FHFA would be responsible for setting and monitoring capital levels based on market conditions, portfolio performance and overall safety and soundness. FHFA would approve all new mortgage products purchased by the co-ops.

Closing

Private entities will succeed Fannie Mae and Freddie Mac; that much is all but settled. Still to be determined is what form those entities will take – instruments of Wall Street or those in which community banks and large banks are equally represented and communities and customers of all varieties are served.

ICBA looks forward to working with this committee, the Administration, and our industry partners to enact our proposal or another proposal that meets our criteria and is in the best interest of the communities we serve.

Thank you.

NMHC National Multi Housing Council®
Apartments: Smart Communities, Smarter Living

NAA National Apartment Association

STATEMENT FOR THE RECORD

ON BEHALF OF THE

NATIONAL MULTI HOUSING COUNCIL

AND THE

NATIONAL APARTMENT ASSOCIATION

BEFORE THE

HOUSE COMMITTEE ON FINANCIAL SERVICES

GSE REFORM

March 1, 2011

1850 M Street, NW, Suite 540 ▪ Washington, DC 20036 ▪ 202.974.2300 ▪ FAX 202.775.0112 ▪ www.nmhc.org ▪ info@nmhc.org

Chairman Bacchus, Ranking Member Frank and distinguished Members of the Committee, the National Multi Housing Council (NMHC) and the National Apartment Association (NAA) commend you for your efforts to address the future of the housing finance system and respectfully submit this statement to present the perspective of the multifamily industry, specifically with respect to the reform of the Government Sponsored Enterprises (GSEs) Fannie Mae and Freddie Mac.

NMHC and NAA represent the nation's leading firms participating in the multifamily rental housing industry. Our combined memberships are engaged in all aspects of the apartment industry, including ownership, development, management and finance. The National Multi Housing Council represents the principal officers of the apartment industry's largest and most prominent firms. The National Apartment Association is the largest national federation of state and local apartment associations. NAA is a federation of 170 state and local affiliates comprised of more than 50,000 multifamily housing companies representing more than 5.9 million apartment homes.

The bursting of the housing bubble exposed serious flaws in our nation's housing finance system. As policymakers craft solutions to fix the single-family housing problems, they should be mindful not to do so at the expense of the much smaller and less understood, but vital, multifamily sector.

Apartments are a critical component of the nation's housing market and should not be overlooked in the reform debate or considered of secondary importance to the single family "for sale" market. The capital needs of the multifamily industry are quite different and deserve special attention to ensure that reform efforts in the single-family area, such as moving to a fully privatized market, do not create unintended consequences for the rental housing industry.

This is especially important given the successful track record of the GSEs' multifamily business. They continue to operate with very low default rates and generate net revenues for the government. Proposals to fully privatize the mortgage finance system threaten this success by failing to recognize the fact that history has shown that the private markets cannot meet a majority of the industry's capital needs, even in healthy economic times. For this and other reasons, we believe a federally backed secondary market is absolutely critical to the sector's health and our continued ability to meet the nation's growing demand for rental housing.

Administration Report to Congress: Reforming America's Housing Finance Market

We are encouraged by the recently released Obama Administration's blueprint for winding down the operations of Fannie Mae and Freddie Mac, mostly for what it did not propose, i.e., a single rigid reform policy. The three options it outlined serve as a good starting point for discussion. They are:

(1) completely eliminating Fannie Mae and Freddie Mac and move to a privatized mortgage market;
(2) phasing out the government's guarantee of mortgage-backed bonds until it is left as the insurer of the last resort for times of crisis; and
(3) continuing to offer a more limited federal guarantee at all times.

We have given considerable attention to the range of options and urge lawmakers to focus their attention—at least in terms of serving the rental housing industry—on the third option, e.g., a system that provides a federal guarantee at all times.

While we are encouraged by the thawing in the private capital markets and support a return to a marketplace dominated by private capital, lawmakers need to understand that even in healthy economic times history has made it clear that the private market simply cannot meet a majority of the rental housing industry's capital needs. Multifamily mortgages are far more complicated than single-family mortgages, which are more easily served by the private sector.

We also have serious doubts about the ability of an "emergency-only" federal guarantee—option number two—to ramp up quickly enough to adequately respond to a capital crisis.

Key Points: The Apartment Market, GSE Performance and Private Capital

As you contemplate future policy positions to alter the government's role in mortgage financing, we ask that you consider the following key points about the apartment industry, the performance of the GSEs' multifamily business and the state of private capital investment in multifamily:

- In stark contrast to the single-family sector, the apartment industry did not overbuild during the housing boom. As noted above, the lack of capital during the economic downturn has created the perfect storm of rising demand and decreased supply.

- The GSEs' multifamily programs did not contribute to the housing meltdown. In fact, quite the opposite can be said. Overall loan performance in the $2 trillion multifamily sector remains relatively healthy, with the strongest performance recorded by the debt provided by the GSEs. Their multifamily delinquency and default rates remain below one percent—a tenth of the size of the delinquency/default rates plaguing single-family. In short, the GSEs' multifamily programs are not broken. They pose no risk to the taxpayer and have produced net revenues for the U.S. government.

- Nearly ALL of the multifamily funding provided by the existing GSEs helped create workforce housing (not just the capital they provided to properties designated "affordable"). Fully 90 percent of the apartment units financed by Fannie Mae and Freddie Mac over the past 15 years—more than 10 million units—were affordable to families at or below the median income for their community. This includes an overwhelming number of market-rate apartments with no federally appropriated subsidy, produced with virtually no risk to the taxpayer.

- Through careful underwriting, the GSEs' multifamily models have met the test. They have attracted enormous amounts of private capital; helped finance millions of units of market-rate workforce housing without federal appropriations; sustained liquidity in all economic climates; and ensured safety and soundness in their multifamily business. As a result of the liquidity provided by the GSEs, the United States has the best and most stable rental housing sector in the world.

- Private market sources of capital for multifamily are not sufficient. Banks are limited by capital requirements and have never been a source of long-term financing. They currently hold 31.2% of outstanding multifamily mortgage debt. Between 1990 and 2010, they provided 24% ($136.49 billion) of the total net increase in mortgage debt but have provided limited amounts of capital to the industry since the financial crisis.

  Life insurance companies typically lend primarily only to newer, luxury high-end properties and enter and leave the multifamily market based on their investment needs and economic conditions. They currently hold just 5.6% of outstanding multifamily mortgage debt. Between 1990 and 2010, they accounted for just 3% ($18.3 billion) of the net increase in multifamily mortgage debt.

FHA has exceeded its capacity to meet the sector's capital demands, and their capital targets construction lending. FHA/Ginnie Mae currently hold 14% of outstanding multifamily mortgage debt. From 1990 to 2010, they accounted for 10.7% ($59.6 billion) of the total net increase in mortgage debt.

The private-label CMBS market is unlikely to return to the volume and market share it reached a few years ago. It peaked at 16.5% of the market ($17.6 billion a year) in the housing bubble years of 2005-2007. The CMBS market now holds 12.2% of the outstanding multifamily mortgage debt.

While covered bonds might provide some additional liquidity to apartment borrowers, they are unlikely to provide the capacity, flexibility and pricing superiority necessary to adequately replace traditional sources of multifamily mortgage credit, including the GSEs.

