B. J. Mark McWatters

Although I concur with much of the analysis provided in the April report and respect the sincere and principled views of the majority, I dissent from the issuance of the report and offer the observations noted below. I appreciate, however, the spirit with which the Panel and the staff approached this complex issue and incorporated suggestions offered during the drafting process.

Executive Summary

I offer the following summary of my analysis:

- The Administration's foreclosure mitigation programs – including the HAMP and the HARP – have failed to provide meaningful relief to distressed homeowners and, disappointingly, the Administration has created a sense of false expectation among millions of homeowners who reasonably anticipated that they would have the opportunity to modify or refinance their troubled mortgage loans under the HAMP and HARP programs. It is exceedingly difficult not to conclude that these programs have served as little more than window dressing carefully structured so as to placate distressed homeowners.

- In fairness to the tepid efforts of the Administration, I remain unconvinced that government sponsored foreclosure mitigation programs are necessarily capable of lifting millions of American families out of their underwater home mortgage loans. In my view, the best foreclosure mitigation tool is a steady job at a fair wage and not a hodgepodge of government-subsidized programs that create and perpetuate moral hazard risks and all but establish the U.S. government as the implicit guarantor of distressed homeowners.

- If the economy is indeed improving, it would be preferable to let the housing market recover on its own without the expenditure of additional taxpayer funds and without investors being forced unnecessarily to recognize huge losses that will reduce or even deplete their capital base and increase mortgage loan interest rates.

- Insufficient taxpayer funds are available under HAMP for the government to bail out millions of homeowners in an equitable and transparent manner. The Administration should not commit the taxpayers to subsidize any such bailouts where there is no reasonable expectation for the timely repayment of such funds.

- If the taxpayers do not subsidize reductions in first and second lien mortgage loan principal to the extent required under HAMP and the Administration's other foreclosure mitigation programs, the investors who own the distressed mortgage loans and securitized debt instruments will bear the financial burden of such modifications, and the regulatory capital of many financial institutions will no doubt suffer from the realization of losses

triggered by the write-down s of mortgage principal. As a result, such institutions may have little choice but to seek to raise mortgage loan interest rates and curtail their lending and other financial services activities to the detriment of qualified individuals and businesses in search of capital. It is also possible that the taxpayers will be required to fund additional capital infusions to those weakened institutions through TARP, a Resolution Trust Corporation-type structure or otherwise.

- In private sector foreclosure mitigation efforts, however, the participating investors may readily determine the extent to which voluntary reductions in mortgage principal will reduce or impair their regulatory capital. As such, each private sector investor will have the opportunity to develop its own customized foreclosure mitigation program that carefully balances the costs and benefits to the institution that may arise from the write-down of outstanding mortgage principal. Prudent investors and servicers recognize the purpose and necessity of offering their borrowers voluntary mortgage principal reductions in certain well-defined circumstances, and the government should welcome and encourage their active participation in and contribution to the foreclosure mitigation process without the imposition of an overarching one-size-fits-all mandate.

- In the Panel's October report on foreclosure mitigation, Professor Alan M. White reported to the Panel that, subject to certain reasonable assumptions, the mortgage loan investor's net gain from a non-subsidized mortgage modification could average $80,000 or more per loan over the foreclosure of the property securing the mortgage loan. If Professor White is correct in his assessment, why should Treasury mandate that the taxpayers fund payments so as to motivate investors in mortgage loans and securitized debt instruments to take actions that are in their own best interests absent the subsidies?

- While many homeowners have recently lost equity value in their residences, others have suffered substantial losses in their investment portfolios including their 401(k) and IRA plans. Why should the taxpayers bail out a homeowner who has lost $100,000 of home equity value and neglect another taxpayer who has suffered a $100,000 loss of 401(k) and IRA retirement savings? This is particularly true if the homeowner was able to cash out of some or all of the homeowner's equity appreciation. That is, what public policy goal is served by bailing out the homeowner who received a ski boat, trailer, and all wheel drive SUV as proceeds from a $100,000 home equity loan while neglecting the taxpayer who suffered a $100,000 investment loss in her 401(k) and IRA accounts?

- Suppose, instead, two taxpayers purchased condominiums in the same building for $200,000 each with 100 percent financing. After the condominiums appreciated to $300,000 each, the first homeowner secured a $100,000 home equity loan to pay the college tuition of the first homeowner's son; the second homeowner declined to accept a home equity loan (expressing a "this is too good to believe" skepticism) and the second

homeowner's daughter financed her college tuition with a $100,000 student loan. If the condominiums subsequently drop in value to $200,000 each, why should the taxpayers subsidize the write-off of the first homeowner's home equity loan and in effect finance the college tuition of the first homeowner's son while the second homeowner's daughter remains committed on her $100,000 student loan? I do not concur with any public policy that would yield such an inequitable treatment, particularly since the second homeowner acted in a prudent and fiscally responsible manner by electing not to over leverage the residence.

- What about (i) the retired homeowner whose residence drops in value by $100,000 after she has diligently paid each installment on her $300,000 mortgage over 30 years, (ii) the taxpayer who rents her primary residence and with a $300,000 mortgage loan purchases real property for investment purposes that subsequently drops in value by $100,000, and (iii) the homeowner suffering from a protracted illness or disability who loses $100,000 of equity value upon the foreclosure of her residence for failure to pay property taxes? HAMP and the other programs offered by the Administration offer no assistance to these taxpayers.

- Since it is neither possible nor prudent for the government to subsidize the taxpayers for the trillions of dollars of economic losses that have arisen over the past two years, the government should not undertake to allocate its limited resources to one group of taxpayers while ignoring the equally (or more) legitimate economic losses incurred by other groups.

- Only a relatively modest (although certainly not insignificant) percentage of Americans are facing foreclosure after properly considering the number of taxpayers who are current on their mortgage obligations, who are renting their primary residence, and who own their home free of mortgage debt. Is it fair to ask the overwhelming majority of Americans who are struggling each month to meet their own financial obligations to bail out the relatively modest group of homeowners who are actually facing foreclosure?

- What message does the government send to the taxpayers by treating a discrete group of homeowners as per se "victims" of predatory lending activity and undertaking to substantially subsidize their mortgage indebtedness at the direct expense of the vast majority of taxpayers who meet their financial obligations each month? Will the former group of homeowners modify their behavior and become more fiscally prudent, or will they continue to over-leverage their households with the expectation that the government will offer yet another taxpayer-funded bailout as needed?

