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OVERSIGHT OF THE EMERGENCY ECONOMIC STABILIZATION ACT: EXAMINING FINANCIAL INSTITUTION USE OF FUNDING UNDER THE CAPITAL PURCHASE PROGRAM

HEARING

BEFORE THE

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS UNITED STATES SENATE

ONE HUNDRED TENTH CONGRESS

SECOND SESSION

ON

THE FINANCIAL INSTITUTIONS USE OF FUNDING UNDER THE CAPITAL PURCHASE PROGRAM

THURSDAY, NOVEMBER 13, 2008

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C O N T E N T S

THURSDAY, NOVEMBER 13, 2008

WITNESSES

OVERSIGHT OF THE EMERGENCY ECONOMIC STABILIZATION ACT: EXAMINING FINANCIAL INSTITUTION USE OF FUNDING UNDER THE CAPITAL PURCHASE PROGRAM

THURSDAY, NOVEMBER 13, 2008

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
Washington, DC.

The Committee met at 10:05 a.m., in room SD–538, Dirksen Senate Office Building, Senator Christopher J. Dodd (Chairman of the Committee) presiding.

OPENING STATEMENT OF CHAIRMAN CHRISTOPHER J. DODD

Chairman DODD. The Committee will come to order.

Let me thank our witnesses in advance of their participation in this morning's hearing, and as is the normal practice, I will begin with a brief opening statement. I will then turn to—I believe Senator Crapo is going to be making an opening statement, and then to my colleagues who are here for any comments they may have as well on the subject matter of today's hearing, or any other matter related to the issue before us.

This hearing is the third hearing we have had in as many weeks on the oversight of the economic stabilization act that was adopted in the waning days of this Congress, and we did not have a hearing during the election week, but we have had oversight hearings every other week during that period of time on a variety of subject matters. And I fully recognized at the time that because of the election cycle, not all of my colleagues could be here for those hearings, but I appreciate very much those who were able to attend and participate, as well as the witnesses who came before us.

So today is our fourth hearing, and we will continue, by the way, through the month of November, into December if necessary, to follow up. Obviously, this matter requires our ongoing attention, as all in this room certainly fully understand. And so I would just advise my colleagues to fully expect a very active Committee during these weeks, as well as, obviously, beginning in January, I presume even before the Inauguration on the 20th, to have an active period of time, whether it is confirmation hearings or continued oversight of the subject matter that is, of course, our financial situation in the country.

Today's hearing is entitled "Examining the Financial Institution's Use of Funding under the Capital Purchase Program," and so I welcome all who are here. Today the Committee continues its oversight of the implementation of the Emergency Economic Stabilization Act of 2008, known as EESA. Three weeks ago, we heard from the administration witnesses about what steps they were taking to implement this important legislation. Today we hear from four of our largest firms that have received assistance pursuant to that law. We are also joined by three very distinguished witnesses who will share their views on the effectiveness of recent actions by lenders and regulators and on what additional steps would be appropriate in order to help stabilize and strengthen our economy.

Forty-one days ago, President Bush signed into law the $700 billion EESA bill. Ten days later, on October 13th, the Secretary of the Treasury announced that nine of the largest financial institutions in our Nation, including the four who are with us today, would receive a total of $125 billion of EESA funds in the form of direct equity investments by the Treasury Department.

These investments of taxpayer dollars are not the only taxpayer-backed benefits that have been made available to these and other financial institutions. On the contrary, they amount to just a fraction of the approximately $5 trillion taxpayer dollars that have been put at risk in recent weeks and months for the benefit of our Nation's financial institutions. And I want to enumerate those because it is the subject matter of the hearing today to understand what the expectation is coming back as a result of those kinds of commitments.

Those $5 trillion have been committed in several forms, and let me enumerate them for you: one, the guarantee of all non-interest-bearing deposit accounts at federally insured banks and thrifts; the increase in deposit insurance for interest-bearing accounts to $250,000 per account; the guarantee of senior unsecured bank debt for a period of 3 years, which financial institutions may opt out of; the decision to place Fannie Mae and Freddie Mac, whose mortgage financing is used by virtually every home lender in the country, into conservatorship and provide them with a $200 billion Federal backstop; the guarantee of hundreds of billions of dollars in money market funds; the decision by the Treasury to reverse over two decades of tax law to allow companies, including financial institutions and banks, to write off their taxes the losses of companies that they acquire; the guarantee of major segments of the commercial paper market; and, last, the creation by the Federal Reserve of numerous facilities and special purpose vehicles for bank holding companies, primary dealers, and commercial firms so that they can find sources of reliable, affordable financing for their business activities. The Fed alone has committed $1 trillion in tax dollars so far to the recovery effort.

By any measure, these actions amount to an extraordinary commitment of public resources. On some level, all of us, including members of the public, expect that this extraordinary commitment befits the extraordinary financial crisis now facing our Nation. It is an unprecedented sum for these unprecedented economic times.

It is no secret that some who have received funds under EESA, including some of the institutions represented here this morning, did not ask for this funding. Nevertheless, they accepted it. Indeed, given the irrationality of the markets that seemed to target and take down one renowned firm after another, these public investments serve as a seal of approval. That explains why so many other firms are quickly lining up for their capital injections.

Given that fact, it is reasonable, I think, for us to ask, now that they have the money that they have received, what are they going to do with these resources. What is their responsibility to the citizens of our country who are making enormous sacrifices to support the financial sector and the economy as a whole? The acceptance of public funding carries with it a public obligation, in my view. One cannot benefit from taxpayer support in all of its many forms and assume that one has no duty to serve that same taxpayer. The people of this great country of ours are generous and understanding, but they are entitled, in my view, to expect that those who benefit from their sacrifices will act with appropriate restraints and purpose. In my view, lenders who enjoy benefits conferred by taxpayers owe those same taxpayers consideration that includes the following:

First, that they preserve homeownership. This Committee has said this over and over and over again, beginning with the very first hearing almost 2 years ago, over and over again. In fact, one of our witnesses here today was a witness 2 years ago before this Committee and predicted some 2 million foreclosures. It now seems quaint, that number. And yet at the time, it was suggested that somehow he was exaggerating and engaging in hyperbole. We now know the numbers this morning indicate how bad that situation is, and I am going to continue on this. It is still confounding to me why the Secretary of the Treasury and others refuse to understand this is the heart of the problem. And until we address this, this problem is not going to go away.

So the first issue is preservation of homeownership. The foreclosure crisis is the root cause of the larger financial crisis, and the root of the foreclosure crisis, of course, was bad lending practices in which many of the well-known lending institutions engaged. Until we solve the foreclosure problem, we will not have any hope of solving the larger economic issues.

Now, I appreciate the efforts that numerous lenders have started to make in this area, including some who are here today, and I appreciate that very much. But more, much more, must be done on a lender-by-lender as well as on an industry-wide basis to address the foreclosure crisis. Even lenders who have modified a relatively large number of loans are doing so in a manner whereby many of those loans default or redefault. That does not seem to be good for anyone, borrowers or lenders. Now is the time to utilize Hope for Homeowners and other initiatives designed to truly preserve homeownership and stabilize the economy.

Second, lenders who receive public funds should use those funds to lend. Many are failing to do that. CEOs have been directly quoted as saying they intend to use public dollars to acquire other financial firms and widen their capital cushion. Let me say as clearly as I can this morning, hoarding capital and acquiring healthy banks are not, I repeat not, reasons why Congress authorized $700 billion in emergency funding. The core purpose of this law and the purpose of virtually every other action taken during this crisis is to get lenders back into the business of lending. Credit is the lifeblood of the economy, and it is absolutely essential to businesses and consumers.

Lenders have a duty to use these funds, in my view, to make affordable loans to creditworthy borrowers on reasonable terms. If they do not, then in my view they are acting outside the clear intent of the statute and should reform their actions immediately.

Third, and last, lenders who are eligible for EESA funding and for other items on the smorgasbord of Federal assistance to financial firms would do well to examine their executive compensation policies. EESA sets forth clear, if modest, I might add, restrictions on executive compensation for companies that receive financial assistance under this act. I would suggest that these restrictions serve as a beginning, not an end, to the restraint firms should show in compensating their most highly paid employees.

Our Nation clearly is in a crisis. We all know this. We are at war in two distance countries. Our financial markets remain uncomfortably close to the precipice of collapse. Working Americans have been forced to cut back in their personal lives, even as they have been asked to shoulder the enormous burden of propping up the financial sector. At this time of austerity and apprehension, it would be regrettable if some carried on as if they do not owe a duty of restraint and modesty to those countless Americans whose sacrifice helps make your viability and prosperity possible of national economic peril.