Why Getting It Right for Multifamily Matters

It is critical for Congress to understand why it is more important than ever that the multifamily sector have reliable and sufficient access to capital. The United States is on the cusp of a fundamental change in our housing dynamics. Changing demographics are causing a surge in rental demand that will continue long after the economic recovery. This includes 78 million echo boomers entering the housing market, baby boomers downsizing and a dramatic decrease in the number of married couples with children to less than 22% of households.

Between 2008 and 2015, nearly two-thirds of new households formed will be renters. That's six million new renter households. University of Utah Professor Arthur C. Nelson predicts that half of all new homes built between 2005 and 2030 will have to be rental units. Yet, private capital for new apartment construction all but disappeared during the crisis, virtually halting new development activity for nearly two years.

New multifamily construction set an all-time post-1963 low in 2010 at 97,000 new starts. We need to be building an estimated 300,000 units a year to meet expected demand. However, most forecasts suggest we'll start fewer than half that many in 2011. That's not even enough to replace the units lost every year to demolition, obsolescence and other losses.

Without government credit support of multifamily mortgages or mortgage-backed securities to ensure a steady and sufficient source of capital going forward, the apartment industry will not be able to meet the nation's housing needs and Americans will pay more for workforce housing. A federally backed secondary market is critical not only for the long-term health of the industry but also to help refinance the more than $200 billion in multifamily mortgages that will mature over the next five years.

Key Principles for GSE Reform

The apartment industry urges you to consider the following key points for inclusion in any reform measure:

1. **Do No Harm: Preserve Multifamily Lending Programs**
   The multifamily sector produces the vast majority of this nation's affordable, workforce housing. Given that private capital cannot meet the industry's financing needs, it is an appropriate and important public mission for the government to ensure sufficient liquidity to the sector. In addition, the multifamily sector, and more specifically the GSEs' multifamily programs, did not contribute to the housing meltdown. Therefore, as policymakers "fix" the

problems in the single-family sector, they should not do so at the detriment of the multifamily industry.

2. **Protect the Taxpayer: Look to Proven Multifamily Models**
The taxpayer is footing the bill for the breakdown of the single-family housing sector, and that should never happen again. The GSEs' multifamily programs can serve as a model for a reformed housing finance system. They have performed extraordinarily well and have less than a one-percent delinquency rate. Historically, they have been well capitalized, have covered all their losses through the loss reserves they collected and have earned a profit. Even during conservatorship, the GSEs' multifamily programs have earned net revenues of $2 billion.[1] Their success is the result of strong business models that use retained risk and stringent underwriting criteria.

To protect the taxpayer going forward, these models should be carefully studied for a broader application within the larger housing finance system. Specifically, the government must ensure strong regulatory oversight. It should consider implementing some level of retained risk by mortgage originators and servicers and adequate capital standards to fund loan-loss reserves. These steps would preserve the strong mortgage loan performance and track record seen in the multifamily sector and protect the taxpayer.

3. **Federal Government Involvement Necessary and Should Be Appropriately Priced**
Even after we transition to a new housing finance system, there will be an ongoing need for an explicit federal government guarantee on multifamily mortgage securities and portfolio-held loans. Over the past 40 years, there have been numerous occasions when the private sector has been unable or unwilling to finance multifamily loans. There is a legitimate concern that the private sector cannot be counted on, from both reliability and capacity standpoints, to consistently finance the majority of multifamily borrowers' needs. Hence, it is hard to envision a reformed housing finance system without some form of federal credit enhancement. However, that credit should be priced at an appropriate level that reflects the mortgage risk and the value of the government's credit enhancement and in such a way that it complements, but does not unfairly compete with, private debt capital.

4. **Liquidity Support Should Be Broad and Available at All Times, Not Just "Stop-Gap" or Emergency**
Any federal credit facility should be available to the entire apartment sector and not be restricted to specific housing types or specific renter populations. Narrowing any future credit source would remove a tremendously important source of capital to a large portion of our industry, namely market-rate developers who actually provide a large volume of unsubsidized workforce housing. Such a facility should also be available at all times to ensure constancy in the U.S. housing market throughout all business cycles. It would be impossible to turn on and off a government-backed facility without seriously jeopardizing capital flows.

5. **Mission Should Focus on Liquidity, Not Mandates**
The public mission of a federally supported secondary market should be clearly defined and focused primarily on using a government guarantee to provide liquidity and not specific affordable housing mandates. Such mandates create conflicts within the secondary market and are partially responsible for the housing crisis because of the distortions the mandates introduced into the GSEs' business practices. Instead of mandates, the new housing finance system should provide incentives to support the production and preservation of af-

[1] Source: GSE SEC filings. This does not include write-downs of Low-Income Housing Tax Credit holdings that the firms have been prohibited from selling and liquidating.

fordable multifamily housing. Absent incentives, the government should redirect the affordability mission to HUD/FHA and the Low-Income Housing Tax Credit program.

6. **Retain Portfolio Lending While Expanding Securitization**
   Securitization must be used to attract private capital for multifamily mortgage capital. However, unlike single-family loans, multifamily loans are not easily "commoditized." Without the ability to hold some loans in portfolio, multifamily lending activities will be significantly curtailed. In addition, securitizing multifamily loans is not always the best way to manage credit risk. Portfolio capacity is also required to aggregate mortgages for a structured securities sale.

7. **Create Certainty and Retain Existing Resources/Capacity During the Transition**
   To avoid market disruption, it is important that policymakers clearly define the role of the government in a reformed system and the timeline for transition. Without that certainty, private capital providers (e.g., warehouse lenders and institutional investors) are likely to limit their exposure to the market, which could cause a serious capital shortfall to rental housing. In addition, during the transition years, we believe it is critical to retain many of the resources and capacity of the existing GSEs. The two firms have extensive personnel and technology expertise as well as established third-party relationships with lenders, mortgage servicers, appraisers, engineers and other service providers that are critical to a well-functioning secondary market.

We appreciate the opportunity to present the views of the apartment industry and look forward to working with you to build a world-class housing finance system that meets the nation's changing housing needs while also protecting the taxpayers.

December 20, 2010

The Honorable Shaun Donovan
Secretary of Housing and Urban Development
451 7th Street, SW
Washington, DC 20410

The Honorable Timothy Geithner
Secretary of the Treasury
1500 Pennsylvania Avenue, NW
Washington, DC 20005

Dear Secretary Donovan and Secretary Geithner:

On behalf of the millions of diverse homeowners, future homebuyers, and renters represented by our organizations, we write to provide three recommendations for you to consider as you map out the next phase of our nation's housing finance system. Ensuring that all Americans have access to fair and sustainable credit opportunities is crucial to our economic recovery. Yet our communities have long been underserved by the housing markets, targeted by predatory lenders, and denied opportunities to build housing wealth. The current policy debate surrounding the structure of our housing system, including the government-sponsored enterprises Fannie Mae and Freddie Mac, provides a unique opportunity to make improvements. The future housing finance system must affirmatively establish pathways to homeownership for qualified borrowers and safe and affordable rental homes for all families.

The federal government has a critical role to play in ensuring that the secondary market serves all borrowers in a fair and equitable manner. Without federal incentives or interventions, the housing finance system will not reach all segments of borrowers and geographic areas. We urge you to support a balanced national housing policy that facilitates a stable, liquid secondary market—accessible to small and large lenders alike—which will extend credit and capital on an equitable basis to all qualified borrowers and in all communities.