- I remain troubled that HAMP *itself* may have exacerbated the mortgage loan delinquency and foreclosure problem by encouraging homeowners to refrain from remitting their

monthly mortgage installments based upon the expectation that they would ultimately receive a favorable restructure or principal reduction subsidized by the taxpayers. The curious incentives offered by HAMP arguably convert the concept of home ownership into the economic reality of a "put option" – as long as a homeowner's residence continues to appreciate in value the homeowner will not exercise the put option, but as soon as the residence falls in value the homeowner will elect to exercise the put option and walk away or threaten to walk away if a favorable bailout is not offered.

- The TARP-funded HAMP program carries a 100 percent subsidy rate according to the GAO. This means that the U.S. government expects to recover *none* of the $50 billion of taxpayer-sourced TARP funds invested in the HAMP foreclosure mitigation program. Since Treasury is charged with protecting the interests of the taxpayers who funded HAMP and the other TARP programs, I recommend that Treasury's foreclosure mitigation efforts be structured so as to incorporate an effective exit strategy by allowing Treasury to participate in any subsequent appreciation in the home equity of any mortgagor whose loan is modified under HAMP or any other taxpayer subsidized program. An equity appreciation right – the functional equivalent of a warrant in a non-commercial transaction – will also mitigate the moral hazard risk of homeowners who may undertake risky loans in the future based on the assumption that the government will act as a backstop with no strings attached.

- In many instances it is unlikely that holders of second lien mortgage loans are *truly* out-of-the-money since today's fire-sale valuations are not representative of the actual intermediate to long-term fair market value of the residential collateral securing the underlying loans. I am not unsympathetic to the argument that an 80-year historic low in the housing market does not reflect a true representation of fair market value, particularly given the tepid mortgage loan and refinancing markets. If holders of second lien mortgage loans previously advanced cash to their borrowers under home equity loans, they may also be reluctant to write off such loans since the homeowners received *actual cash value* from the home equity loans and not just additional over-inflated house value. It is also entirely possible that holders of second lien mortgages are reluctant to write down their loans past a certain level for fear of impairing their regulatory capital, which could trigger another round of TARP funded bailouts or worse.

- Since the actions of Fannie Mae and Freddie Mac – the GSEs – may directly influence Treasury's foreclosure mitigation programs under the TARP, I recommend that the GSEs conduct their own foreclosure mitigation efforts in an equitable, fully transparent and accountable manner. The Federal Reserve, Treasury and the GSEs should disclose on a regular and periodic basis a detailed analysis of the amount and specific use of all

taxpayer-sourced funds they have spent and expect to spend on their foreclosure mitigation efforts.

- This analysis is in no way intended to diminish the financial hardship that many Americans are suffering as they attempt to modify or refinance their underwater home mortgage loans, and I fully acknowledge and empathize with the stress and economic uncertainty created from the bursting of the housing bubble. It is particularly frustrating – although not surprising – that many of the hardest hit housing markets are also suffering from seemingly intractable rates of unemployment and underemployment. As such, I *strongly encourage* each mortgage loan and securitized debt investor and servicer to work with each of their borrowers in *good faith, in a transparent and accountable manner,* to reach an economically reasonable resolution prior to pursuing foreclosure. If Professor White is correct in his analysis, it is clearly in the best economic interest of the investors and servicers to modify the distressed mortgage loans in their portfolios rather than to seek foreclosure of the underlying residential collateral. It is regrettable that HAMP and the Administration's other foreclosure mitigation programs create disincentives for investors and servicers as well as homeowners by rewarding their dilatory behavior with the expectation of enhanced taxpayer-funded subsidies.

- EESA authorizes Treasury "to purchase, and to make and fund commitments to purchase, troubled assets from any financial institution."[517] In response to a request from Panelist Paul Atkins as to whether Treasury was authorized to fund HAMP under EESA, Treasury's General Counsel delivered a legal opinion to the Panel concluding that Treasury was so authorized. Interestingly, Treasury has requested that the Panel not publish the opinion in the Panel's report even though Treasury has permitted the Panel to quote extensively from the opinion in the report and deliver a copy of the opinion to outside experts. It is my understanding that Treasury has not asserted an attorney-client privilege regarding the opinion, but, instead, has suggested that disclosure of the opinion may impact its ability to assert attorney-client privilege over related material in other contexts. After reviewing the opinion and the basis upon which the opinion was rendered, I can think of no legal theory in support of Treasury's assertion that an attorney-client privilege could be waived by disclosure of the opinion now that Treasury has agreed that the Panel may quote extensively from the opinion in the Panel's report and deliver a copy of the opinion to outside experts. Treasury's legal analysis regarding the subject matter of the opinion is fully disclosed and discussed by the Panel and the outside experts in the Panel's report. I request that Treasury promptly abandon any position – including the assertion of an attorney-client privilege – that would keep the opinion confidential.

[517] 12 U.S.C. § 5211.

HAMP and HARP Have Failed

The Administration's foreclosure mitigation programs –HAMP and HARP – have failed to provide meaningful relief to distressed homeowners. Disappointingly, the Administration has only structured approximately 169,000 "permanent modifications" out of its stated goal of three to four million modifications and, remarkably, 40 percent or more of such homeowners will most likely redefault on their permanent modifications. Worse yet, the Administration has created a sense of false expectation among millions of homeowners who reasonably anticipated that they would have the opportunity to modify or refinance their troubled mortgage loans under the HAMP and HARP programs. It is exceedingly difficult not to conclude that these programs have served as little more than window dressing carefully structured so as to placate distressed homeowners.

In fairness to the tepid efforts of the Administration, I remain unconvinced that government sponsored foreclosure mitigation programs are necessarily capable of lifting millions of American families out of their underwater home mortgage loans. In my view, the best foreclosure mitigation tool is a steady job at a fair wage and not a hodgepodge of government-subsidized programs that create and perpetuate moral hazard risks and all but establish the U.S. government as the implicit guarantor of distressed homeowners. The tax and regulatory policies of the Administration have injected a substantial and relentless element of uncertainty into the private sector. Significant job growth will arguably not return in earnest until the business and investment communities have been afforded sufficient opportunity to assess and assimilate the daunting array of tax increases and enhanced regulatory burdens that have arisen over the past 15 months. If the Administration continues to introduce and actively promote new taxes and regulatory changes, it is not unreasonable to suggest that the recovery of the employment and housing markets will proceed at a less than optimal pace.[518]

Recovery of the Housing Market without Taxpayer-Funded Subsidies

The Administration suggests the economy is improving, and there have been positive signs in the housing market. There is still uncertainty, however, on whether the country is "out of the woods" and can reach sustainable levels of economic growth and job recovery. If the economy is indeed improving, it would be preferable to let the housing market recover on its own without the expenditure of additional taxpayer funds and without investors being forced unnecessarily to recognize huge losses that will reduce or even deplete their capital base and increase mortgage interest rates.[519] It is worth noting that the S&P/Case-Shiller Index rose 0.3

---

[518] *See* Burton Folsom Jr. and Anita Folsom, *Did FDR End the Depression?*, *The Wall Street Journal* (Apr. 12, 2010) (online at online.wsj.com/article/SB10001424052702304024604575173632046893848.html?KEYWORDS=burt).