For those tempted to conduct business as usual with respect to their compensation policies, I would simply ask: Where would your company and your industry be today without taxpayer-backed deposit insurance, without taxpayer-backed guarantees of your bank debt, without taxpayer-backed special lending facilities at the Federal Reserve, and without all of the other special benefits that your industry is receiving courtesy of the American taxpayer?

If you believe that you would be no worse off than you are today, then I invite you to return to the Treasury the billions of dollars in taxpayer investments, guarantees, and discounts that you currently receive. And I wish you well as you try to make it on your own. Until that happens, I think I speak for many Members of this Committee and the Senate in saying that we want to see more progress, and your friends in the financial sector, more progress in foreclosure mitigation and affordable lending and in curbing excessive compensation. And if that progress is not forthcoming, then we are prepared to legislate—now if possible, but next year if necessary.

With that, let me turn to Senator Crapo for any opening comments he may want to make.

STATEMENT OF SENATOR MIKE CRAPO

Senator CRAPO. Thank you very much, Mr. Chairman, and, again, I appreciate the attention you have given to the need for strong and continuous oversight by this Committee after now seeing the extreme and serious repercussions throughout every aspect of our economy as a result of the credit crisis.

According to one study, for every dollar of net losses on loans and securities, there is a multiplier of 10 in the reduction of credit. If we use the most recent number of $1 trillion in writedowns and credit losses and take into consideration the fact that the banks have raised $350 billion in new capital, there would be a $650 billion net loss and, using that formula, a $6.5 trillion loss in credit available in the market. I am not sure whether these are the right numbers or whether we actually know what they are or what the deleveraging is. But it is clear that we are facing a significant credit loss, and it has the potential to become even worse.

Secretary Paulson's announcement that Treasury is not planning to buy toxic assets and that there are more effective ways to use the taxpayer dollars that have been provided provides a perfect opportunity to assess the results of the rescue package and to consider other directional changes.

As you know, Mr. Chairman, I was not one of those who supported the notion of purchasing these toxic assets and have been very concerned that not only was the taxpayer not adequately protected, but that Treasury's proposal to buy toxic assets created an incentive for investors to stay on the sidelines and watch what the Government would do to then step in at a later date and either buy or purchase or finance purchases from the Government at a discount.

I am very interested in what ways our witnesses believe these taxpayer dollars should be used and in what direction we should go. I have always believed that the direct utilization of our resources to increase liquidity with specific actions was a more appropriate direction that we should take, and I am hopeful to hear the witnesses' advice on those matters as well.

In addition, Mr. Chairman, I hope that we can get into a strong discussion about some of the broad regulatory, structural reforms that we need to consider. Again, as you know, I have strongly argued for regulatory reform of our financial institutions, and this is an opportunity now for us to evaluate just exactly what is the regulatory structure our Nation should have.

This week, the head of the CFTC said that he believes the United States should scrap the current outdated regulatory framework in favor of an objectives-based regulatory system consisting of three primary authorities: a new systemic risk regulator, a new market integrity regulator, and a new investor protection regulator. The risk regulator would police the financial system for hazards that could ratchet across companies to have broad economic consequences. The market integrity regulator would oversee safety and soundness of exchanges and the key financial institutions, effectively acting as a replacement for existing bank regulators and the SEC's function of regulating brokerages. The investor protection regulator would protect investors and business conduct across all firms.

This is a similar idea to the outline provided in March by Secretary Henry Paulson of the Treasury, and I for one believe we should evaluate these kinds of proposals. I hope we also evaluate the potential for a single regulator, as has been done in other parts of the world where we have seen some significant effectiveness. But whatever our new regulatory structure is, I think it is important that we move from the outdated regulatory structure that we have now into one that still protects a strong, viable market, but allows for the consumer protections and the other protections against the systemic risks that we are seeing today that the Chairman has described. And I look forward to working with you closely as we evaluate this important part of our regulatory system.

Thank you, Mr. Chairman.

Chairman DODD. I thank you, Senator, very much.

Let me just say to you very quickly here, it is my intent as Chairman of the Committee that we are going to examine thoroughly the whole issue of modernization of financial regulations. And these suggestions you have made this morning, among others, will certainly be a part of the Committee's deliberation. It is maybe the most important issue for us in the long term for this Committee to address and make recommendations to the full Senate.

Senator CRAPO. Thank you, Mr. Chairman. As we do that, we have got to be sure we get it right, and I look forward to working with you.

Chairman DODD. Senator Johnson. Congratulations, by the way. Welcome back.

STATEMENT OF SENATOR TIM JOHNSON

Senator JOHNSON. Thank you, Mr. Chairman, for holding this hearing today.

Since the passage of the bailout, which I voted against, this Committee has talked with the regulators regarding the implementation of the $700 billion package. While there are clearly some concerns about implementation, it is moving forward. I think it is equally important that this Committee talk with the institutions that are receiving this money, and I thank the witnesses for being here today.

I have been concerned in past weeks with reports of continued executive compensation, expensive trips, and other benefits for CEOs of some companies receiving Government help, and reports that over one-half of Capital Purchase Program funds will be used to pay investor dividends. In a business environment where accountability has clearly been lacking and contributed to our current economic situation, I want assurances from financial organizations using Treasury funds that they will not misuse the taxpayers' money and that there will be punitive actions by Members and regulators if funds are misused.

I have a problem with the funds being used for executive compensation and dividends. Both of these should be rewards for a job well done, and that is currently not the case for many in this industry.

The intent of the bailout was to stabilize troubled financial institutions and help those businesses and individuals on Main Street affected by the credit freeze—a freeze resulting from poor decisions in the subprime mortgage market. Those making the decisions on how to spend the $700 billion and those receiving the funds must remember this intended use.

Thank you, Mr. Chairman.

Chairman DODD. Thank you very much, Senator.

Senator Martinez.

STATEMENT OF SENATOR MEL MARTINEZ

Senator MARTINEZ. Mr. Chairman, thank you very much for calling this timely hearing, and thank you also for your very passionate remarks, and I tend to agree with much of what you had to say.

Let me begin by just saying that over the last several days I have had the opportunity to travel around the State of Florida, and the news on the ground is really not good. Talking to bankers, real estate developers, and others in the home industry, it is clear to me that until we change the dynamics of what is occurring today where foreclosures continue to pile up, where we continue to see banks—and I am talking now about local banks, I am talking about community banks, I am talking about Main Street banks that are being told by regulators that even though they have performing loans that are on their books, because they are real estate loans, perhaps they should call them in. And all of a sudden we have now builders that are in the toughest of times but able to maintain that business going and keep people on the job, being told that their lines of credit are being canceled or not extended because the banks simply are being squeezed by regulators.

This is a real problem. It also relates to the problem that they are facing at the level of not also being sure what is going to occur with TARP. You know, one set of rules was first put out. They were going to try to work under that set of rules, and now changes have been made to how the Treasury is handling the whole TARP matter. I think some clear guidelines so that bankers and others in the lending business know exactly what the rules of the game are going to be are essential, and I think the sooner we do that, the better that it is going to be.

Florida has the third highest foreclosure rate in the Nation, and it is clear to me that Florida's entire economy—and I think the Nation's—is impacted by the homeownership crisis. And in my view, until we stem the tide of foreclosures, until we begin to find effective ways of—and I commend some of the banks that are here today for what they are doing. Some of them have been at some events that we have tried to sponsor to help families stay in their homes. To keep those loans as performing loans and active loans, as opposed to foreclosures, is something I think we need to work toward.

Until we get to the bottom of this, until we get to the foreclosure crisis, I do not think any of these other problems are going to ameliorate. I think this crisis began with homeownership problems, and I think it is going to end when we get a handle on that side of the equation. And I believe that your comments are precisely on point. I think we need to ask that as these infusions of capital are being made to the large financial banks, that capital then move downstream and is out there to help local businesses who cannot get credit, to help borrowers who would buy a house if they could just get a loan, and maybe not with 20 percent down but with something different than that.

The bottom line is that until we turn the tide of where we are today in terms of the housing crisis and the foreclosure crisis, I believe that our entire economy continues to be at risk. And I look forward to hearing the testimony from the witnesses today.

I very much support the efforts by FDIC Chairman Sheila Bair to put a more aggressive approach to loan modifications. I think she is on the right track, and I believe that it is time that we get this done and we get aggressive about it. We have done a number of things, the administration has done a number of things, all well intended and, I think, designed to do some good to the problem. But they have all been timid and they have been late. I think we need to get aggressive and get ahead of the problem once and for all.

You are right. We heard a couple of years ago about 2 million foreclosures, and we wish that that was the end of the story. And if we do not get ahead of this, if downward spiraling prices of homes does not get stemmed, if we don't get a floor on the housing economy, I think we are going to see this problem only continue to escalate.