We need a financial system in which all players share accountability to protect consumers and the integrity of the system. The subprime lending and foreclosure crisis is a manifestation of unequal access to banking and financial services, not simply an isolated anomaly or the fault of a few fraudulent lenders and borrowers. Thus, one of our primary objectives in revising the national housing system is to ensure the affirmative delivery of fairly priced capital to underserved borrowers and neighborhoods. Our organizations have come together to establish a set of principles on which to base housing finance reform.[1] We are using these principles as benchmarks for evaluating all related policy proposals. Together we have reviewed the proposals publicly available on the Department of Treasury website and testimony delivered at

[1] A copy of the principles is attached and was disseminated at a series of meetings with staff from the Treasury, Department of Housing and Urban Development, and White House.

hearings hosted by the Department of Housing and Urban Development, as well as met with several of the staff from your agencies. Based on our assessment of the current state of the policy debate, we are offering three recommendations for your final proposal. These recommendations do not represent everything that there is to be said about housing finance reform. However, we consider these points to be the most critical from a civil rights perspective at this point in the conversation.

Recommendation 1: Ensure that the housing finance system furthers our nation's fair housing goals.

The federal government is obligated to promote nondiscrimination, residential integration, and equal access to the benefits of decent and safe housing and ownership opportunities. However, clear standards for implementation have not been applied to our housing finance system. For decades our housing finance system has operated on a "dual track" where factors other than a borrower's creditworthiness affected the terms of his or her home loan. African American, Asian American, Pacific Islander, Native American, Hispanic, immigrant, elderly, and female borrowers have been routinely steered into substandard mortgages, even when their credit warranted a prime loan.[2] Such loans are more expensive and more likely to go into foreclosure, costing African American and Latino families alone billions of dollars in lost wealth.[3] This two-tiered financial system is known as the dual credit market.

Federal policies have allowed the dual credit market to persist, feeding the racial, ethnic, and gender wealth gaps. U.S. policy has subsidized homeowners and homeownership in a variety of ways, including through generous tax subsidies and backing for secondary market entities. These policies direct the largest subsidies to wealthier homeowners. Their lack of access to conventional credit has meant that borrowers of color, women, and other underserved groups—regardless of their income—have not had the same access to the benefits created by these federal supports. Such subsidies also benefit the corporations that can conduct a profitable business because of the federal government's investment. As a consequence, the Obama administration must unequivocally and effectively apply fair housing and equal credit principles to our federal housing system and end the dual credit market. We offer two recommendations for this challenge:

- Require all lenders and securitizers receiving a government guarantee of any kind to affirmatively market and offer credit in a manner that promotes equal opportunity in all neighborhoods. The receipt of federal support, including insurance and guarantees,

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[2] An analysis conducted by First American Loan Performance found that 41% of subprime loans made in 2004 went to borrowers who actually would have qualified for prime rate loans. See Ezra Klein, "Digging into Finance's Pay Dirt: The Risky Business of Payday Loans and More," *Washington Post*, July 25, 2010, http://www.washingtonpost.com/wp-dyn/content/article/2010/07/24/AR2010072400153.html (accessed December 20, 2010). Another study found that 55% of subprime borrowers in 2005 and 61% of subprime borrowers in 2006 would have qualified for prime rate loans. See Rick Brooks and Ruth Simon, "Subprime Debacle Traps Even Very Credit-Worthy," *Wall Street Journal*, December 3, 2007, http://online.wsj.com/article/SB119662974358911035.html (accessed December 20, 2010).

[3] Debbie Gruenstein, Keith Ernst, and Wei Li, *Foreclosures by Race and Ethnicity: The Demographics of a Crisis* (Durham, NC: Center for Responsible Lending, 2010), http://www.responsiblelending.org/mortgage-lending/research-analysis/foreclosures-by-race-and-ethnicity.pdf (accessed December 20, 2010).

invokes the mandate to affirmatively further the objectives of the Fair Housing Act. Therefore, the delivery of government-supported mortgage credit or rental financing cannot be withheld from any geographic location or neighborhood. Instead, the delivery infrastructure must make deliberate provisions for the flow of credit to all qualified borrowers and neighborhoods. Moreover, the infrastructure must include a mechanism for monitoring and enforcing compliance, both by the government and the public. Simple, transparent, and timely data must be made publicly available to measure the market's progress in providing fair, sustainable capital to underserved people and communities.

- Establish the necessary mechanisms to prevent the targeting or limiting of mortgage capital by any segment of the housing finance system in a manner that is discriminatory or perpetuates segregation or redlining (including reverse redlining).[4] Racial segregation has been a significant predictor of the share of subprime loans a neighborhood receives, even after controlling for the percentage of minorities within the metropolitan area as a whole, credit score, median home value, poverty, and education. By contrast, neither poverty nor unemployment is a statistically significant predictor of the percent of subprime loans.[5] No one in the housing finance system—originators, private mortgage insurers, government-backed securitizers, or private label securitizers—should be allowed to adjust the levers of mortgage capital in a metropolitan area or geographic region in a manner that creates artificial barriers to favorable, sustainable credit.

Recommendation 2: Avoid overreliance on Federal Housing Administration (FHA) mortgage insurance.

FHA plays a critical role in the market by making credit available to people with modest incomes. These borrowers have the ability to repay a mortgage but may have less-than-perfect credit or limited resources for a down payment and closing costs. However, several proposals for modifying the housing finance system have suggested that borrowers who fall outside the banking industry's preferred profile (which may be based on characteristics other than risk or creditworthiness) would be best served by FHA mortgage insurance. We strongly caution against this flawed framework. Leaving an entire borrower segment and whole neighborhoods reliant on a single source of mortgage credit is bad policy for a number of reasons.

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[4] The practice of targeting borrowers and communities of color for loans on unfavorable terms is known as reverse redlining. Redlining is a practice in which banks identify communities—usually communities of color—where they refuse to make loans or extend credit. Reverse redlining occurs when lenders promote predatory credit to the same communities that found themselves starved of credit because of redlining. Reverse redlining is a recognized violation of the federal Fair Housing Act. See Raymond H. Brescia, "Subprime Communities: Reverse Redlining, the Fair Housing Act and Emerging Issues in Litigation Regarding the Subprime Mortgage Crisis," *Albany Government Law Review* 2, no. 164 (2009): 164–216.

[5] Gregory D. Squires, Derek S. Hydra, and Robert N. Renner, *Segregation and the Subprime Lending Crisis*, Briefing Paper #244 (Washington, DC: Economic Policy Institute, 2009), http://www.epi.org/publications/entry/segregation_and_the_subprime_lending_crisis (accessed December 20, 2010). Squires et al. found that a 10% increase in African American segregation, on average, is associated with a 1.4% increase in high-cost lending, and a 10% increase in Hispanic segregation, on average, is associated with a 0.6% increase in high-cost lending.

The FHA program insures home loans, but FHA is not directly involved in the underwriting or servicing of those loans. This gives the federal government limited control over its implementation in the marketplace.[6] For example, lenders are able to impose additional fees and charge higher interest rates to FHA borrowers, undermining affordability and blocking qualified borrowers from accessing the program. Limited program oversight has opened the door to a variety of abuses, including inflated appraisals, property flipping, and other fraudulent or sloppy origination practices. When these problems led to high levels of foreclosures concentrated in particular communities (often communities of color), FHA did not demonstrate the capacity to manage a large real estate owned portfolio. This, in turn, led to declining property values, the deterioration of vacant homes, and a host of other problems in affected neighborhoods. The problems associated with the overconcentration of FHA lending in communities of color and low- and moderate-income communities look very much like the problems we are currently experiencing in neighborhoods that were flooded with subprime and other exotic and unsustainable loans.