[519] Under such an approach, investors and servicers would be free to exercise their independent business judgments regarding which mortgage loans to modify or refinance, which to leave unchanged, and which to

percent, seasonally adjusted, in January from December, its eighth consecutive monthly increase, and that Los Angeles, San Francisco, San Diego, Dallas, Washington, D.C., Boston, Denver and Minneapolis have experienced year-over-year increases in housing prices from January 2009 to January 2010.[520] This trend indicates that the housing market is beginning to recover in many significant regions of the country on its own without government assistance and the attendant expenditure of taxpayer-sourced funds.[521] The Administration should refrain from developing its foreclosure mitigation policies by fixating on the rear-view mirror when the road ahead shows signs of clearing.

The Unaffordable Cost of the Administration's Foreclosure Mitigation Programs

In my view, insufficient taxpayer funds are available under HAMP for the government to bail out millions of homeowners in an equitable and transparent manner. By suggesting otherwise the Administration continues to propagate misguided expectations and fuzzy accounting. For example, if the taxpayers are required to fund $25,000 in payments to servicers, investors and homeowners per mortgage modification, the total cost of modifying four million mortgages will equal $100 billion – exactly twice the amount of TARP funds presently allocated to HAMP – with a projected 100 percent subsidy or loss rate to the taxpayers.[522] If the taxpayers *also* subsidize first and second lien mortgage loan principal reductions of another $50,000 per modification (which may understate the issue), the total cost to the taxpayers will equal $300 billion[523] – six times the amount of TARP funds presently allocated to HAMP – with a projected 100 percent subsidy or loss rate to the taxpayers.[524] The Administration should not commit the

---

foreclose without the influence of government-subsidized programs and their ability to skew rational market-based economic decisions. In addition, it is unlikely that the regulatory capital of the investors will be impaired from the voluntary write-down of mortgage loan principal.

[520] *See* David Streitfeld, *U.S. Home Prices Inch Up, But Worries Remain*, New York Times (Mar. 30, 2010) (online at www.nytimes.com/2010/03/31/business/economy/31econ.html?hp); Javier C. Hernandez, *Sharp Rise in Home Sales in February*, New York Times (Apr. 5, 2010) (online at www.nytimes.com/2010/04/06/business/economy/06econ.html?hp); Lynn Adler, *US Subprime Delinquencies Drop 1st Time in 4 Years*, Reuters (Apr. 8, 2010) (online at www.reuters.com/article/idUSN0715337220100407); Deborah Solomon, *Light at the End of the Bailout Tunnel*, Wall Street Journal (Apr. 12, 2010) (online at online.wsj.com/article/SB10001424052702304846504575177950029886696.html?mod=googlenews_wsj).

[521] It seems unlikely that the 169,000 permanent modifications out of a projected three to four million HAMP modifications has affected the housing market for the better.

[522] Congressional Budget Office, *The Troubled Asset Relief Program: Report on Transactions Through June 17, 2009* (June 2009) (online at www.cbo.gov/ftpdocs/100xx/doc10056/06-29-TARP.pdf).

[523] The $300 billion total cost figure is derived by multiplying four million mortgage modifications by $75,000 total cost per mortgage modification ($25,000 plus $50,000).

[524] If the *actual* goal of the Administration is to modify, for example, *only* one-million mortgage loans, the cost of the program will total far less than $300 billion. Such a reduced mandate, however, will most likely produce only modest results absent robust independent efforts from private sector mortgage loan and securitized debt investors and servicers.

taxpayers to subsidize any such bailouts where there is no reasonable expectation for the timely repayment of such funds.

If the taxpayers do not ultimately subsidize reductions in first and second lien mortgage loan principal to the extent required under HAMP and the Administration's other foreclosure mitigation programs, the investors who own the distressed mortgage loans and securitized debt instruments will bear the financial burden of such modifications, and the regulatory capital of many financial institutions will no doubt suffer from the realization of losses triggered by the write-downs of mortgage principal. As a result, such institutions may have little choice but to seek to raise mortgage loan interest rates and curtail their lending and other financial services activities to the detriment of qualified individuals and businesses in search of capital. It is also possible that the taxpayers will be required to fund additional capital infusions to those weakened institutions through the TARP, a Resolution Trust Corporation-type structure, or otherwise.

If the policies of the Administration result in the near-term recognition of substantial losses by the holders of mortgage loans and securitized debt instruments, and if the housing market rebounds over the near to intermediate term, the Administration will have accomplished little more than orchestrating a huge transfer of wealth from the investment community to that select group of homeowners who were able to qualify for inclusion in HAMP or one of the Administration's other foreclosure mitigation programs. The taxpayers will share the burden of this wealth transfer to the extent that the Administration subsidizes the write-off of mortgage principal by investors and, if investors who help finance these home loans anticipate a large risk that they will not be repaid, homeowners will ultimately suffer through increased mortgage interest rates.[525] For example, a mortgage loan or securitized debt investor will suffer a $50,000 economic loss[526] upon forgiving a homeowner's like amount of mortgage principal, but the homeowner will realize a $50,000 economic gain if the mortgaged residence subsequently appreciates by a like amount.[527] If four million home mortgage loans are restructured in a similar manner and if the housing market steadily recovers over the near to intermediate term, the taxpayers and the investment community will suffer the burden of transferring approximately

[525] It is entirely understandable that many taxpayers may have little sympathy for the plight of struggling financial institutions after the generous taxpayer-funded bailouts they received under the TARP. I appreciate and do not disagree with this sentiment but note that any action that impairs the capital of these financial institutions or increases mortgage loan interest rates is not in the best interest of the taxpayers.

[526] The investor most likely will also incur additional costs and expenses with respect to each mortgage loan modification.

[527] If the contract that governs the mortgage modification contains an equity participation feature, then some or all of the $50,000 of subsequent appreciation will inure to the benefit of the taxpayers and, perhaps, the investors.

$200 billion[528] of value to the homeowner participants in the Administration's foreclosure mitigation programs.[529]

In voluntary private sector foreclosure mitigation efforts, however, the participating investors may readily determine the extent to which voluntary reductions in mortgage principal will reduce or impair their regulatory capital. As such, each private-sector investor will have the opportunity to develop its own customized foreclosure mitigation program that carefully balances the costs and benefits to the investor that may arise from the write-down of outstanding mortgage principal. In my view, this approach is preferable to a government mandated, across-the-board mortgage principal reduction program where investors are required (or pressured) to write off a certain amount of mortgage principal in accordance with a static matrix or a generic ability-to-pay formula. Prudent investors and servicers recognize the purpose and *necessity* of offering their borrowers voluntary mortgage principal reductions in certain well-defined circumstances, and the government should welcome and encourage their active participation in and contribution to the foreclosure mitigation process without the imposition of an overarching one-size-fits-all mandate.