Thank you.

Chairman DODD. Thank you for that, and, of course, the news this morning is, I think, 9,128 foreclosures on average per day in the month of October, up 5 percent from the month of September and up 25 percent from a year ago. So the problems persist.

Senator Casey.

STATEMENT OF SENATOR ROBERT P. CASEY

Senator CASEY. Mr. Chairman, thank you very much, again, for calling this hearing and keeping a steady vigilance of this problem. I just have a very short statement.

I think that the witnesses here today know as well as anyone in this room knows, anyone in the country would know, that until we get serious about the foreclosure problem, we are not going to be able to tackle this, and no financial system or no financial institution is going to be in good shape until we do that.

Unfortunately, the Treasury Department does not seem to have the same urgency with regard to preventing foreclosures and helping homeowners as it had to get the legislation passed and to help financial institutions. Of course, that is my opinion, but I think there is a broad consensus that they are not moving with the same intensity that they moved to get the legislation passed, the emergency economic stabilization legislation passed in October.

This foreclosure problem is an ever bleeding wound on our economy, and until we get serious about it, we are not going to rescue our financial system and, therefore, stabilize our economy more broadly.

I was just looking at the numbers today from across the country, but just in terms of Pennsylvania, the State that I represent, which is not in the top ten, fortunately for us, still, in October, the fifth straight month where Pennsylvania saw that more than 4,000 foreclosures filings, the largest—I should say the longest such stretch since at least 2005.

So we have got much work to do on this issue, and I hope that the Treasury Department moves with much greater speed than they have demonstrated so far when it comes to preventing foreclosures. And that is why I think this hearing and so many like it are so important, Mr. Chairman.

Thank you very much.

Chairman DODD. Thank you very much, Senator.
Senator Brown.

STATEMENT OF SENATOR SHERROD BROWN

Senator BROWN. Thank you, Mr. Chairman, for calling this morning's hearing and those hearings that have preceded it. Thank you for all the work you have done in the last several weeks with oversight and with what we need to do, discussing what we need to do in the future.

I want to thank our witnesses. I commend the banks that have recently announced major efforts to modify loans in a broad and meaningful fashion. I appreciate the efforts of those on the panel who are advocating on behalf of our Nation's homeowners. Thank you for that.

It has been a month and a half since Treasury Secretary Paulson and Federal Reserve Chairman Bernanke and their colleagues came before this Committee to ask for the authority to commit $700 billion for stabilizing our economy. Congress responded quickly to provide that authority, as we know, but as Secretary Paulson recognized in his testimony then, such an extraordinary grant of authority must be accompanied by oversight and by transparency.

Mr. Chairman, you were accomplishing the former, the oversight. I am not convinced we have achieved the latter. Almost 3 weeks ago, the people of northeast Ohio learned that National City Bank, which had been in business since 1845, would be purchased by PNC. The taxpayer funds that would have been allocated to National City were instead allotted to PNC. PNC will be able to take advantage of the recent decision by the IRS to permit banks to write off the losses of banks that they acquire without limitation.

I do not fault in any way PNC in this. Given the Government's decisions, its actions made sense. It gives every indication it will be a good corporate citizen, as National City has been in Cleveland. But while this was the first acquisition funded by the Emergency Economic Stabilization Act, it appears it will not be the last. Several banks have indicated they plan to use taxpayer capital for acquisitions. I have asked Treasury a number of questions regarding the planned acquisition of National City as well as the larger issue of using taxpayer funds to finance mergers and acquisitions. Several of my colleagues on this panel have done the same. I am not aware of any answers having yet been supplied.

The American people are waiting for answers, too. Many of them were not thrilled with the idea of committing $700 billion in taxpayer money to some of the very companies that engineered this crisis. They know we face a credit crunch, but must reconcile that against companies that seem to be carrying on business as usual, as Senator Johnson said, with their lavish retreats and their healthy bonuses.

I hope our witnesses today will provide some answers. We all understand, as Secretary Paulson discussed yesterday, the need to change tactics when one approach does not work or when, as Secretary Paulson said, circumstances change. But the purpose of the legislation we passed remains the same: to unfreeze the credit markets. If taxpayers' funds are not going to be used for lending, then we need to give serious thought to whether this effort still makes sense.

The whole purpose of the economic rescue bill is to prevent a recession from becoming something worse, maybe not the Great Depression, but perhaps the Not So Great Depression. I mean no offense to our witnesses, but I did not vote to save Wall Street. I voted to save Main Street. I voted to save Main Street not just from the credit crunch that has engulfed the country for the past few months, but from the grinding pace of foreclosures that has gripped my State for several years.

I do not see how any strategy to right the economy can succeed if it does not bolster banks' lending efforts and fix the damage from the evaporation of lending standards over the past several years. We have only solved half the problem if we get credit to a tool and die shop, but its employees are losing their homes.

We are finding ourselves forced, in effect, to impose underwriting standards in the middle of a loan rather than at the outset. That inevitably is going to be messy. Some loans will still default. Some people just bought too much house or lost a job and simply cannot afford their mortgage or any mortgage. But we owe it to the millions of homeowners facing foreclosure to work with them. It is in the investor's interest to keep that person in the home rather than taking on the expense of foreclosure and selling it into today's market. And it is in the Government's interest to accept an imperfect approach as the better alternative to inaction.

As Franklin Roosevelt said some 70 years ago, "Better the occasional faults of a Government that lives in a spirit of charity than the consistent omissions of a Government frozen in the ice of its own indifference."

We cannot be indifferent to the millions of Americans who face the prospect of losing their homes. We need to live in a spirit of charity while making very rational—very rational—decisions on how to deploy the resources of the Federal Government to help both the struggling credit markets and the millions of people who depend on them.

Thank you, Mr. Chairman.

Chairman DODD. Thank you very much, Senator, and before turning to Senator Schumer, you have made the point, and it deserves being remade. I read this morning about we are going to see the Treasury move now to consumer issues on credit cards and car loans, and that sounds good. But to put that ahead of homeownership to me is just, once again, denying the underlying problem that we face.

Senator Schumer.

STATEMENT OF SENATOR CHARLES E. SCHUMER

Senator SCHUMER. Thank you, Mr. Chairman. I want to thank you for your diligence throughout this period of holding a whole series of hearings. It is vital that we make sure that the programs implemented by Treasury and the Federal Reserve are accomplishing the goals of restoring our financial system and our economy, and these hearings play a major role in that, so I thank you.

Now, although we seem to have avoided the devastating effects of a full-fledged depression through the recent emergency interventions, particularly the Government backing interbank lending and business deposits at banks, we still face frozen credit markets for consumers and businesses as well as a recession that threatens to be too long and too painful for the entire country.

I am glad that Secretary Paulson and the rest of the Treasury team have finally seen the light and decided to abandon asset purchases. It was the worst-kept secret in Washington that the asset purchases and the auctions Treasury proposed would not work and were likely to be scrapped. During the entire negotiations, from the days you and I, Mr. Chairman, and some of the others sat across the table, Treasury never figured out how to price the assets, whether by auction or by purchase. So it was just a matter of time until Secretary Paulson finally acknowledged that reality, and I am glad he did so we could move on.

Now, many of my colleagues and I recognized that capital injections were clearly the correct approach from the beginning, and we gave Secretary Paulson the authority to do them without him asking for them. Now I suspect he is grateful we did, since it has become the most indispensable tool to restore confidence in our financial system, and I am glad we have moved away from auction and asset purchase and to capital injection.

But the Capital Injection Program is not working either, not because there is a fundamental flaw in the concept of capital injection, but because of the way the program is structured. Because of the way it is structured, it is not meeting its goals of improving stability in the system and increasing lending the way it should. Treasury's stated purpose for the capital injections was to give banks a strong capital base so that they could increase lending into the economy for things like credit cards, auto loans, and small business loans. But in these uncertain and difficult times where nobody is sure of asset values, banks are inclined to hoard rather than deploy capital. They do not know how much lower the value of the assets they have will go, so they are hoarding the new capital in case they go lower. And in its zeal to include the largest banks and avoid any stigma in participating, Treasury failed to make the rules strict enough to overcome that inclination. And as a result, the Capital Injection Program is not producing very much new lending.

Even if Treasury may not be able—now I intend to ask the witnesses here from the banks why they are not lending more with this additional capital. But even if Treasury cannot change the terms retroactively, any new capital injection must come with tougher requirements. Treasury should revise the terms for the next $125 billion, and if they come to us and ask us for the additional $350 billion, I intend to write those provisions—do my best with, I know, the support of many of my colleagues here, to put those provisions into the new terms of the law.