FHA works best in a competitive market where it is one of many options available to a wide range of borrower segments. Not only is this critical to keeping FHA actuarially sound, it keeps lenders engaged in the low down payment and underserved markets. In the absence of competition for their business on safe and sustainable terms, our communities face two troubling scenarios: being overrun with FHA loans and denied access to conventional credit, or being cut off from credit entirely if lenders decline to offer the FHA product. Both scenarios leave certain borrowers and neighborhoods vulnerable to a resurgence of predatory or substandard credit and enable a two-tiered financing system.

To avoid overcommitting too much of the market to FHA, the federal housing finance proposal must support responsible yet flexible underwriting within loans that receive federal backing or support on the secondary market. This should include the development of low down payment products. Doing so will keep credit markets available to qualified minority and underserved homebuyers.

Recommendation 3: Support integrated neighborhoods and equal homeownership opportunities.

Too often the rental and ownership tenures are pitted against one another in housing policy debates. However, balanced housing policy requires neighborhoods and families to have access to viable options in both markets. Safe and affordable rental housing in opportunity-rich neighborhoods is critical to breaking down the barriers of segregation. Communities hit hard by

[6] The Department of Justice recently reached a settlement with PrimeLending to resolve alleged civil rights violations. The lender charged African American borrowers higher interest rates than White borrowers for FHA-insured mortgages in its retail loans. See U.S. Department of Justice, "Justice Department Reaches Settlement with National Mortgage Lender to Resolve Allegations of Lending Discrimination," news release, December 8, 2010, http://www.justice.gov/opa/pr/2010/December/10-crt-1406.html (accessed December 20, 2010); and National Community Reinvestment Coalition, *Working-Class Families Arbitrarily Blocked from Accessing Credit: NCRC's Fair Lending Investigation of Credit Score Restrictions by Federal Housing Administration-approved Lenders* (Washington, DC: National Community Reinvestment Coalition, December 2010), http://www.ncrc.org/images/stories/mediaCenter_reports/fha%20white%20paper-120810-final.pdf (accessed December 20, 2010).

the foreclosure crisis, unemployment, and divestment require unique rebuilding strategies. Homebuyers and owners who have historically lacked access to prime credit need reliable loans. These market demands can be harmonized by the secondary market with government support. We recommend the following:

- Increase the supply of affordable rental housing (both subsidized and unsubsidized) to meet demand. This will prevent low-income families from having to forgo basic necessities to pay their rent. It will also allow them to take the first steps toward homeownership—budgeting, saving, and creating a positive credit history. In addition, the way to greater civic and economic opportunity should be paved by creating incentives to locate new, affordable housing outside of areas that are racially concentrated and have high levels of poverty. Securitizers should be discouraged from isolating their financing in a manner that concentrates all market rate developments in low-poverty areas and all "affordable" developments in high-poverty areas. Rather, new standards should create incentives for mixed-income and inclusionary housing development, as well as community rebuilding. Federal support must not be used in a manner that perpetuates the concentration of poverty and racial segregation. We also note that sustaining smaller, existing multifamily housing (in the 1–4 and 5–50 unit ranges, which serve the majority of our country's renters) in diverse urban and suburban neighborhoods requires a reliable source of long-term financing. Existence of a liquid, affordable secondary market for such loans requires involvement of the federal government and must be a part of the housing finance system of the future.

- Support a wide array of housing choices, including affordable family rentals, cooperative and shared equity housing, affordable condominiums, and starter homes. In addition, flexible and affordable mortgage products proven to be sustainable should also be supported. This includes those that are fully documented and allow for low down payments and alternative measures of creditworthiness. Such products have a track record of good performance and help to meet the credit needs of underserved communities. This type of responsible flexibility is the key to equalizing homeownership rates. It also helps to close the wealth gap among people of different races and ethnicities. This, in turn, represents a critical step toward rebuilding the wealth that has been drained from communities of color as a result of the targeted and irresponsible lending that spurred the foreclosure crisis.

We believe that these three points are essential and should be included in the Treasury's initial proposal for housing finance reform, and we urge you to incorporate them into the plan you release next month. However, we also recognize that the complex task of rethinking our housing finance system involves a number of other factors, including investigating the impact of the Dodd–Frank Act and addressing the need to strengthen fair lending oversight and enforcement in the primary and secondary markets. These are important policy questions that we intend to address, and we hope to do so in partnership with your agencies. To discuss our recommendations further, please contact Janis Bowdler, National Council of La Raza (NCLR), at (202) 776-1748 and jbowdler@nclr.org or Debby Goldberg, National Fair Housing Alliance, at (202) 898-1661 or dgoldberg@fairhousing.org. We look forward to continuing this dialogue with you and your staff.

Sincerely,

Bonnie Milstein
The David L. Bazelon Center for Mental Health Law

Martin Eakes
Center for Responsible Lending/Self-Help Credit Union

john powell
Kirwan Institute

Wade Henderson
The Leadership Conference on Civil and Human Rights

Hilary O. Shelton
NAACP

Leslie Proll
NAACP Legal Defense & Educational Fund, Inc.

Lisa Hasegawa
National Coalition for Asian Pacific American Community Development

Janet Murguía
National Council of La Raza

Shanna Smith
National Fair Housing Alliance

Marc Morial
National Urban League

Victor Galloway
North Carolina Institute of Minority Economic Development

Alan Jenkins
The Opportunity Agenda

Angela Glover Blackwell
PolicyLink

Philip Tegeler
Poverty & Race Research Action Council

cc: Jacob Lew, Director, Office of Management and Budget
Xavier Briggs, Associate Director for General Government Programs, Office of Management and Budget
Austan Goolsbee, Chairman, Council of Economic Advisors
Melody Barnes, Director of the Domestic Policy Council, White House

Civil Rights Statement of Principles for Secondary Market Reform

Equal access to mainstream financial services and affordable rental and owner-occupied housing is a critical step toward providing all families with access to wealth-building opportunities, good jobs, schools, transportation, health care, and other factors that determine positive life outcomes. Providing this access has been, and must remain, an important government policy goal.

One of the lessons of the current financial crisis is that our nation's housing finance system has not worked well for people of color and other underserved groups. Perverse incentives in the secondary market often drove unregulated brokers to target borrowers in communities of color with unsustainable loans. This fed a securitization regime so poorly understood and regulated that it ultimately destabilized the global economy. As the secondary market helped to drive this phenomenon, it also failed to make necessary investments in rental housing that met the needs of communities and opened opportunities for people.

Unregulated and often predatory subprime lending not only failed to maintain or promote sustainable homeownership opportunities but also established a dual credit market where factors other than a borrowers' creditworthiness determined the type and terms of the mortgages that were sold. All too often, families were denied the best credit for which they qualified, and their communities were flooded with unsustainable mortgage credit. As these unsustainable loans failed, the housing finance system failed to provide these families with the home-saving options that they were due. Instead of being able to use homeownership as the path to wealth-building and financial stability that our public policy promises, families have had their wealth stripped away and are facing financial setbacks that will take a generation or more to overcome.