Cost Benefit Analysis of Voluntary Mortgage Modification vs. Foreclosure

In the Panel's October report on foreclosure mitigation, the Panel retained Professor Alan M. White to conduct a cost-benefit analysis of HAMP as well as an analysis of whether it is more cost effective to modify a mortgage loan (without the payment of any government sponsored subsidy to the servicer, the investor or the homeowner) or foreclose the property securing the mortgage loan. [530] Professor White concluded that, subject to certain reasonable assumptions, the investor's net gain from a non-subsidized mortgage modification could average $80,000 or more per loan versus the foreclosure of the property securing the mortgage loan.[531] If Professor White is correct in his assessment, it is difficult to appreciate why the government

---

[528] The $200 billion transfer is derived by multiplying four million mortgage modifications by a $50,000 principal reduction per mortgage modification.

[529] By comparison, TARP's Capital Purchase Program totaled $204.9 billion of which $129.8 billion has been repaid as of February 25, 2010. *See* Congressional Oversight Panel, *March Oversight Report: The Unique Treatment of GMAC under the TARP* at 139 (Mar. 10, 2010) (online at cop.senate.gov/documents/cop-031110-report.pdf).

[530] *See* Congressional Oversight Panel, October Oversight Report: An Assessment of Foreclosure Mitigation Efforts After Six Months: Additional Views of Congressman Jeb Hensarling (Oct. 9, 2009) (online at cop.senate.gov/documents/cop-100909-report-hensarling.pdf)*;* Congressional Oversight Panel, *January Oversight Report: Exiting TARP and Unwinding Its Impact on the Financial Markets: Additional Views of J. Mark McWatters and Paul S. Atkins* (Jan. 13, 2010) (online at cop.senate.gov/documents/cop-011410-report-atkinsmcwatters.pdf).

[531] It is important to note that the modification versus foreclosure analysis does not turn upon the realization of net gains anywhere near $80,000 per mortgage loan modification. As long as the mortgage lender breaks even (after considering all costs and expenses including any addition fees paid to the mortgage servicer as well as all cost savings from not foreclosing), the lender should prefer modification.

should undertake to subsidize mortgage loan modifications. Why should Treasury mandate that the taxpayers fund payments to motivate investors in mortgage loans and securitized debt instruments to take actions that are in their own best interests absent the subsidies?

If the difficulty with respect to modifying mortgage loans on a timely basis arises from the unwillingness of mortgage servicers to discharge their contractual duties without the receipt of additional fee income, investors may respond by either suing the servicers for breach of their obligations under their pooling and servicing agreements or – perhaps more prudently – agreeing to share a portion of their $80,000 or so net gain per modification with the servicers. In either event, the taxpayers will not be required to subsidize the mortgage loan modification process, the investors will receive a substantial net gain from modifying their mortgage loans instead of foreclosing the underlying collateral, the servicers will receive the benefit of their contractual bargain as, perhaps, amended, and *the homeowners will not suffer the foreclosure of their residences*. If an investor stands to benefit from the modification of a mortgage loan it seems reasonable to ask the investor – *and not the taxpayers* – to share part of its "gain"[532] from the workout with the servicer so as to "motivate" the servicer to restructure the loan.[533] Treasury should not gum up the works by offering to subsidize the contractual commitments of mortgage servicers. Any such action will only motivate the investors and servicers to sit on their hands and wait for Treasury to turn on the TARP money machine. In other words, why should the government offer an expensive and needlessly complex taxpayer-funded subsidy when a cost-effective private sector solution is readily available?

I am troubled that the otherwise objective and transparent mortgage loan modification process has been arguably derailed by the enticement of TARP-funded subsidy payments and the expectation that the government will increase the subsidy rate if the mortgage loan and securitized debt investors and servicers continue to drag their feet and all but refuse to modify their portfolio of distressed mortgage loans. With the passage of EESA and the expectation that Treasury would soon introduce a foreclosure mitigation subsidy program, it is not surprising that some investors and servicers apparently elected to adopt a wait-and-see approach. Although unfortunate, such action is entirely rational and presents the investors and servicers with the opportunity to receive additional fee income and net gains by deferring their foreclosure

[532] The investor's "gain" most likely will be realized in the form of cash proceeds received and cash expenditures not made over an extended period. As such, investors will need to balance their cash flow against the additional cash fees paid to the mortgage servicers.

[533] I certainly appreciate that mortgage servicers should not merit the payment of additional fees in order to discharge their contractual undertakings. Nevertheless, in order to provide prompt relief to distressed homeowners, such approach is preferable to doing nothing.

mitigation efforts.[534] Without HAMP or a similar program, the investors and servicers would have arguably undertaken to modify many of their distressed mortgage loans on an expedited basis so as to benefit from Professor White's estimated $80,000 net gain. As long as the government continues to offer investors and servicers generous and ever-increasing subsidies to perform actions that are already in their best economic interests it should surprise no one if some of these recipients revert to stand-by mode and wait for the best deal. Since the TARP does not end until October 3, 2010, it is possible that some investors and servicers will wait on the sidelines for Treasury to again sweeten an already favorable offer.

Principles of Equity, Moral Hazard Risks and Implicit Guarantees

The public policy rationale underlying taxpayer-funded support for HAMP and the Administration's other foreclosure mitigation efforts appears inequitable when compared to the assistance offered other taxpayers who have suffered economic reversals during the recession. While many homeowners have recently lost equity value in their residences, others have suffered substantial losses in their investment portfolios, including in their 401(k) and IRA plans. Why should the taxpayers bail out a homeowner who has lost $100,000 of home equity value and neglect another taxpayer who has suffered a $100,000 loss of 401(k) and IRA retirement savings?