Because consumers and businesses around the country depend on credit, if it is not available, the recession will be deeper and longer than it has to be. And yesterday Secretary Paulson said, well, let us focus on auto loans and credit card loans and small business loans. But he is ignoring the best way to get to do it, which is through the Capital Injection Program, but a Capital Injection Program with some stringency, with making sure that the institutions who take it—and I am against forcing institutions to take it; I think that was a bad idea—but that those who take it, need it, should have to meet some requirements.

It is particularly true for small businesses that need credit to expand and create jobs. I just got a call yesterday and saw up in Buffalo a company of 300 employees, been there for a long time, cannot get a loan. Good-paying jobs in Buffalo, they do not come easy, and they are ready to go under even though the firm has been in business for a long time. And I am sure that story can be repeated in every one of our States over and over and over again. Small businesses need credit to expand and create jobs. They also need it to keep their doors open to protect the jobs they have. Millions more jobs could be in jeopardy if we do not fix the lending markets, and fast. The Federal Reserve Quarterly Lending Report for the third quarter reported that 75 percent of banks have tightened credit on commercial and industrial loans to small firms during the third quarter. That was up from 65 percent in the second quarter and 50 percent in the first.

So Senator Kerry and I have been working on adding some targeted small business items to the stimulus package, such as temporarily waiving all lender and borrower fees, and increasing the maximum loan amount, and I will be asking these questions in addition to encourage banks to lend to small business as larger banks.

I also believe, as some have stated—I think you, Mr. Chairman, and I could not agree with you more—that tougher terms should include more stringent restrictions on executive compensation to ensure that there are not incentives for executives to take excessive risk and more help for struggling homeowners. Chairman Bair's proposal in combination with the change in bankruptcy laws—and I believe this will only work if we change the bankruptcy laws—is the clearest and cleanest solution.

One more point, Mr. Chairman. It is critical that we ensure the Government's capital is not wasted in other ways. I am calling for any mergers completed with the help of TARP money first to be approved by Treasury. And this relates to my colleague from Ohio's point. While there are mergers that should take place to improve systemic stability and encourage lending, in a very weak institution a merger may be the right way to go. Giving away Government money so that it can be used to gobble up competitors in a way that will not have any impact on the overall stability of the financial sector should not be endorsed.

Mr. Chairman, the Government's assistance has to include significant help from Main Street as well as Wall Street. Consumers and businesses must see improved access to credit as a result of the Government's actions, and struggling homeowners must see a renewed commitment from the Government to help them avoid foreclosure.

I look forward to discussing these issues with the panel, and thank you for holding the hearing.

Chairman DODD. Thank you very much, Senator.

We have been joined by Senator Bayh, and I do not want to spring it on you here just as you sit down, but would you like to make an opening comment, Senator?

STATEMENT OF SENATOR EVAN BAYH

Senator BAYH. No, Mr. Chairman, except to say that I share the concerns of our colleagues as I understand that they have been expressed with regard to executive compensation dividends and, most of all, getting the capital that has been provided into the marketplace to get the job done for which it was intended.

So I look forward to hearing from our panelists, and thank you for this very, very timely hearing.

Chairman DODD. Thank you very much, Senator.

Well, let me welcome our panelists, and I am going to introduce them briefly and then turn to them for any opening statements. Let me encourage you to try and keep your statements relatively brief, if you can, and then we take the full statements, obviously, as part of the record, and any supporting documentation or evidence that you think would be helpful for the Committee to have, we will consider it as accepted at this juncture. So I look forward to your full testimony.

Let me, first of all, introduce Martin Eakes, and Martin is no stranger to this Committee. In fact, at the outset of my remarks, I pointed out that we had witnesses in February of 2007 to come and talk about the very issue which is the subject matter in part of today's hearing, and it was Martin Eakes who made the statements that caused some voices in this city and elsewhere to ridicule his predictions of 2 million foreclosures 2 years ago. So, Martin, we thank you for being with us.

Martin is the CEO and founder of Self-Help, a community development lender, and CEO of the Center for Responsible Lending. He has received numerous awards, including the MacArthur Foundation Fellowship in 1996, and I want to note, as I did a minute ago, that in 2007, Martin Eakes testified before this Committee—at one of our first hearings, I might add, under my chairmanship—that there would be 2 million foreclosures, a number that was met with great skepticism by people in the industry, and others. I think everyone would agree today that we would be lucky if that were the number, as Senator Martinez pointed out, that we were actually dealing with.

Next to Martin Eakes is Barry Zubrow, who is Executive Vice President and Chief Risk Officer for JPMorgan Chase, also serves as the Chairman of the New Jersey Schools Department Authority. I do not know which is the tougher of those two jobs. We thank you for being with us.

Our next witness is Mr. Gregory Palm, Executive Vice President and General Counsel, The Goldman Sachs Group, and a member of its Management Committee. He joined Goldman Sachs as a partner in 1992. Previously, Mr. Palm served as law clerk to Justice Lewis Powell of the Supreme Court. We thank you, Mr. Palm, for being with us.

Then we will hear from Susan Wachter, who is the Richard Worley Professor of Financial Management and a professor of real estate and finance at the Wharton School, University of Pennsylvania. She served as Assistant Secretary for Policy Development and Research at HUD from 1998 to 2001.

The next witness is Anne Finucane. Anne is the Global Corporate Affairs Executive of Bank of America Corporation, also serves as the Northeast President, Executive Vice President of Corporate Communications, and a member of the CEO senior management team. She is someone I have known for a long time. Anne, thank you for being here with us today.

We are then going to hear from Jon Campbell, who is the Chief Executive Officer of the Minnesota Region and Executive Vice President of Wells Fargo Bank. In his current position, he is responsible for the Wells Fargo Regional Banking Mergers and Acquisitions Program.

And our final witness is Ms. Nancy Zirkin, well known to many of us here. She is Executive Vice President and Director of Public Policy for the Leadership Conference on Civil Rights. Ms. Zirkin joined the Leadership Conference in 2002, and under her leadership the organization has gone from a 10-person operation to four times as many who work on these issues, and, Nancy, we thank you for joining us this morning.

With that, Martin Eakes, we welcome you to the Committee, and the floor is yours.

STATEMENT OF MARTIN EAKES, CHIEF EXECUTIVE OFFICER, CENTER FOR RESPONSIBLE LENDING

Mr. EAKES. Good morning, Chairman Dodd and Members of the Committee. Thank you for holding this hearing and for inviting me to testify.

My organization Self-Help has made $5 billion of loans to 55,000 low-wealth families to purchase their first homes. I take it personally when people are losing those homes.

I am also the CEO of the Center for Responsible Lending, a non-profit, non-partisan research and policy organization dedicated to protecting homeownership. I have been at this work a long time, more than 10 years, trying to stop abusive loans and foreclosures.

In 1998, I helped put together the coalition in North Carolina of banks, credit unions, realtors, home builders, seniors, churches, civil rights groups, housing groups, to put together an almost unanimous bill to stop abusive lending in North Carolina.

I have testified at Federal Reserve and congressional hearings starting in 2000, and virtually one or two every year since. In 2007, I testified in front of this Committee saying that we had a silent storm of foreclosures that were 20 to 30 times the magnitude of Hurricane Katrina in its devastation. Unfortunately, that storm is no longer silent.

So you will excuse me, I hope, for being a little bit impatient at this point. I have taken calls and sat with hundreds of parents facing foreclosure, and every single one of them are numb in their face and have tears in their eyes, and I have had to watch them lose their homes. I have sat in State legislative hearings where 90-year-old grandmothers walk to the podium with their walker, saying that they were looking in the want-ads to get a job so that they could prevent foreclosure of their home. They were not going to get a job.

Let me just say flat out that voluntary efforts by lenders and servicers, while admirable, will not fix the problem of bad loans in this country and the problem of foreclosures. The voluntary efforts have been too little, too late at every single stage of the crisis. It is not that Hope Now, the voluntary association, intends to be ineffective, but there are structural barriers that make it so. Eighty percent of the foreclosures we see today are happening in private label securities. These are subprime loans and Alt-A that are in these complicated structured securitizations.

Within those securitizations, the various tranches have what we call "tranche warfare." When one party benefits, another one loses, and they threaten to sue the servicer if they continue modifying loans. Fifty percent of the subprime and Alt-A loans that are subject to foreclosure have piggyback second mortgages, which makes it almost impossible to structure and modify those loans, because you still have a party that is not part of the solution.

