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

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

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

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

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

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

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

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

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

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

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

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

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

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

Moreover, I further testified that:

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

    Treasury is not involved in these decisions.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

I agree with Ms. Caldwell's statement.