It is because of this unfortunate history of exclusion of underserved communities from sustainable credit and housing options that civil rights organizations are invested in the housing finance reform debate and should be counted on as important civic partners. This debate is unfolding in the context of four decades of widening income and wealth inequality that have kept many borrowers from accessing the financial tools and options that provide an economic ladder to the middle class. Federal housing policy must reverse this and incorporate bold policy solutions to address inequality and segregation in the United States. It is in this spirit that we offer the following principles for secondary mortgage market reform. The principles were drafted by a group of more than 20 organizations that serve millions of members of underbanked communities throughout the United States, including African American, American Indian, Asian American, Pacific Islander, Latino, and low-income populations, as well as people with disabilities and the elderly. The points below are critical in shaping the future secondary mortgage market.

1. **Federal housing finance policy must align with and support longstanding federal housing goals to protect against discrimination.** The secondary mortgage market must promote residential integration, the elimination of housing discrimination, and the provision of safe, decent, and affordable housing for all.

2. **The federal government has a responsibility to ensure that the secondary market serves all borrowers in a fair and equitable manner and to foster the equalization of homeownership rates.** Despite clear demand from qualified families, the mortgage market does not reach all segments of borrowers and geographic areas. It is incumbent upon the federal government to use its resources to facilitate a stable, liquid housing finance system that will extend credit and capital on an equitable basis to all borrowers and in all communities, with the goal of achieving the same rates of homeownership among communities of color as among whites. While not all household heads must become homeowners, a commitment should be made to achieve similar homeownership levels across all communities. In addition, the system must be made accessible by a wide range of lending institutions for both owner-occupied and rental housing.

3. **A reformed housing finance system must eliminate the dual credit market.** Such a market has relegated people of color and other underserved groups and communities to riskier, higher cost forms of credit that strip wealth and undermine financial security. To accomplish this goal, reform of the secondary market must be coordinated with reform in the primary market for housing and other types of credit.

4. **Regulatory oversight of the housing finance system must be rigorous and comprehensive and must include effective fair lending enforcement.** Further, oversight and enforcement must extend to all secondary market entities, whether or not they avail themselves of any federal guarantee or other support.

5. **Secondary market transactions must be transparent and accountable to the public.** Detailed, granular data about the operations of all secondary market entities must be made available to the public on a timely and consistent basis. This includes data about the race, gender, national origin, and other relevant characteristics of borrowers; how a loan was serviced, purchased, and securitized; and the terms and conditions of the loans.

6. **The system must have an affirmative obligation to offer capital and credit in communities devastated by the foreclosure crisis and offer access to families who were targeted for inappropriate and unsustainable mortgages.** It must engage with community-based financial institutions and community-based organizations to design sustainable solutions that are appropriate for specific locales.

7. **The housing finance system must provide capital for sustainable rental and ownership development in all communities.** Neighborhoods require affordable and sustainable rental and homeownership opportunities to thrive. Capital, especially that which comes with a

government subsidy or guarantee, should be directed to underserved areas and investments in opportunity-rich neighborhoods. This balance will provide the maximum range of housing choices for all, as there is not currently an adequate supply of affordable housing for underserved families.

8. **The housing finance system must support product flexibility and sustainable innovation and offer access to institutions of all sizes and in all geographic areas.** To do so requires that the secondary market avoid over concentration and that secondary market institutions have the ability to retain loans in their portfolio. Local institutions are often the first responders to local needs, adapting underwriting models to fit their clientele and funding innovation through their own deposit-based portfolios. Without a secondary market outlet, the volume of these loans will always be constrained. Further, because innovation is not always immediately scalable or easily standardized, it runs the risk of being overlooked by large financial institutions or secondary market purchasers.

Questions for the Record
Treasury Secretary Timothy F. Geithner
Financial Services Committee Hearing entitled
"Mortgage Finance Reform: An Examination of the Obama Administration's Report to Congress"
March 1, 2011

Questions from Rep. Perlmutter

1. **In your testimony, you reference the losses Fannie Mae and Freddie Mac have inflicted on the taxpayers as one of the primary reasons for the need to reform our current housing finance system. These losses to the taxpayer make it imperative that we require the GSEs to operate efficiently and that they attempt to return as much money to the taxpayer as possible. In this spirit, I want you to be aware of a practice that has been brought recently to my attention, i.e. that Freddie Mac is leaving substantial money on the table by not exercising clean-up call rights on its REMIC issues. In fact, while Freddie (unlike Fannie) puts call rights into its contracts, it does not exercise them. Can you please provide me with contractual or other restrictions preventing Freddie Mac from exercising these clean-up calls?**

Exercising clean-up calls could disrupt smoothly functioning markets and negatively affect the value of Freddie Mac's securities in the future. FHFA, as conservator and regulator of Freddie Mac, has oversight over these matters and Treasury is not involved in any of the day-to-day operating business decisions of the GSEs. Please ask FHFA for further information on this issue.

2. **As you know, Freddie Mac owns the right to redeem the REMIC, but the residual holder holds the right to any additional value on redemption. Typically in other private sector exchanges, the residual holder will offer incentives to the call right holder by sharing a substantial percentage of the benefit with the call right holder. It is quite common, for the benefit to be shared equally between the two parties. Given this analysis, is it not to be the advantage of the taxpayer to receive the benefit that could arise from this type of exchange? Is there any reason that Freddie Mac should not indicate that it is open to such activity, especially in this relatively low interest rate environment?**

Please see above response.

Questions for the Record
Treasury Secretary Timothy F. Geithner
Financial Services Committee Hearing entitled
"Mortgage Finance Reform: An Examination of the Obama Administration's Report to Congress"
March 1, 2011

<u>Questions from Rep. Patrick McHenry</u>

1. **I'm concerned by reports that Administration officials with no enforcement authority in this area reportedly are participating in the development of settlement options. In particular, Elizabeth Warren – your advisor on the CFPB – and members of her staff are reportedly helping to craft these settlement proposals. What is her role in this process?**

As I stated in a letter to Representative Bachus on March 15, 2011, under the Dodd-Frank Wall Street Reform and Consumer Protection Act, the Bureau of Consumer Financial Protection (CFPB) does not have current authority to administer penalties and therefore will not be a party to any formal settlement with mortgage servicers. Under that same law, the CFPB will obtain significant authority to set standards for the mortgage servicing industry on July 21, 2011. For this reason, Elizabeth Warren and the CFPB have been invited to advise the other agencies on how to design appropriate servicing standards for the mortgage servicing industry.

2. **Can you confirm that political officials are not involved in deciding how to settle these foreclosure cases?**

A broad interagency group, including federal and regulatory agencies, as well as state attorneys general, continues to work toward a comprehensive resolutionthat holds servicers accountable if they have not followed the law. The Obama Administration, along with the banking regulators and the state attorneys general, are committed to ensuring that the servicers are held fully accountable for any wrongdoing.

3. **It is my understanding that if the U.S. government reaches a monetary settlement with the banks, the funds for redress belong to the U.S. Treasury, because it was the government who was harmed. Therefore, it would not be legally permissible for the CFPB, or any other regulator, to resolve these matters by having funds directed to any place other than the taxpayers through the Treasury. To then allocate these funds, Congress would need to authorize that spending. Is this your understanding?**

If the government entered into a monetary settlement with banks, the terms of the settlement agreement would govern where the funds would be placed and how the funds could be disbursed. If there were no specific provision in such a settlement, funds collected by the government would be deposited into the General Fund of the United States. Money in the General Fund is available to pay any legal obligation of the United States that has not been directed to be paid from another source.