Then, finally, one of the most pernicious barriers is that there is actually an incentive in the industry now to foreclose versus working out loans. Loan servicers who govern these securitizations get paid when they foreclose, but they do not get paid when they work out a loan. They just do not get paid. In the worst cases, the servicer gets paid twice when it forecloses. The world owes Bank of America, one of the best banks in America, a debt of gratitude for taking on the thankless task of cleaning up Countrywide's wasteland of unethical lending practices. But Bank of America has not had time to get rid of Countrywide's affiliates which prevent a conflict of interest in fees that are paid to its own affiliates every time there is a foreclosure. For most of Countrywide's foreclosures, they would order a credit report and an appraisal, purchased from an affiliate that they owned 100 percent every time there was a foreclosure. They would order a forced placed insurance for people who got behind on their payments, again, from a company 100 percent owned by Countrywide. And, finally, when there was a foreclosure necessary, the trustee that was hired was 100 percent owned by Countrywide. In my book, that is simply corrupt.

I have been in meetings where the senior executives of the largest banks have talked about being arm-twisted into accepting the $25 billion of Government risk capital at a dividend rate of 5 percent. Taking the money was an act of patriotism, agreed to in order to protect the anonymity of those other banks, those anonymous ones that really were weak enough to actually need it.

Let me just say on this panel we have four of the strongest, best managed financial institutions in the world, but not a single one of these banks would exist today if it were not for support and backing from the Federal Government. If there were not Federal deposit insurance and access to the Federal-backed liquidity windows at the Federal Reserve and Federal Home Loan Bank, not a single one of these banks would have survived from August 2007 until today.

So there is a duty to fix these loans and make the steps, and there are two things we need to do right now. The first has been referenced already. Lift the ban on judicial loan modifications so that loans against a personal residence can get fixed if the lender is unwilling to do it voluntarily. Note that the recent bills that have been presented to fix this bankruptcy provision would not allow a modification of the home loan if the lender voluntarily modified it in advance. Lifting the ban on judicial modifications for residences is what solved the debt problem for farmers in the 1990s, and it will do the same thing here.

No. 2, we should insist that Treasury invest up to $50 billion of the $700 billion, or 7 percent, in the plan proposed by Sheila Bair and the FDIC. It is the only plan that has been put forward thus far that will actually work to help the foreclosures on the ground. Many of you commented in your opening statements that we cannot solve this crisis until we go right to the source, which is foreclosures and the spillover effect. Every time a house gets foreclosed, it damages and destroys the neighbors all around it.

The FDIC's plan is really the carrot, if bankruptcy is the stick, saying do the right thing or we will let a court do it. This is a carrot. What the plan says is let us induce loan servicers to make the loan modifications that have not been able to be done voluntarily. It would set a 31-percent housing-payment-to-income ratio as the threshold for what is an affordable modification. And in order to have the lenders reduce the interest rates on their loans to as low as 3 percent or extend the term or defer principal to get the loan to an affordable level, the Government would then take on 50 percent of the redefault losses if those loans that were modified eventually went to default. Loan servicers have told us that is their biggest concern, so it addresses the problem not only taking on 50 percent of the losses, there is still an incentive for the lenders to not throw losses at the Government because they would still have losses themselves.

This program could reach 3 million households. If 2 million of them were successful and one-third redefaulted, the one-third would create $100,000 of loss per house, let's assume, times a million households, would be $100 billion of loss. The Government's 50-percent share of that would be $50 billion. It is a pretty paltry amount to invest to actually solve the problem that we have been facing.

When are we going to insist that the taxpayer funds that were set up to solve this problem are actually spent on the people who are losing their homes, particularly in Florida and Arizona and Michigan, Ohio and California, places where the problem is utterly out of control?

So I thank you for holding this hearing. I appreciate your work, and let me help you any way I can in putting some pressure on Treasury to do the right thing.

Chairman DODD. Thank you, Martin, very much. And I am sure we are going to—I know I am going to raise the question with the other panelists about the Sheila Bair proposal, and just get prepared as witnesses to anticipate that question that Mr. Eakes has raised and address it.

Mr. Zubrow, thank you for being with us. You have to pull that microphone a little closer to you.

STATEMENT OF BARRY L. ZUBROW, EXECUTIVE VICE PRESIDENT, CHIEF RISK OFFICER, JPMORGAN CHASE

Mr. ZUBROW. Thank you very much, Mr. Chairman. Chairman Dodd and Members of the Committee, thank you for including us in today's hearing on the Capital Purchase Program. I am pleased to represent JPMorgan Chase before this Committee. You have with you my detailed written testimony. Given the size of this panel, allow me to summarize a few key points.

At JPMorgan Chase, we believe that the Government's investment in our firm comes with a responsibility to honor the goals of the Capital Purchase Program. To that end, we are using the CPP funds to expand the flow of credit into the U.S. economy and to modify the terms of hundreds of thousands of residential mortgages. At the same time, we continue to maintain prudent business practices and underwriting standards that have helped JPMorgan Chase to create and maintain a fortress balanced sheet.

What does this mean in practice? Let me begin with our loan modification efforts, which we believe will help to strengthen the U.S. real estate markets and to keep people in their homes.

Last week, we announced the significantly expanded loan modification program that we expect will help roughly 400,000 additional families to stay in their homes. Since early 2007, Chase has helped about 250 families avoid foreclosure, primarily by modifying their loans or their loan payments. Our new initiative is reaching out to additional customers of Chase, but also to Washington Mutual and the EMC unit of Bear Stearns, which are now part of the bank.

As part of these efforts, we are opening 24 regional counseling centers to provide borrowers with face-to-face help in high delinquency areas.

We are hiring over 300 new loan counselors, bringing our total to more than 2,500, so that homeowners can work with the same counselor from the start to the finish of the process.

Proactively, we are reaching out to borrowers to offer pre-qualified modifications, such as interest rate reductions and principal forbearance.

We seek to expand the range of financing alternatives which are available to our customers and to provide an independent review of each loan before moving it into the foreclosure process. Until all of these changes are fully implemented—we hope within the next 90 days—we have stopped any new foreclosure proceedings on our owner-occupied properties.

The Capital Purchase Program's goal of providing capital to the U.S. economy is absolutely consistent with our own core business of supporting our customers through lending operations. Despite the challenges economic conditions, we continue to provide credit to our customers, whether they are consumers, small businesses, large corporations, not-for-profit organizations, or municipalities.

Throughout the past year, during some of the most turbulent and difficult conditions many of us have ever witnessed, we have prided ourselves on being there for our clients, whether by making markets, committing capital to facilitate client business, investing in infrastructure and other projects, or making loans to creditworthy borrowers. In short, we have been open for business and we continue to be open for business. The CPP enhances our ability to lend to consumers and businesses large and small, and we are committed to honoring the goals of this program.

The Committee has also asked us to address executive compensation practices, and I am pleased to do so. JPMorgan is in business for the long term, and our compensation philosophy reflects that.

Simply stated, we believe that compensation should be based on the long-term performance of our firm and the individual's contribution to his or her business, and to provide important and appropriate safeguards for safe and sound behavior. We require our senior executives to retain at least 75 percent of all their equity awards that are granted to them so that their interests are aligned with the long-term interests of our shareholders. We offer no golden parachutes or special severance packages. Our top executives are subject to the exact same severance provisions as all of our employees.

Even prior to the CPP, our firm had in place a bonus recoupment policy. We have obviously amended that to ensure full compliance with the terms of the CPP.

We are not yet in a position to provide specific information about compensation for this year, given that the year is not complete. However, given the type of year we are experiencing and even though we have produced profitable results in each quarter to date, I have little doubt that employees and executives will make substantially less than they did last year. Let me also state very clearly that the CPP money will have no impact on the compensations that are taken for JPMorgan Chase employees or executives.

The Government's investment in our firm came along with a special responsibility, as you have noted, Mr. Chairman, to America's taxpayers. We fully intend to honor that responsibility by promoting the goals of the CPP while also acting prudently and sensibly and in the interests of all of our shareholders to maintain a healthy and vibrant company.

Many believe that irresponsible lending was one of the causes of the current distress in the financial markets. No one wants a repeat of those mistakes. Every day we seek to make capital available in a responsible, safe, and sustainable way to help get the economy back on track.

John Pierpont Morgan once said that he wanted to do first-class business in a first-class way. That continues to be a guiding principle for us. It remains our goal and our commitment to our customers, to our shareholders, our employees, and to the taxpayers of this Nation.

Thank you very much.

Chairman DODD. Thank you very much.

Mr. Palm.

STATEMENT OF GREGORY PALM, EXECUTIVE VICE PRESIDENT AND GENERAL COUNSEL, THE GOLDMAN SACHS GROUP, INC.

Mr. PALM. Thank you. Chairman Dodd and Members of the Committee, on behalf of Goldman Sachs, I wish to thank you for inviting us to participate in today's hearing.