This problem is exacerbated if the homeowner was able to benefit from accrued home equity appreciation prior to the decline in housing prices. For example, a homeowner may have purchased a residence for $200,000 (with 100 percent financing), taken out a $100,000 home equity loan as the residence appreciated to $300,000, and used the $100,000 of cash proceeds from the home equity loan to purchase a ski boat, trailer, and all-wheel-drive SUV. If the residence subsequently fell in value to $200,000 it makes little sense for the taxpayers to subsidize any reduction in the outstanding principal balance of the home equity loan since the homeowner *actually received* the proceeds of the loan in the form of a ski boat, trailer, and all-wheel-drive SUV and not as overinflated house value. That is, what public policy goal is served by bailing out the homeowner who received a ski boat, trailer, and all-wheel-drive SUV as proceeds from a $100,000 home equity loan while neglecting the taxpayer who suffered a $100,000 investment loss in her 401(k) and IRA retirement savings accounts?[535]

---

[534] Although such approach may qualify as "rational," I strongly disagree with any mortgage lender or servicer who delays its foreclosure mitigation actions based upon the expectation of additional TARP-sourced subsidy payments.

[535] In other words, why should the homeowner who *did not suffer* an economic loss (because she retains the ski boat, trailer, and all-wheel-drive SUV) receive a $100,000 taxpayer-funded bailout, while the 401(k) and IRA investor who *actually suffered* a $100,000 economic loss in her retirement savings receives nothing? More broadly stated, why should those homeowners who benefitted from the use of their homes as an ATM expect other taxpayers to offer a bailout?

Suppose, instead, two taxpayers purchased condominiums in the same building for $200,000 each with 100 percent financing. After the condominiums appreciated to $300,000 each, the first homeowner secured a $100,000 home equity loan to pay the college tuition of the first homeowner's son; the second homeowner declined to accept a home equity loan (expressing a "this is too good to believe" skepticism) and the second homeowner's daughter financed her college tuition with a $100,000 student loan. If the condominiums subsequently drop in value to $200,000 each, why should the taxpayers subsidize the write-off of the first homeowner's home equity loan and in effect finance the college tuition of the first homeowner's son while the second homeowner's daughter remains committed on her $100,000 student loan? I do not concur with any public policy that would yield such an inequitable treatment, particularly since the second homeowner acted in a prudent and fiscally responsible manner by electing not to over leverage the residence.

Other examples come to mind. What about the retired homeowner whose residence drops in value by $100,000 after she has diligently paid each installment on her $300,000 mortgage over 30 years? The homeowner has certainly suffered an economic loss, but she does not qualify for relief under HAMP or otherwise because she has repaid her mortgage in full. What about the taxpayer who rents her primary residence and purchases (with a $300,000 mortgage loan) real property for investment purposes that subsequently drops in value by

---

See Alyssa Katz, *How Texas Escaped the Real Estate Foreclosure Crisis*, Washington Post (Apr. 4, 2010) (online at www.washingtonpost.com/wp-dyn/content/article/2010/04/03/AR2010040304983.html?sub=AR) ("But there is a broader secret to Texas's success, and Washington reformers ought to be paying very close attention. If there's one thing that Congress can do to help protect borrowers from the worst lending excesses that fueled the mortgage and financial crises, it's to follow the Lone Star State's lead and put the brakes on "cash-out" refinancing and home-equity lending. A cash-out refinance is a mortgage taken out for a higher balance than the one on an existing loan, net of fees. Across the nation, cash-outs became ubiquitous during the mortgage boom, as skyrocketing house prices made it possible for homeowners, even those with bad credit, to use their home equity like an ATM. But not in Texas. There, cash-outs and home-equity loans cannot total more than 80 percent of a home's appraised value. There's a 12-day cooling-off period after an application, during which the borrower can pull out. And when a borrower refinances a mortgage, it's illegal to get even a dollar back. Texas really means it: All these protections, and more, are in the state constitution. The Texas restrictions on mortgage borrowing date from the first days of statehood in 1845, when the constitution banned home loans."

See also Did Consumer Protection Laws Prevent Texas Housing Bubble?, Wall Street Journal (Apr. 6, 2010) (online at blogs.wsj.com/developments/2010/04/06/did-consumer-protection-laws-prevent-texas-housing-bubble/tab/print/) ("Texas avoided a bubble to begin with, in part because it didn't have a rampant speculation and house flipping that arguably sparked the bubble markets in Florida, Nevada and Arizona. Indeed, real-estate investors have argued that higher property taxes in Texas made it less attractive to hold properties as investments versus states such as California, while urban planners have argued that less restrictive land-use laws didn't drive up prices by constraining supply. Texas, of course, may also have fresh memories of a real-estate bubble, as housing economist Thomas Lawler notes, given that the state had the "absolute worst regional downturn in home prices in the post-World War II period" prior to the current downturn during the "oil patch" boom and bust of the 1980s. (The bulk of "default asset management" operations – how to dispose of foreclosures – for Fannie Mae and Freddie Mac are still headquartered in Dallas as a byproduct of that era.) Mr. Lawler says while any actions designed to discourage excessive borrowing is an "incredibly good idea, I'm not sure that Texas is an all around 'good' example.'"

$100,000? As in the prior example, the renter has certainly suffered a $100,000 economic loss, but she does not qualify for relief under HAMP or otherwise. What about the homeowner suffering from a protracted illness or disability who loses $100,000 of equity value upon the foreclosure of her residence for failure to pay property taxes? Again, the taxpayer has suffered a $100,000 economic loss, but HAMP and the Administration's other foreclosure mitigation programs offer no assistance.

These examples illustrate the inequity of assisting only one group of Americans to the exclusion of others who have also suffered from the recession. Since it is neither possible nor prudent[536] for the government to subsidize the taxpayers for the trillions of dollars of economic losses that have arisen over the past two years, the government should not undertake to allocate its limited resources to one group of taxpayers while ignoring the equally (or more) legitimate economic losses incurred by other groups.

It is also worth noting that only a relatively modest (although certainly not insignificant) percentage of Americans are facing foreclosure after properly considering the number of taxpayers who are current on their mortgage obligations, who are renting their primary residences and who own their homes free of mortgage debt.[537] Is it fair to ask the overwhelming majority of Americans who are struggling each month to meet their own financial obligations to bail out the relatively modest group of homeowners who are actually facing foreclosure? This issue becomes far more compelling when considering the economic difficulties facing many members of the majority group – as noted in the foregoing examples – that have received next to no attention from the Administration. I do not believe that it is equitable to ask these taxpayers to shoulder the burden of funding HAMP and the Administration's other foreclosure mitigation programs.

In addition to a compelling sense of inequity, the bailout of distressed homeowners creates profound moral hazard risks and all but establishes the U.S. government as the implicit guarantor of homeowners who overextend their mortgage obligations. What message does the government send to the taxpayers by treating a discrete group of homeowners as per se "victims" of predatory lending activity and undertaking to substantially subsidize their mortgage indebtedness at the direct expense of the vast majority of taxpayers who meet their financial obligations each month? Will the former group of homeowners modify their behavior and

---

[536] If the government undertook to cover explicitly or implicitly the investment losses of the taxpayers, such a policy would – in addition to bankrupting the government – most likely encourage many taxpayers to select high-risk investments for their portfolios with the expectation that they will retain all of the upside from such investments but that the government would subsidize any losses on the downside.