Questions for the Record
Treasury Secretary Timothy F. Geithner
Financial Services Committee Hearing entitled
"Mortgage Finance Reform: An Examination of the Obama Administration's Report to Congress"
March 1, 2011

<u>Questions from Rep. Carolyn McCarthy</u>

1. **Your proposals aim to minimize government exposure with regard to housing finance, in some cases completely, which I understand the need to do. However, I have concerns with how much of a role the private market is willing to take on. We have seen private lending become very conservative in an effort to minimize their risk exposure, which is understandable, however, as a result, many potential homebuyers will be shut out of the process.**

   Has there been consideration of the potential impact reducing the FHA loan limits could have on potential homebuyers in high cost of living areas that are disqualified from the private market, for example, because they don't meet the down payment requirements?

The Administration recommends that Congress allow the temporary increase in loan limits that was approved in 2008 be allowed to expire as scheduled on October 1, 2011. Higher cost mortgages represent a relatively small fraction of the overall business activity of FHA, Fannie Mae, and Freddie Mac; they comprised approximately 5 percent of the total loan volume of FHA, Fannie Mae, and Freddie Mac in 2010.

But reducing conforming loan limits is only one policy lever that can be utilized to begin reducing the government's footprint in housing finance. Other important measures include increasing guarantee fees and increasing the amount of credit risk syndicated to the private market through Private Mortgage Insurance and other measures.

Furthermore, Treasury will continue to evaluate its recommendations based on developing market conditions and the private market's capacity to provide new mortgages. We are committed to ensuring that the FHA has sufficient capacity so that creditworthy families with modest incomes can obtain a mortgage. HUD and FHA continue to evaluate the affect of any reforms on their lending programs.

2. **How long do you anticipate the transition process of winding down the portfolio of Fannie and Freddie will take, and how will that transition process positively or negatively impact the housing market?**

The pace of the wind down will depend on market conditions. We cannot forget that while we have made important progress stabilizing the housing market, this critical sector of the economy remains fragile. Private capital has not yet fully returned to the market, and the government continues to play an outsized, though unfortunately necessary role in ensuring the availability of mortgage credit. Proposals that prematurely constrain Fannie Mae and Freddie Mac's ability to guarantee loans could limit the availability of mortgage credit, shock the economy, and expose taxpayers to greater losses on the loans already guaranteed by Fannie Mae and Freddie Mac.

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Specifically with respect to Fannie Mae and Freddie Mac's investment portfolios, the Preferred Stock Purchase Agreements require reductions in the investment portfolios at an annual pace of no less than 10 percent. We do not anticipate any changes to that policy at this time.

3. **With regard to the credit risk retention rules required by the Dodd-Frank Act, how do you plan to ensure the rule doesn't prematurely disqualify potential homebuyers, as well as discourage potential homebuyers from going to the private lending market?**

Asset-backed securitization provides important economic benefits by improving the availability and affordability of credit to a diverse group of consumers, businesses, and homeowners. However, as the recent financial crisis made clear, the securitization chain contained critical flaws – it lacked transparency, standardization, and accountability, making it difficult for both investors and regulators to track and recognize risk as it moved through the securitization chain.

The risk retention rules when finalized (promulgated under Section 941 of the Dodd-Frank Act) will help address pre-crisis flaws and rebuild trust and integrity in the mortgage market. This is a key component of the Administration's plan to bring private capital back into the housing finance system. The Secretary of the Treasury, as Chairman of the FSOC, is responsible for coordinating rules under Section 941. The statute itself mandates that securitizers generally retain 5 percent of the credit risk of the assets they securitize. This requirement will improve transparency among participants in the securitization chain and disincentivize brokers and originators from using poor underwriting standards, as many did prior to the financial crisis. Before the crisis, originators and securitizers could sell 100 percent of their credit risk to investors without holding any risk themselves and without regard to those loans' or securities' future performance. The new rule will require securitizers, and in some cases originators, to have "skin in the game" instead of passing the total risk to investors. The rule includes an exemption from the risk retention requirements for the Qualified Residential Mortgage (QRM), which is defined by Section 941, as a residential mortgage loan that has underwriting and product features that historical loan performance data indicate result in a lower risk of default.

A fundamental objective of these rules is to align the interests of originators, securitizers, and investors without unduly constraining or raising the cost of credit. The Administration is listening carefully to industry groups and stakeholders to make sure that the final rule is consistent with this objective.

This rule will also improve efficiency by better coordinating standards across the mortgage market. In the past, multiple regulatory agencies often had varying standards, even for the same asset classes, and there was no level playing field among financial institutions. Six regulatory agencies are worked together to develop this proposed rule, and each agency will enforce the same standards once they become final regulations.

Questions for the Record
Treasury Secretary Timothy F. Geithner
Financial Services Committee Hearing entitled
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March 1, 2011

Questions from Rep. Randy Neugebauer

1. **The Basel III framework requires that large complex banking institutions hold higher levels of capital to account for the risk such institutions pose to the broader financial system should they experience difficulty. As you know, the DFA also requires US regulators to impose a capital surcharge on institutions designated as "systemically important." Will the DFA add-on satisfy the requirements of Basel III or will it be added in addition to the Basel requirement? If it is likely to be added, what are the competitive implications of higher regulatory capital for US-based institutions relative to European or Asian institutions?**

Regulators are working to ensure that Dodd-Frank's requirement that the Federal Reserve establish capital standards for all systemically important financial institutions results in standards consistent with the Basel III framework and the Basel Committee on Banking Supervision international standard for systemically important banks. This will avoid any competitive disadvantage for US firms, and allow the US to comply with its Basel III obligations.

The Treasury Department does not have authority to promulgate capital rules for banks. This is the job of independent banking regulators. These regulators are doing the necessary technical work to develop rules for Basel III implementation in the United States and to satisfy requirements under Dodd-Frank.

In addition, the Basel Committee is reviewing the need for an international standard that would require additional capital to address the externalities created by systemically important firms. Given the complexities of our bank capital standards and the interaction of work in that area with Dodd-Frank implementation, I encourage you to engage with our regulators on these important matters.

2. **Higher levels of higher quality capital have become a central aspect of the policy response to the recent financial crisis. The focus on capital is certainly understandable and even appropriate. But I think you would agree, Mr. Chairman, that effective supervision entails much more that just capital requirements and lots of capital is no guarantee of safety and soundness. Moreover, unnecessarily high capital requirements amount to an obstacle to economic recovery since they limit lending. Given those observations, how do you view the role of capital in ensuring the safety and soundness of banking companies? How should supervisors, and bankers themselves, think about capital in relation to other critical variables such as business activities, risk management, internal control, and corporate governance? Finally, are you concerned that higher capital has been over emphasized in the policy response to the recent crisis, given other important aspects of effective supervision and given the need to encourage and facilitate new lending to support growth and job creation?**

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We believe it is critical that banks continue to operate in times of crisis without turning to the taxpayer for extraordinary support. Increasing capital requirements will undoubtedly reduce the probability of a future financial system crisis. Basel III requirements, which increase the quality and quantity of capital that banks hold, are designed to ensure that major banks hold enough capital to withstand losses as large as what we saw in the depths of this recession. Another important objective of increased capital requirements is to reduce the riskiness of banks. As the market becomes comfortable with the lower risk of banking, the risk premiums associated with investing in the activity should decline, lowering the cost of capital.