Clearly, the last several months have been an extraordinary and unsettling time in financial markets and the economy generally. The actions taken by Congress, regulators, and the administration to address the market dislocation have been significant and decisive. We also recognize, however, that much remains to be done, and hard and thoughtful work will be required by all of us. We look forward to working with all concerned parties to work our way through the current crisis and to identify and address the failings that have led to this difficult situation.

First, the Committee asked us to discuss our plans for the use of funds provided under the CPP. Goldman Sachs' principal businesses are investment banking, securities, and investment management. A number of our core businesses require the commitment of capital. In investment banking, offering strategic advice remains at the center of what we do. But clients frequently expect our advice to be accompanied by access to the capital necessary to make that advice actionable and practical. In short, our value to clients depends not only on the quality of our advice, but on our willingness to draw on both our expertise and balance sheet to help finance transactions or support a company's strategic direction.

In addition, Goldman Sachs plays a very significant role as a market maker. As you know, market making is essential to the liquidity, efficiency, and stability of financial markets. In dislocated markets, the role we play as a market maker on behalf of our clients can be challenging, but it is even more important. Illiquid markets and the resulting lack of price discovery produce volatility. Having the ability to take the other side of a client's transaction and establish a price for an instrument contributes to the broad functioning of markets.

With the $10 billion in capital received through the TARP Capital Purchase Program, Goldman Sachs has additional capacity to inject capital and liquidity, which will contribute not only to the stability of financial markets, but to their vitality and growth.

In addition, we play an important role as a co-investor with our clients. Goldman Sachs has and will raise funds to inject capital across the corporate capital structure. These funds will extend needed capital to a variety of companies whose growth opportunities would otherwise be limited.

For example, we recently established a $10.5 billion senior loan fund that makes loans to companies in need of capital. The fund invests both our own capital and that of our clients. This is significant because the normal market mechanisms to facilitate the extension of credit in many areas have broken down. In the next year, Goldman Sachs expects to launch additional funds and deploy capital to various parts of the market.

You also have asked us to discuss the compensation in the context of executive compensation standards for financial institutions that participate in the Capital Purchase Program and how we align compensation with performance.

First, perhaps an obvious point, since the year is not yet finished, no financial compensation decisions have been made at Goldman Sachs. We are only now in the process of reviewing performance and making recommendations for year-end compensation. The Compensation Committee of the Board of Directors, which is comprised solely of outside independent directors, determines the appropriate compensation for Goldman Sachs' executives.

Second, we have complied and will comply with all executive compensation standards and restrictions imposed as a result of our participation in the CPP. The CPP executive compensation requirements will be a focus at our Board Compensation Committee meeting next week.

I would also note that Goldman Sachs has never had special golden parachutes, employment contracts, or severance arrangements with its executive officers, and that we have always believed that the potential for increased compensation should never be an incentive for excessive risk taking.

Third, and most importantly, I want to make clear that the firm's bonuses for 2008 will be paid only out of the firm's earnings for 2008, not its capital, and certainly will not increase as a result of having received TARP funds.

Since we became a public company, we have had a clear and consistent compensation policy. We pay our people based on three factors: the performance of the individual, the performance of the business unit, and the performance of the firm taken as a whole. And that is a long-term perspective.

Compensation for each employee is comprised of salary and bonus. Generally, the percentage of the discretionary bonus awarded in the form of equity increases significantly as an employee's total compensation increases. In fiscal year 2007, for example, the equity portion of our senior-most executives' compensation was 60 percent.

All of the equity rewards are subject to future delivery and/or deferred exercise. This aligns employees with the long-term interests of our shareholders. In that vein, our CEO, CFO, COOs, and Vice Chairmen are required to retain at least 75 percent of the equity they have received as compensation since becoming a senior executive officer.

Overall, we believe our compensation policy, which is consistently and rigorously applied no matter how good or bad the market environment, has produced a strong record of aligning performance with compensation.

Since 2000, Goldman Sachs has exhibited a correlation between changes in net revenues and compensation of 98 percent. I will not dwell on our record over that period because I would like to make one final point.

All that said, while we are on track to deliver positive results for year-end 2008 despite remarkably challenging markets and events, net revenue for the year will be lower than in recent years. As such, compensation also will be down very, very significantly this year across the firm, particularly at the senior levels. We get it.

As to mortgage servicing, finally, on the subject of modifying home loans, I would emphasize that Goldman Sachs has never been a significant originator of residential mortgages. A Goldman Sachs affiliate, Litton Loan Servicing, services residential mortgage loans. We acquired Litton a little less than a year ago. As part of its business, Litton expends significant resources to identify homeowners who may be in danger of losing their homes and works with them on potential solutions, like loan modifications—whether it involves lowering the interest rate, changing the principal amount, or otherwise. These are all designed to allow the homeowners to stay in their homes. Over time Litton has been able to demonstrate to loan owners that loan modifications very often produce lower losses than foreclosures.

In the last 12 months, for example, Litton has modified in excess of 41,000 mortgage loans totaling approximately $7.5 billion in principal balance. The number of employees dedicated to this effort over this period has increased 400 percent.

Although modifications to existing mortgage loans are not a magic panacea that will cure all that ails the current housing market, we believe that thoughtful restructuring of existing arrangements to provide homeowners with payment relief is a positive step toward combating its decline.

Mr. Chairman, we look forward to working with you and the Committee to accomplish the important tasks set out in the Emergency Economic Stabilization Act. I would be happy to answer any questions.

Thank you.

Chairman DODD. Thank you, Mr. Palm, very, very much.

Dr. Wachter, we thank you for being with us this morning.

STATEMENT OF SUSAN M. WACHTER, WORLEY PROFESSOR OF FINANCIAL MANAGEMENT, WHARTON SCHOOL OF BUSINESS, UNIVERSITY OF PENNSYLVANIA

Ms. WACHTER. Thank you. Chairman Dodd and other distinguished Members of the Committee, it is my honor to be here today to provide my perspective on the ongoing mortgage crisis and how and why stabilizing the housing market is essential to stabilizing the broader U.S. economy.

The ongoing crisis in our housing and financial markets derives from an expansion of credit through poorly underwritten and risky mortgage lending. Until the 1990s, such lending was insignificant. By 2006, almost half of mortgage originations took the form of risky lending.

The unprecedented expansion of poorly underwritten credit induced a U.S. housing asset bubble of similarly unprecedented dimensions and a massive failure of these loans and to today's system breakdown.

Today's economic downturn could become ever more severe due to the interaction of financial market stress with declines in housing prices and a worsening economy feeding back in an adverse loop. We have the potential for a true economic disaster.

I do not believe we will solve our banking liquidity problems if the housing downturn continues, and the housing market decline shows no signs of abating.

Moreover, despite bank recapitalization and rescue efforts, economically rational loan modifications that would help stabilize the market are not occurring. We must directly address the need for these loan modifications in order to halt the downward spiral in mortgage markets and the overall economy.

It is critical to bring stability to the housing market. While today prices may not be far from fundamental levels, just as they overinflated going up, there is great danger for overcorrection on the downside.

In our current situation, as prices fall, market dynamics give rise to further expectations of price decline, limiting demand, and supply actually increases due to increased foreclosures, causing prices to decline further. A deflationary environment with demand decreases due to expectations of further price decline was in part responsible for Japan's "lost decade" of the 1990s.

We cannot rely on a price decrease floor at currently market-justified fundamental levels if we rely on market forces alone, even, it appears, if augmented by the interventions so far of the Federal Reserve and Treasury. In fact, home inventories are not declining, and up to half of the inventory of homes are being sold through foreclosures at fire-sale prices in many markets. The Case-Shiller Price Index reflects the massive deterioration of housing wealth so far. Since the peak in 2006, housing values have fallen over 20 percent. While another 5- to 10-percent fall could bring us to market-clearing levels, actual price declines may far exceed this. And as house prices decline, these declines undermine consumer confidence, decrease household wealth, and worsen the system-wide financial stress.

While banks have been recapitalized through the Capital Purchase Program—and there is discussion of the use of this funding for acquisitions—as yet, there is little evidence that bank lending has expanded. In order for the overall economy to recover and for conditions not to worsen, prudent lending to creditworthy borrowers needs to occur. Without financing for everyday needs, for education, small business investment and health, American families are at risk. And today the U.S. economy and the global economy are depending on the stabilization of their financial well-being. Moreover, the plans that are already in place do not appear to be leading to the modification of loans at the scale necessary in order to assure a market turnaround at fundamental levels instead of a severe and ongoing overcorrection.

Barriers to economically rational loan modifications include conflicting interests, poor incentives, and risks of litigation to modify loans, particularly to modify loans deriving from mortgage-servicing agreements.