[537] *See* Congressional Oversight Panel, *October Oversight Report: An Assessment of Foreclosure Mitigation Efforts After Six Months: Additional Views of Congressman Jeb Hensarling* (Oct. 9, 2009) (online at cop.senate.gov/documents/cop-100909-report-hensarling.pdf).

become more fiscally prudent, or will they continue to over-leverage their households with the expectation that the government will offer yet another taxpayer-funded bailout as needed? Will formerly prudent homeowners look at the windfall others have received and modify their behavior in an adverse manner? Such behavior, while certainly not commendable, is by no means irrational and only demonstrates that consumers will respond to economic incentives that are in their own self-interest. If the government offers to subsidize a homeowner's mortgage payments (or credit card debt), it is arguably difficult to criticize the homeowner for accepting the misguided offer, yet I would be remiss if I did not question any government-sanctioned policy that encourages taxpayers to act in a fiscally imprudent manner.

This analysis is in no way intended to diminish the financial hardship that many Americans are suffering as they attempt to modify or refinance their underwater home mortgage loans, and I fully acknowledge and empathize with the stress and economic uncertainty created from the bursting of the housing bubble. It is particularly frustrating – although not surprising – that many of the hardest hit housing markets are also suffering from seemingly intractable rates of unemployment and underemployment. As such, I *strongly encourage* each mortgage loan and securitized debt investor and servicer to work with each of their borrowers in *good faith, in a transparent and accountable manner,* to reach an economically reasonable resolution prior to pursuing foreclosure. If Professor White is correct in his analysis, it is clearly in the best economic interest of the investors and servicers to modify the distressed mortgage loans in their portfolios rather than to seek foreclosure of the underlying residential collateral. It is regrettable that HAMP and the Administration's other foreclosure mitigation programs create disincentives for investors and servicers as well as homeowners by rewarding their dilatory behavior with the expectation of enhanced subsidies.

Home Ownership as a "Put Option"

I remain troubled that HAMP *itself* may have exacerbated the mortgage loan delinquency and foreclosure problem by encouraging homeowners to refrain from remitting their monthly mortgage installments based upon the expectation that they will ultimately receive a favorable restructure or principal reduction subsidized by the taxpayers.[538] This "strategic default" issue is magnified by single-action and anti-deficiency laws in effect in several states that permit homeowners to walk away from their mortgage obligations with relative impunity.[539] These laws together with the curious incentives offered by HAMP arguably convert the concept of

---

[538] Although such approach may qualify as "rational," I strongly disagree with any homeowner who purposely declines to make a mortgage payment based upon the expectation of a TARP-sourced bailout.

[539] A "bankruptcy cram down" law pursuant to which a bankruptcy judge would be authorized to change (i.e., cram down) the terms of a mortgage loan over the objection of the mortgage loan holder could arguably encourage homeowners to act in a similar manner.

home ownership into the economic reality of a "put option"[540] – as long as a homeowner's residence continues to appreciate in value the homeowner will not exercise the put option, but as soon as the residence falls in value the homeowner will elect to exercise the put option and walk away or threaten to walk away if a favorable bailout is not offered.[541] I am also concerned that Treasury's attempt to "streamline" the loan modification process will result in materially lower underwriting standards that may lead to the creation of a new class of Treasury-sanctioned and subsidized subprime loans that may inflate yet another housing bubble. Any inappropriate loosening of prudent underwriting standards may also cause the re-default rate to surpass the already distressing projected rate of 40 percent.

Taxpayer Protection – the Importance of Equity Participation Rights[542]

The TARP-funded HAMP program carries a 100 percent subsidy rate according to the General Accounting Office (GAO).[543] This means that the United States government expects to recover *none* of the $50 billion of taxpayer-sourced TARP funds invested in the HAMP foreclosure mitigation program.[544] The projected shortfall will become more burdensome to the taxpayers as Treasury contemplates expanding HAMP or introducing additional programs targeted at modifying or refinancing distressed home mortgage loans. Since Treasury is charged with protecting the interests of the taxpayers who funded HAMP and the other TARP programs, I recommend that Treasury's foreclosure mitigation efforts be structured so as to incorporate an effective exit strategy by allowing Treasury to participate in any subsequent appreciation in the

---

[540] A put option is a contract providing the owner with the right – but not the obligation – to sell a specified amount of an underlying security or asset at a specified price within a specified period of time. The right afforded the homeowner in a jurisdiction with an anti-deficiency or one-action law is arguably the functional equivalent of a put option.

[541] If a homeowner exercises the put option, her credit rating will suffer and she may not qualify for another home mortgage loan for several years. It may, however, be in the best long term financial interest of the homeowner to walk away from her house and mortgage obligations in favor of renting a residence until her credit rating recovers.

[542] *See* Congressional Oversight Panel, *January Oversight Report: Exiting TARP and Unwinding Its Impact on the Financial Markets: Additional Views of J. Mark McWatters and Paul S. Atkins* (Jan. 13, 2010) (online at cop.senate.gov/documents/cop-011410-report-atkinsmcwatters.pdf). I have incorporated such Additional Views into my analysis of equity participation rights.

[543] Government Accountability Office, *Financial Audit: Office of Financial Stability (Troubled Asset Relief Program) Fiscal Year 2009 Financial Statements*, at 15 (Dec. 2009) (online at www.gao.gov/new.items/d10301.pdf).

[544] Congressional Budget Office, *The Troubled Asset Relief Program: Report on Transactions Through June 17, 2009* (June 2009) (online at www.cbo.gov/ftpdocs/100xx/doc10056/06-29-TARP.pdf).

home equity of any mortgagor whose loan is modified under HAMP or any other taxpayer subsidized program.[545]

In order to encourage the participation of mortgage lenders in Treasury's foreclosure mitigation efforts, such lenders could also be granted the right – subordinate to the right granted Treasury – to participate in any subsequent equity appreciation. Understandably, many feel little sympathy for lenders on the other side of the mortgage contract. However, if the lenders are not allowed to partake in a slice of the equity appreciation after they agree to take an upfront loss in a principal reduction, homeowners could suffer across-the-board by being required to pay higher premiums for loans in the future.