Questions for the Record
Treasury Secretary Timothy F. Geithner
Financial Services Committee Hearing entitled
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March 1, 2011

Questions from Rep. Schweikert

1. **What is the Department of the Treasury's opinion with respect to the regulatory burden being faced by many smaller financial institutions across the United States? The head of one well-capitalized bank from Arizona recently told me that his institution underwent fourteen outside audits, examinations, or reviews in the last twelve months. There should be agreement that such a number is inefficient for both the banking institutions as well as the regulators.**

Treasury agrees that it is important to avoid subjecting smaller financial institutions to an undue supervisory burden. However, the recent crisis made clear that the appearance of sound financial condition can mask hidden vulnerabilities. Therefore, supervisors must continue to be vigilant to make sure they understand the risks of financial institutions they supervise.

At the same time, we recognize the importance of striking the right balance between promoting safety and soundness and minimizing the compliance costs, especially for smaller banks. That is why we supported provisions in the Dodd-Frank Act that provide that the regulator now responsible for monitoring the safety and soundness of community banks will enforce rules promulgated by the new Consumer Financial Protection Bureau. Folding both supervisory and consumer protection functions into one regulator will allow small banks to avoid multiple exams.

It is also worth noting several other aspects of Dodd-Frank that strengthen the important role of community banks in our financial system and that work to put community banks on a more equal footing with their competitors, including by reducing unfair funding advantages enjoyed by large financial institutions. Specifically, Dodd-Frank:

- Raises deposit insurance protection to $250,000, providing greater protection for one of community banks' core sources of funding.

- Requires deposit insurance premiums to be based on total liabilities, which are a more accurate reflection of risk than deposits alone. As a result of this change, the premium burden will shift away from smaller banks to larger, riskier banks.

- Provides that large financial institutions will be subject to heightened prudential standards, including requirements to hold more capital and maintain larger liquidity buffers. Community banks, which do not pose the same type of risks to the system as large firms, will not be subject to these obligations.

- Levels the playing field between small banks and nonbank financial service providers – such as payday lenders and independent mortgage brokers – by giving federal regulators the ability to regularly examine nonbank financial services providers and to prohibit unfair and deceptive practices in which they may engage.

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- Reduces the unfair funding advantages enjoyed by the largest institutions prior to the crisis by setting out a process for those institutions to be wound down, broken apart, and liquidated when facing imminent failure.

2. **There are approximately 7,000 community banks across the United States, if each institution underwent fourteen audits, examinations, or reviews in a twelve month period that would be a total of 98,000 such actions. Do you believe that our nation's financial regulators have the ability to adequately process the findings of such a volume of actions?**

Treasury agrees that it is important for regulators to carefully consider how to allocate their resources in light of their agencies' respective missions. Supervisors have a heavy responsibility to effectively monitor and examine financial institutions in order to maintain safety and soundness of the U.S. banking system, and these responsibilities ultimately require regulators to focus on an institution's risks. Likewise, supervisors should continue to be vigilant about avoiding supervisory policies and practices whose benefits are outweighed by the burdens they create, particularly when it comes to community banks. The Dodd-Frank Act reforms are focused on our largest, most complex financial firms, because the Act's authors recognized that those firms, and not community banks, pose the greatest risk to the system.

3. **I have also received feedback from several bank executives noting a lack of regulatory consistency. For instance, the message from Washington is an emphasis on more lending and the need to extend credit to get the economy growing. At the same time, field examiners have been extremely strict on interpretation of rules and have imposed limits on concentration of real estate loans. How can the administration improve coordination between Washington agencies and field examiners?**

Bank examiners must balance the competing goals of encouraging banks to extend credit with ensuring that banks are acting prudently. As we know from the recent financial crisis, imprudent lending is ultimately unsustainable and can hurt the economy.

The Administration is working with the federal banking regulators to ensure that they clearly communicate expectations to bank examiners so that the right balance is achieved. With respect to the flow of credit generally, federal banking regulators have recently issued an interagency statement directing bank supervisors to encourage banking organizations to practice viable and appropriate lending.[1] With respect to commercial real estate in particular, federal banking

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[1] *Interagency Statement on Meeting the Needs of Creditworthy Borrowers*; (http://www.federalreserve.gov/newsevents/press/bcreg/20081112a.htm); *Interagency Statement on Meeting the Needs of Creditworthy Small Business Borrowers* (http://www.federalreserve.gov/newsevents/press/bcreg/20100205a.htm)

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regulators have issued interagency policy statements clarifying expectations for real estate appraisals and encouraging banks to restructure commercial real estate loans for customers experiencing financial difficulties.[2]

4. **Another common complaint is that regulators were quick to downgrade financial institutions during the financial crisis but have been slow to do so as economic conditions improve. What is your opinion of these comments and do you believe regulators are doing enough to upgrade banks as conditions improve?**

As discussed above, supervisors should strive for balance and consistency in their examinations. But they must continue to be vigilant in their efforts to understand a bank's risks and use enforcement tools as necessary to ensure that management is sufficiently focused on those risks. It is critical for regulators to be tough and fair in their examination of banks, even in an improved economic environment. Supervisors should ensure that new programs are put in place that will maintain an appropriate supervisory balance throughout all business cycles, avoiding overreaction in times of economic stress or complacency in times of growth.

5. **Switching to the future of the GSEs, how quickly do you believe we should wind down Fannie and Freddie?**

The pace of the wind down will depend on market conditions. While we have made important progress stabilizing the housing market, this critical sector of the economy remains fragile. Private capital has not yet fully returned to the market and the government continues to play an outsized, though unfortunately necessary role in ensuring the availability of mortgage credit. Proposals that prematurely constrain Fannie Mae and Freddie Mac's ability to guarantee loans could limit the availability of mortgage credit, shock the economy, and expose taxpayers to greater losses on the loans these institutions already guarantee.

6. **Would you support legislation that prohibited the GSEs from engaging in new activities or areas of business?**

We would be willing to discuss potential legislation that increases recovery value for taxpayers while not prematurely constraining the availability of mortgage credit. Acting Director of the FHFA DeMarco commented on this issue in recent testimony:

"FHFA is not permitting the Enterprises to offer any new products or enter new lines of business. Their operations are focused on their existing core businesses and on loss mitigation.

[2] *Interagency Appraisal and Evaluation Guidelines* (http://www.federalreserve.gov/boarddocs/srletters/2010/sr1016.htm); *Policy Statement on Prudent Commercial Real Estate Workouts* (http://www.federalreserve.gov/newsevents/press/bcreg/20091030a.htm).

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"As the Subcommittee deliberates the particulars of such a mandate, it may wish to consider whether any exceptions should be provided for products that advance other purposes of the transition. For example, if the mandate is too narrow it could preclude the development of Enterprise risk-sharing structures that could meet the goal of attracting more private capital to the market and reduce the taxpayers' exposure. Perhaps a prohibition on new products should have an exception for activities that might attract private capital inflows or otherwise promote the statutory mandate of the conservatorship. Otherwise, though, I support the concept and FHFA is already operating in a manner consistent with that approach."

7. **With respect to the first option, in your testimony, you reiterated the position stated in the Treasury White Paper, namely that the overwhelming majority of mortgages would be financed by lenders and investors. I share this goal, however I would point out that the GSEs currently own or insure 95 percent of all mortgages right now. Since that is the case, what interim steps do you believe need to be taken to help create more private label mortgage backed securities and move away from such a lopsided break down between GSE mortgage backed securities and private label mortgage backed securities?**

The financial crisis required the GSEs to provide exceptional support to the housing market to make sure Americans had continued access to mortgage credit and avoid further damage to the economy. The GSEs along with FHA back or insure over 90% of mortgage origination right now. Under normal market conditions, the essential components of housing finance – buying houses, lending money, determining how best to invest capital, and bearing credit risk – are fundamentally private sector activities. Although the government still has an important role to play in housing finance, private markets – subject to strong oversight and standards for consumer and investor protection – should ultimately be the primary source of mortgage credit and bear the burden for losses.