Given the freefall in housing markets and its implications for credit conditions and the overall economy, there is a need for policies to address these barriers today.

It is both necessary and possible to take effective action now. While housing values may not be far from fundamental levels, as housing values continue to fall, resolving the problem will become increasingly difficult and costly. Thus, solutions that are now possible may not be available going forward. Without expeditiously and directly addressing the housing market mortgage crisis, the Nation is at risk.

Thank you.

Chairman DODD. Thank you very much, Doctor. That is very worthwhile testimony.

Ms. Finucane, welcome to the Committee, and I want to underscore the point that was made by Martin Eakes, the appreciation of what Bank of America did. I think it was a number like $8.4 billion or something dedicated to foreclosure mitigation. That has not gone unnoticed. We welcome you to the Committee.

STATEMENT OF ANNE FINUCANE, GLOBAL CORPORATE AFFAIRS EXECUTIVE, BANK OF AMERICA

Ms. FINUCANE. Thank you. Good morning, Chairman Dodd and Members of the Committee.

At the outset, I would like to emphasize Bank of America's continued strength, stability, and commitment to serving local communities, even during these challenging times. Bank of America earned $5.8 billion in the first three quarters of this year, reinforcing our position as opposed to one of the most profitable financial services companies in the world.

In recent months, Bank of America has taken three major steps that are contributing to the alleviation of the financial crisis faced by our Nation.

First, at the encouragement of the Federal Government but with no Government assistance, Bank of America acquired Countrywide Financial Corporation at a time when the mortgage industry was being viewed with increasing alarm as a risk to the broader health of the national economy. Since that acquisition, Bank of America has announced providing relief for more than $100 billion in loans, enough over 3 years to keep up to 630,000 borrowers in their homes.

Second, with the encouragement of the Federal Government but, again, with no Government assistance, in the midst of the impending failure of Lehman Brothers, Bank of America announced plans to acquire Merrill Lynch.

Third, despite having completed our own capital-raising effort with no Government assistance, Bank of America agreed to participate in the TARP Capital Purchase Program. We agreed to participate in this program at the encouragement of the Treasury, and we do so in the belief that it is in the best interests of the national financial system.

With regard to the Bank of America home loan modification program, we are intensely focused on helping borrowers stay in their homes. In the last 6 months, Bank of America has announced two major home retention programs that together will address the needs of up to 630,000 homeowners and $100 billion in current home loans. We have more than doubled the number of our home retention professionals in the last year to more than 5,600 individuals who are equipped to serve eligible borrowers with this new program, elements beginning on December 1. A foreclosure process will not be initiated nor will it be advanced for a customer likely to qualify until Bank of America has made a decision on a customer's eligibility. Modification options will include, among others, FHA refinancing under the Hope for Homeowners Program, interest rate reductions, and principal reductions.

Now I would like to address more specifically our participation in the TARP program. Under the TARP program, we have received $15 billion from the Treasury in exchange for shares of preferred stock. This investment by Treasury is designed to be a profitable one for the Federal Government. With these capital levels, Bank of America is focused on serving the financial needs of our customers, so we would look at about a 9-percent Tier 1 capital ratio.

So what are we doing? Well, by example, in the third quarter of this year, we have made more than $50 billion of mortgage loans and more than $6 billion of home equity loans. Further, business lending remains strong, and we have continued making loans to States and municipalities in a time of extraordinary uncertainty.

While the fourth quarter results are not available until January, thus far this year our total commercial, large corporate, and Government commitments have increased by more than $33 billion, or 6 percent. The funding of new loan commitments this year has increased by 6 percent over the previous year. And, in addition, we have committed or reaffirmed nearly $23 billion of credit to State and local governments thus far in 2008. And with this enhanced capital, we are now actively engaged in the purchase of mortgage-backed securities contributing to the increased liquidity in the market, which was one of the original objectives of the TARP program.

Finally, I would like to address the issue of executive compensation, which has been the subject of much discussion here today and in relation to the TARP program. Executive compensation at Bank of America will not be paid using the capital infusion received from Treasury last week. The Bank of America Board of Directors instead determines executive compensation on an annual basis based on the financial performance of our company, and as I stated previously, Bank of America has earned $5.8 billion in the first three quarters of this year.

Nevertheless, as these earnings are reduced compared to previous years, this year's bonus compensation pool for senior managers at Bank of America is expected to be reduced by more than 50 percent. While final decisions on our compensation have not been completed by the board, executive compensation levels are not impacted nor will they be enhanced by last week's capital infusion from the Treasury.

With that, I will conclude my testimony. Thank you, Senator Dodd, and Members of the Committee.

Chairman DODD. Thank you very much, Ms. Finucane.

Mr. Campbell, thank you. Welcome to the Committee.

STATEMENT OF JON CAMPBELL, EXECUTIVE VICE PRESIDENT, CHIEF EXECUTIVE OFFICER OF THE MINNESOTA REGION, WELLS FARGO BANK

Mr. CAMPBELL. Mr. Chairman and Members of the Committee, I am Jon Campbell. I am Executive Vice President of Wells Fargo's Regional Banking group. Thank you for allowing me to comment on Wells Fargo's participation in the Capital Purchase Program.

Wells Fargo believes that our financial system is more important than any one individual company. We believe the Capital Purchase Program is a positive step toward stimulating the United States' economy. It is Wells Fargo's intention to use the CPP funds for additional lending and to facilitate appropriate home mortgage solutions.

Wells Fargo continues to be one of the strongest and best capitalized banks in the world. The investment from the U.S. Government adds to our already strong balance sheet and will enable Wells Fargo to offer appropriately priced credit at a time when several sectors of the financial industry have shut down.

Since mid-September when capital markets froze, Wells Fargo has led the industry in lending to existing and new creditworthy customers. During this time nonprofit organizations, hospitals, universities, municipalities, small businesses, farmers, and many others had nowhere to turn when their existing capital market channels vanished. We were there to provide credit so they could continue to offer the services that our communities depend upon.

We are able to lend through these difficult times because of our emphasis on prudent and sound lending which includes understanding what our customers do and what their financing needs are. As demonstrated over the past several years, we are willing to give up market share if a product is not in the best interest of our customers. And simply put, those companies that didn't put the customer at the center of every decision they made are no longer here today.

We intend to expand lending in all of our markets. As demand warrants, we will have more than adequate capital to lend to creditworthy customers in an appropriate manner and, as required, will pay back the CPP investment with interest.

Wells Fargo remains a strong lender in areas such as small business and agriculture. By volume, we are the No. 1 commercial real estate lender in this country. In fact, we grew commercial real estate loans 37 percent year to date in 2008. And our middle market commercial loans—made to Fortune 1500-sized companies across the country—are up 24 percent from this same time last year.

As far as consumer lending is concerned, we are certainly open for business. Our consumer loan outstandings have increased almost 9 percent in the third quarter of 2008 in comparison to the same quarter in the previous year.

The Committee has asked whether CPP funds would be spent on executive compensation. The answer is no. Wells Fargo does not need the Government investment to pay for bonuses or compensation.

Wells Fargo's policy is to reward employees through recognition and pay based on their performance in providing superior service to our customers. That policy applies to every single employee, starting with our Chairman and our CEO. For example, the disclosures in our 2008 proxy statement show that the bonuses for all Wells Fargo named executive officers were reduced based on lower 2007 performance.

Mr. Chairman, since the middle of 2007 when you convened your Housing Summit, Wells Fargo has implemented the principles you laid out by working with borrowers at each step of the mortgage crisis. With the changes in our economy and the continuing declines in property values across many parts of the country, even more people do need our help.

As a number of new foreclosure relief programs require capital to implement, the availability of CPP funds will make it easier to successfully reach delinquent homeowners. This capital, leveraged with the announcement this week of a streamlined large-scale loan modification process that applies to loans serviced for Fannie Mae and Freddie Mac, will enable Wells Fargo to utilize a variety of programs quickly and also institutionalize an approach that servicers can rely on going forward.

The strength of our franchise, earnings, and balance sheet positions us well to continue lending across all sectors and satisfying all of our customers' financial needs, which is in the spirit of the Capital Purchase Program.

Mr. Chairman and Members of the Committee, thank you, and I look forward to your questions.

Chairman DODD. Thank you very much.

Last, but not least, Ms. Zirkin. We thank you very much for being before the Committee.

STATEMENT OF NANCY M. ZIRKIN, EXECUTIVE VICE PRESIDENT, LEADERSHIP CONFERENCE ON CIVIL RIGHTS

Ms. ZIRKIN. Thank you, Senator Dodd and other Members of the Committee. Again, I am Nancy Zirkin, Executive Vice President of the Leadership Conference on Civil Rights, our Nation's oldest and largest civil and human rights coalition.