The mechanics of an equity participation right may be illustrated by the following example of a typical home mortgage loan modification.[546]

Assume a homeowner borrows $200,000 and purchases a residence of the same amount.[547] The home subsequently declines in value to $175,000; the homeowner and the mortgage lender agree to restructure the loan under a TARP-sponsored foreclosure mitigation program, pursuant to which the outstanding principal balance of the loan is reduced to $175,000, and Treasury advances $10,000[548] in support of the restructure. Immediately after the modification the mortgage lender has suffered a $25,000[549] economic loss and Treasury has advanced $10,000 of TARP funds. If the homeowner subsequently sells the residence for $225,000, the $50,000 of realized equity proceeds[550] would be allocated in accordance with the

[545] Doing so will also mitigate the moral hazard risk of homeowners who could undertake problematic loans in the future based on the assumption that the government will act as a backstop with no strings attached. See Congressional Oversight Panel, December Oversight Report: Taking Stock: What has the Troubled Asset Relief Program Achieved?: Additional Views of Congressman Jeb Hensarling (Dec. 9, 2009) (online at cop.senate.gov/documents/cop-120909-report-hensarling.pdf).

[546] The incorporation of an equity participation right may be achieved by the filing of a one-page document in the local real property records when the applicable home mortgage loan is modified.

[547] These facts illustrate the zero ($0.00) down-payment financings that were more common a few years ago.

[548] The $10,000 of TARP-sourced funds advanced by Treasury may be, for example, remitted to the mortgage loan servicer and the homeowner under HAMP.

[549] The $25,000 loss equals the $200,000 outstanding principal balance of the original loan, less the $175,000 original principal balance of the modified loan. The example does not consider the consequences of modifying the interest rate on the loan.

[550] The $50,000 of realized equity proceeds equals the $225,000 sales price of the residence, less the $175,000 outstanding principal balance of the modified loan. The example makes certain simplifying assumptions such as the absence of transaction and closing fees and expenses.

following waterfall – the first $10,000[551] is remitted to reimburse Treasury for the TARP funds advanced under the foreclosure mitigation program; the next $25,000[552] is remitted to the mortgage lender to cover its $25,000 economic loss; and the balance of $15,000 is paid to the homeowner.[553]

Prior to the repayment of all funds advanced by Treasury and the economic loss suffered by the mortgage lender, the homeowner should not be permitted to borrow against any appreciation in the net equity value of the mortgaged property unless the proceeds are applied in accordance with the waterfall noted above. That is, instead of selling the residence for $225,000 as assumed in the foregoing example, the homeowner should be permitted to borrow against any net equity in the residence, provided that $10,000 is remitted to Treasury and $25,000 is paid to the mortgage holder prior to the homeowner retaining any such proceeds.[554] Such flexibility allows the homeowner to cash out the interests of Treasury and the mortgage lender without selling the residence securing the mortgage loan. The modified loan documents should also

---

[551] In order to more appropriately protect the taxpayers, the $10,000 advanced under the TARP-sponsored foreclosure mitigation program could accrue interest at an objective and transparent rate. For example, if the 30-year fixed rate of interest on mortgage loans equals five percent when the mortgage loan is modified, the $10,000 advance would accrue interest at such a rate, and Treasury would be reimbursed the aggregate accrued amount upon realization of the equity proceeds. If at such time $2,500 of interest has accrued, Treasury would be reimbursed $12,500 ($10,000 originally advanced, plus $2,500 of accrued interest) instead of only the $10,000 of TARP proceeds originally advanced.

[552] The mortgage lender may also argue that its $25,000 loss should accrue interest in the same manner as provided Treasury. In such event, the mortgage lender would be entitled to recover $25,000, plus accrued interest upon the realization of sufficient equity proceeds.

[553] Treasury, the mortgage lender, and the homeowner may also agree to share the $50,000 net gain in a manner that is more favorable to the homeowner. For example, the parties could agree to allocate the net gain as follows – (i) 50 percent to Treasury, but not to exceed 75 percent of Treasury's aggregate advances; (ii) 25 percent to the mortgage lender, but not to exceed 50 percent of the mortgage lender's economic loss; and (iii) the remainder to the homeowner. Under such an agreement the $50,000 net gain would be allocated as follows – (i) $7,500 to Treasury (50 percent x $50,000 net gain, but not to exceed 75 percent x $10,000 aggregate advances by Treasury); (ii) $12,500 to the mortgage lender (25 percent x $50,000 net gain, but not to exceed 50 percent x $25,000 economic loss of the mortgage lender); and (iii) $30,000 to the homeowner ($50,000 net gain, less $7,500, less $12,500).

Treasury may also wish to structure its foreclosure mitigation efforts so as to encourage the early repayment of TARP funds by homeowners. Treasury, for example, could agree to a 20 percent discount or waive the accrual of interest on the TARP funds advanced if a homeowner repays such funds in full within three years following the restructure. Any such sharing arrangements and incentives should appear reasonable to the taxpayers and should not negate the intent of the equity participation right. Mortgage lenders may also agree to similar incentives.

[554] Prudent underwriting standards should apply to all such home equity loans.

permit the homeowner to repay Treasury and the mortgage lender from other sources such as personal savings or the disposition of other assets.[555]

I also recommend that to the extent permitted by applicable law Treasury consider structuring all mortgage loan modifications and refinancings under HAMP and any other foreclosure mitigation programs as recourse obligations to the homeowners. If the loans are structured as non-recourse obligations under state law or otherwise, the homeowners may have a diminished incentive to repay Treasury the funds advanced under TARP.

In my view, the incorporation of these specifically targeted modifications into each TARP funded foreclosure mitigation program will enhance the possibility that Treasury will exit the programs at a reduced cost to the taxpayers.

The Overstated Case against Second Lien Mortgage Holders

Some advocate that holders of out-of-the-money second lien mortgages walk away from their loans so as to facilitate the timely modification of in-the-money first lien mortgage loans.[556] In my view, this approach – although certainly not without merit – is generally unrealistic and inequitable to the holders of second lien mortgage loans. In many instances it is unlikely that holders of second lien mortgage loans are *truly* out-of-the-money since today's fire-sale valuations are not representative of the actual intermediate to long-term fair market value of the residential collateral securing the underlying loans.[557] I am not unsympathetic to the argument that an 80-year historic low in the housing market does not reflect a true representation of fair market value, particularly given the tepid mortgage loan and refinancing markets.

---

[555] As noted above, Treasury, the mortgage lender, and the homeowner may agree to share the $50,000 of refinancing proceeds in a manner that is more favorable to the homeowner.

