QUESTIONS FOR THE RECORD
FOR US DEPARTMENT OF THE TREASURY
ASSISTANT SECRETARY HERBERT M. ALLISON, JR
CONGRESSIONAL OVERSIGHT PANEL
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Questions for the Record from Elizabeth Warren, Chair, Congressional Oversight Panel

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Description of default estimates:

Initial Policy Modeling Estimates

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

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

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

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

NPV Model

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

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

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

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

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

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

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

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

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

   Treasury is aware of a number of policy proposals that have been advocated to further assist unemployed borrowers, including the model provided by Pennsylvania's Homeowners' Emergency Mortgage Assistance Program (HEMAP), the Foreclosure and Unemployment Relief Plan proposed by academics at the University of Wisconsin, proposals put forward by economists from the Federal Reserve Bank of Boston, and other

ideas. While our key focus is on helping as many borrowers as quickly as possible under the current program, Treasury recognizes that unemployment presents unique challenges and is still actively reviewing various ideas and suggestions in order to improve implementation and effectiveness of the program in this area. We have not yet concluded this review, and would be happy to schedule time to discuss our evolving insights on the issue on unemployment and HAMP at your convenience.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

repaid more than $70 billion of capital investments made with EESA funds, and we expect another $50 billion of repayments over the next 12-18 months.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

   Secretary Geithner provided the following answer:

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

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

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

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