The Administration will work with FHFA to determine the best way to responsibly reduce Fannie Mae and Freddie Mac's role in the market and ultimately wind down both institutions, creating the conditions for private capital to play the predominant role in housing finance.

We will work with FHFA to gradually increase guarantee fees, gradually raise down payment requirements, and pursue additional credit-loss protection from private insurers and other capital providers, and wind down Fannie Mae and Freddie Mac's investment portfolios at a rate of no less than ten percent annually to continue cutting taxpayer risk,. We also have recommended that Congress allow the temporary increase in limits that was approved in 2008 to expire as scheduled on October 1, 2011.

The Dodd-Frank Act made important progress towards creating a housing finance market that participants – whether they are borrowers, lenders, or investors – can trust. We will move forward with strong consumer protections, stricter and smarter supervision of the financial

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system, improvements in accountability and transparency, and other important measures to make sure our future system is one in which all Americans can have confidence.

8. What impact do you believe QRM standards will have on creating a vibrant private label mortgage backed securities market?

Asset-backed securitization provides important economic benefits by improving the availability and affordability of credit to a diverse group of consumers, businesses, and homeowners. However, as the recent financial crisis demonstrated, reform is necessary to align incentives between different participants in the securitization chain.

The proposed risk retention rules help address pre-crisis flaws and rebuild trust and integrity in the mortgage market, and are an important part of the Administration's goal of bringing private capital back into the housing finance system. The QRM exemption stipulated in the Dodd-Frank Act mandates that rule writers define a mortgage with a low risk of default. This, along with the risk retention requirement, addresses the deterioration of underwriting standards we witnessed leading up to the financial crisis.

This rule is also one of several important steps to improve efficiency by better coordinating standards across the mortgage market. In the past, multiple regulatory agencies often had varying standards, even for the same asset classes, and there was no level playing field amongst financial institutions. Six regulatory agencies are working together to develop this proposed rule, and each agency will enforce the same standards once they become final regulations.

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<u>Questions from Rep. Westmoreland</u>

1. **Recent guidance released by the financial regulators regarding credit risk retention and the definition of qualified residential mortgage (QRM) indicates that mortgages held or secured by Fannie Mae and Freddie Mac would be exempt from risk retention requirements. This is like saying that none of the loans currently held and secured by Fannie Mae and Freddie Mac are risky. Further, it would mean that loan originators could make more risky loans, sell them to Fannie Mae and Freddie Mac and be exempt from risk retention requirements. This only starts the vicious cycle of government bailouts anew and prolongs the taxpayer's support of Fannie Mae and Freddie Mac. Does the Department of the Treasury support this definition of qualified residential mortgage?**

The Secretary of the Treasury, as Chairman of FSOC, is coordinator of the joint rules under Section 941 of the Dodd-Frank Act. We have worked diligently with the rulewriting agencies to develop the proposed rules that were released on March 30, 2011. Under the proposed rules, Fannie Mae and Freddie Mac guarantees will satisfy the risk retention requirement under conservatorship. This is not an exemption from the requirement. Rather, the rule writers have proposed that the structure of the guarantees while Fannie Mae and Freddie Mac are under conservatorship with capital support from Treasury satisfy the requirement. The qualified residential mortgage is separately defined, according to the statute, as a mortgage with a low risk of default.

2. **If the goal of the Department of the Treasury and the Obama Administration is to get the private market back into the business of mortgages, what impact would exempting Fannie Mae and Freddie Mac from risk retention and QRM do to the private market for loan origination?**

The treatment of Fannie and Freddie as part of the risk retention rules stipulate that their full guarantees of principal and interest satisfy the risk retention requirements while they are under FHFA's conservatorship (or receivership) and have the capital support of the US Government. This policy does not advantage Fannie and Freddie over the private market, nor does it constitute an exemption. The rule writing agencies recognize Fannie Mae and Freddie Mac's 100 percent credit guarantee as satisfying the risk retention requirement.

The Administration is committed to housing finance reform that supports a system in which private capital – subject to stronger oversight and standards for consumer and investor protection – provides the dominant source of mortgage credit and bears the burden for losses. We agree that an important part of achieving this goal is leveling the playing field between the GSEs and private market participants. That's why the Administration supports effective means of reducing Fannie Mae and Freddie Mac's advantages, including increasing guarantee fees and lowering

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conforming loan limits. These are more effective and direct mechanisms to bring parity between the GSEs and private market.

3. **Does this exemption lead to the continuation of risky mortgages being born by an explicit government guarantee?**

Fannie Mae and Freddie Mac's treatment under the risk retention rule does not contribute to the unfortunate but necessary continuation of the government's support for the housing finance market. As we have said, the Administration is committed to housing finance reform that supports a system in which private capital – subject to stronger oversight and standards for consumer and investor protection – provides the dominant source of mortgage credit and bears the burden for losses.

In addition, the quality of loans that are backed by the GSEs have significantly improved since they were placed into conservatorship in 2008. The FHFA has monitored their business operations closely and strengthened underwriting standards, reducing risk to American taxpayers. Since 2008, FICO scores and loan-to-value ratios – both key measures of how likely a borrower will be to make mortgage payments – are meaningfully better on new mortgages. These measures demonstrate that the risk being borne by the taxpayer has decreased significantly under conservatorship compared to the several years prior to the crisis.

4. **If the goal is to remove Fannie Mae and Freddie Mac from conservatorship, would the regulations on QRM and risk retention make it more difficult to end the conservatorship?**

The Administration maintains its commitment to winding down Fannie Mae and Freddie Mac. The proposed rules will not alter this commitment or change the timeline to do so.

5. **How much longer will Fannie Mae and Freddie Mac be in conservatorship if the rules on QRM are implemented? How much more would the taxpayer have to commit to Fannie Mae and Freddie Mac?**

The rules have no effect on how long Fannie Mae and Freddie Mac will be in conservatorship, nor will they affect the cost of government support. As we have said, the Administration is committed to housing finance reform that supports a system in which private capital – subject to stronger oversight and standards for consumer and investor protection – provides the dominant source of mortgage credit and bears the burden for losses. Ultimately, however, Congress is responsible for determining the future of the housing finance system. The Administration welcomes the opportunity to work with Congress and the appropriate federal agencies on this important issue.

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6. **How will the draft settlement agreement for "robo-signing" (dated 3/3/2011) impact the ability of the private market to come back and take the stress off taxpayer's bailout of Fannie Mae and Freddie Mac?**

The current mortgage servicing system is broken, and we should work together to establish a stronger set of standards and best practices. Last fall, the Administration launched a coordinated federal agency task force on the mortgage foreclosure and servicing situation involving Treasury, HUD, the Department of Justice, and the relevant federal regulators.

The task force is working collaboratively with the state attorneys general to identify and fix the breakdowns in internal controls, documentation, and corporate governance practices associated with mortgage servicing and foreclosure processes. On-site reviews of major mortgage servicers and vendors have revealed critical deficiencies in the foreclosure processing and mortgage servicing requirements under state and federal law.

On April 13, the federal banking agencies announced formal enforcement actions against certain servicers. Efforts to coordinate further corrective action among the task force members and the state attorneys general are ongoing, but the core objective is clear: servicers that engaged in any wrongdoing must be held fully accountable for their actions.

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