[556] *See* James S. Hagerty, *Banks Rebel Against Push to Redo Loans*, Wall Street Journal (Apr. 13, 2010) (online at online.wsj.com/article/SB10001424052702304506904575180320655553224.html?mod=rss_com_mostcommentart) ("To write down loans enough to bring those debts down to no more than the home values would cost $700 billion to $900 billion, JPMorgan Chase estimated in its testimony. That would include costs of $150 billion to the Federal Housing Administration and government-controlled mortgage investors Fannie Mae and Freddie Mac, the bank said. J.P. Morgan also said broad-based principal reductions could raise costs for borrowers if mortgage investors demand more interest to compensate for that risk. Borrowers probably would have to increase down payments, and credit standards would tighten further, the bank said. Wells Fargo said principal forgiveness "is not an across-the-board solution" and "needs to be used in a very careful manner." Bank of America said that it supports principal reductions for some customers whose debts are high in relation to their home values and who face financial hardships but that "solutions must balance the interests of the customer and the (mortgage) investor").

[557] For example, if a homeowner has encumbered her residence with a first lien mortgage of $200,000 and a second lien mortgage of $100,000, the holder of the second lien mortgage loan is completely out-of-the-money if the residence has a current – fire sale – market value of only $175,000. If the holder of the second lien mortgage in *good faith* anticipates that the residence will appreciate to $240,000 within the next year or so, I can understand why the holder may not be inclined to write off $40,000 of its loan ($240,000 projected fair market value of the residence, less $200,000 outstanding principal balance of the first lien loan).

Second lien lenders may refrain from writing down their mortgage loans if their internal projections reasonably reflect a recovery in the housing market within the next year or so. In addition, if the second lien lenders previously advanced cash to their borrowers under home equity loans, they may also be reluctant to write off such loans since the homeowners received *actual cash value* from the home equity loans and not just more over-inflated house value. In both instances second lien holders may argue that such analysis is based upon their exercise of prudent business judgment as well as the discharge of their fiduciary duties to their shareholders.

While these arguments are compelling, they perhaps mask the real problem arising from the wholesale write-off of second lien mortgage loans. It is entirely possible that holders of second lien mortgages are reluctant to write down their loans past a certain level for fear of impairing their regulatory capital, which could trigger another round of TARP funded bailouts, the failure of second lien holders or worse. This problem may be particularly acute given the high concentration of second lien mortgage loans held by a relatively few financial institutions. Holders of first lien mortgage loans and homeowners may have more success in motivating holders of second lien mortgages to write off part or all of their loans if they offer the holders a contractual equity participation right that permits the subordinate lenders to share in any subsequent appreciation in the fair market value of the underlying residential collateral.

Government Support of Housing Programs through Fannie Mae and Freddie Mac

Since the collapse in home values, the federal government has undertaken extraordinary and unprecedented actions in the housing market. Fannie Mae and Freddie Mac together own or guarantee approximately $5.5 trillion of the $11.8 trillion in U.S. residential mortgage debt and financed as much as 75 percent of new U.S. mortgages during 2009.[558] On December 24, 2009, Treasury announced that it would provide an *unlimited* amount of additional assistance to the two GSEs as required over the next three years.[559] Treasury also revised upwards to $900 billion the cap on the retained mortgage portfolio of the GSEs, which means the GSEs will not be forced to sell mortgage-backed securities (MBS) into a distressed market just as the Federal Reserve ends its program to purchase up to $1.25 trillion of MBS. Treasury apparently took these actions out of concern that the $400 billion of support that it previously committed to the GSEs could prove insufficient as well as to provide stability to an industry still teetering. Additional assistance by Treasury has allowed the GSEs to honor their MBS guarantee obligations and absorb further losses from the modification or write-down of distressed mortgage loans. It also

---

[558] *See* Congressional Oversight Panel, *January Oversight Report: Exiting TARP and Unwinding Its Impact on the Financial Markets: Additional Views of J. Mark McWatters and Paul S. Atkins* (Jan. 13, 2010) (online at cop.senate.gov/documents/cop-011410-report-atkinsmcwatters.pdf). I have incorporated such Additional Views into my analysis of the foreclosure mitigation programs of Fannie Mae and Freddie Mac.

[559] *See* U.S. Department of the Treasury, *Treasury Issues Update on Status of Support for Housing Programs* (Dec. 24, 2009) (online at treasury.gov/press/releases/2009122415345924543.htm).

has provided an advantage by allowing them to raise additional funds through the issuance of debt viewed by markets as virtually risk-free.

The additional commitment and revised cap increase the likelihood that the GSEs will undertake to make significant purchases of distressed MBS for which they provided a guarantee. Presumably, the GSEs may make such purchases from TARP recipients and other holders and issuers, and it will be interesting to note how the GSEs elect to employ the proceeds of the unlimited Treasury facility. It does not seem unreasonable to conclude that the GSEs may use the facility to finance the modification of the residential mortgages they own or guarantee. Since the actions of the GSEs may directly influence Treasury's foreclosure mitigation programs under TARP, I recommend that the GSEs conduct their own foreclosure mitigation efforts in an equitable, fully transparent and accountable manner. The Federal Reserve, Treasury and the GSEs should disclose on a regular and periodic basis a detailed analysis of the amount and specific use of all taxpayer-sourced funds they have spent and expect to spend on their foreclosure mitigation efforts.

In addition, it must be a clear goal that all of these extraordinary actions taken to stabilize markets are temporary in nature. If not, another crisis could result from an over-inflated, government-backed housing market, led by the too-big-to-fail – and getting bigger – GSEs, in which a TARP-like bailout of equal or greater magnitude could occur. While stability is a priority in the short-term, in the medium- to long-term Treasury must make certain that its actions do not exacerbate the same issues that caused the last meltdown and that it enables the return of a viable private sector for housing.

Legal Authority for Treasury to Fund HAMP with TARP Proceeds

EESA authorizes Treasury "to purchase, and to make and fund commitments to purchase, troubled assets from any financial institution."[560] In response to a request from Panelist Paul Atkins as to whether Treasury was authorized to fund HAMP under EESA, Treasury's General Counsel delivered a legal opinion to the Panel concluding that Treasury was so authorized. Interestingly, Treasury has requested that the Panel not publish the opinion in the Panel's report even though Treasury has permitted the Panel to quote extensively from the opinion in the report and deliver a copy of the opinion to outside experts. It is my understanding that Treasury has not asserted an attorney-client privilege regarding the opinion, but, instead, has suggested that disclosure of the opinion may impact its ability to assert attorney-client privilege over related material in other contexts. After reviewing the opinion and the basis upon which the opinion was rendered, I can think of no legal theory in support of Treasury's assertion that an attorney-client privilege could be waived by disclosure of the opinion now that Treasury has agreed that the Panel may quote extensively from the opinion in the Panel's report and deliver a copy of the

[560] 12 U.S.C. § 5211.

opinion to outside experts. Treasury's legal analysis regarding the subject matter of the opinion is fully disclosed and discussed by the Panel and the outside experts in the Panel's report. I request that Treasury promptly abandon any position – including the assertion of an attorney-client privilege – that would keep the opinion confidential.