Let me begin by saying why the foreclosure crisis is so important to LCCR. Homeownership has always been one of the most important goals of the civil rights movement. It is the way most Americans build wealth and improve their lives, and it is essential to stable communities.

For decades, LCCR has worked to break down barriers to fair housing, as well as the barriers from redlining and predatory lending, to the credit that most people need to own a house.

For these reasons, we have argued for a number of years that the modern mortgage system was terribly flawed, that countless irresponsible and abusive loans were being made, often in a discriminatory way, and that without better regulations things would not end well.

Now, after years of denial, I think it is quite obvious that the mortgage crisis is definitely not contained. But to date—and despite the best efforts of you, Mr. Chairman, and others—the whole collective response, based on voluntary efforts, has not done much to actually turn the tide.

At the same time, there are helpful ideas out there now such as the FDIC proposal and the efforts of Bank of America and others. However, LCCR remains convinced that the best way to quickly reduce foreclosures is to let desperate homeowners modify their loans in Chapter 13. It would give borrowers leverage to actually negotiate with servicers and give them a last resort when the negotiations do not work.

It does not use public funds, and more importantly, it would quickly help other homeowners and our economy by keeping the value of the surrounding homes from being eroded, stopping a vicious cycle that can only lead to more foreclosures.

We recognize that the bankruptcy relief has faced intensive opposition from industry, which is ironic to us given the number of lenders that have obtained bankruptcy relief themselves.

Opponents say that allowing bankruptcy would make investors hesitant, limiting "access to credit" for underserved populations. Well, the fact is right now, because of the years of irresponsible lending, there is no access to credit for most of the people, anyway.

We are glad that since your last hearing several banks and the GSEs have planned to drastically increase their loan modification programs, following what the FDIC is doing with IndyMac. We are all for voluntary efforts. Every home that is saved is a step in the right direction.

However, industry efforts have not provided enough affordable, lasting solutions for the borrowers. This obviously has a lot to do with securitization and second mortgages. Until these obstacles can be overcome, industry efforts cannot be a substitute for actually helping homeowners directly. The stakes are simply too high because the credit drought will not be mitigated until foreclosures are controlled.

While LCCR is disappointed that the bankruptcy relief that was blocked earlier this year, we are encouraged by some of the recent discussions with FDIC about a new mortgage guarantee program. As we understand it, the plan would give new incentives for loan servicers to reduce payments to 30 percent debt-to-income ratio in return for Government guarantees.

If the plan can be implemented quickly, and just as importantly, if it is quickly used by the servicers, we believe it will be a great improvement over existing efforts, including Hope for Homeowners Act, moratorium, or even the existing IndyMac plan. It also aims directly at the cause of the economic crisis—foreclosures. So it is a wise investment, especially with the latest controversies over how Wall Street has been using our tax dollars.

For all of these reasons, while we have a few reservations, we strongly believe that the FDIC plan is well worth a try, and it should be adopted as quickly as possible.

Before I conclude, I would be remiss, especially because this is the 40th anniversary of the Fair Housing Act, if I did not note that any measure to implement the financial rescue law must be done in a way that is fully consistent with all applicable civil rights laws—something I discuss in greater detail in my written testimony.

Again, Mr. Chairman, thank you for the opportunity of testifying, and I look forward to answering questions.

Chairman DODD. Thank you very, very much, Ms. Zirkin, and I appreciate your testimony and the testimony of all our witnesses. It has been very helpful this morning.

I am going to have the clock on for 7 minutes, and we will try to keep to that, if we can. We have good participation here today, and I want to make sure everybody has a chance to raise some issues.

Let me, if I can off the bat, focus my first question to the bank representatives here, and I include Goldman Sachs in that because I know you are in the business of becoming a bank. You are the fourth largest bank holding company, I believe, and so I am going to ask the question of you as well. Let me ask the three questions and then ask you to respond, if you can.

One important tool used by the Federal Government to address the freeze in credit markets was the guarantee, as you are all aware, of senior unsecured bank debt for all maturities. This program covers all lending institutions for 30 days, after which any bank can opt out of the program.

So my first question to you, I would like to ask whether any of you here at the table this morning have any plans to opt out of this program.

Second, I would like to know from the panelists if their institutions have made use of any of these number of facilities that were created to help maintain liquidity, and since they were created including the commercial paper funding facility, as I have said, whether the panelists' intentions are to make use of these funds.

And, third, for those of you whose institutions offer money market funds, has the Federal guarantee on those funds been helpful to keeping those funds in your institutions?

Why don't we begin with you, Mr. Zubrow?

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

With respect to your first question about the guarantee of senior bank debt and whether or not JPMorgan Chase is going to opt out of that program, we are still evaluating that and have not yet made a determination on that. Obviously, once we do, we are happy to come back to you and let you and your staff know how we have decided to handle that.

With respect to the commercial paper funding facilities, we certainly think that those have been very helpful in the marketplace, and certainly we have been an active issuer of commercial paper, and many of our clients have been active issuers of commercial paper. And it is absolutely clear that those facilities have been very helpful in bringing back investors into that marketplace, and I think that has been a very helpful step forward.

Then with respect to your third question with respect to the Federal guarantee program, you know, there again, you know, we think that that has been a helpful addition to liquidity in the marketplace, and we think that it is going to make a big difference for bringing investors back into the market.

Chairman DODD. And it has helped keep those funds in your own——

Mr. ZUBROW. And it certainly helped keep funds in the money market funds. We have certainly seen a significant increase—we obviously saw a major increase in inflows into our funds, particularly our Treasury funds, with these different additional programs both for ourselves and across the industry. We have seen a shifting back into what are called the "credit funds" or the "prime funds," which suggests, you know, greater liquidity going into the corporate sector.

Chairman DODD. So all of these issues have been very helpful to JPMorgan Chase?

Mr. ZUBROW. Correct.

Chairman DODD. Yes. Mr. Palm.

Mr. PALM. With regard to your three questions, first, on the opt-out, we have no plan to opt out, but we are still evaluating the program. And as I understand it, certainly the final details of the program have not been announced, and comments have been provided.

Second, the CP facilities and so on, again, I think those have been helpful broadly across markets and certainly for our clients.

And, third, on the money market funds and so on, we believe that will ultimately be quite helpful. What we saw at our firm, which sounds similar to JPMorgan, was there was a great flow of monies out of some of our funds into other funds, i.e., the Fed-related funds, and now some of that money has flowed back.

Chairman DODD. Because of the guarantee.

Mr. PALM. I think so, yes. So obviously, indirectly ultimately that will be of benefit to the credit markets and companies.

Chairman DODD. I agree with that as well, but the institution—Goldman Sachs has benefited clearly as a result of the Federal guarantee.

Mr. PALM. Yes, we believe it is a benefit to the market.

Chairman DODD. Ms. Finucane.

Ms. FINUCANE. I think we see it positively on all three fronts. Certainly the money market fund insurance has been a real positive. We have no plans to opt out. We do need some further guidance to fully understand that. And the same on the commercial paper, it is a real positive.

Chairman DODD. Well, thank you for that as well.

Let me jump, if I can, I want to—I will exclude Mr. Eakes and Ms. Zirkin from the discussion—I am sorry. I apologize. Mr. Campbell from Wells Fargo.

Mr. CAMPBELL. It is OK, Mr. Chairman. I actually was not offended at all.

Chairman DODD. No, no, no.

[Laughter].

Mr. CAMPBELL. Quickly, as it relates to the senior debt guarantees, we are still in an evaluation phase, and so I am not in a position to answer that. But we would be happy to get back to you on that.

As it relates to the commercial paper guarantee, it clearly made a very positive difference in the marketplace. There were numbers of companies who had depended upon that market for many years for liquidity that were frozen out. That market has——

Chairman DODD. Including Wells Fargo?

Mr. CAMPBELL. To some extent, but actually, my answer is more from my perspective as a banker and looking at the customers we take care of. And I saw it more there. Since I am not part of our treasury group, I do not want to comment on what the effect was specifically on Wells.

And as it relates to the money market fund guarantees, the only comment I would offer is that while it has been very helpful and it has clearly helped with outflows, there is a consideration we all need to be thoughtful of, and that is, what is the impact on core bank deposits where we have now created basically a similarity between the money market funds and deposits? And I just think we have to be careful and——

Chairman DODD. That is a legitimate point.

Mr. CAMPBELL [continuing]. Consider that as we move forward.

Chairman DODD. But Wells Fargo has benefited itself from that guarantee is my point.

Mr. CAMPBELL. Yes.

Chairman DODD. Now, I will exclude Mr. Eakes and Ms. Zirkin because you have commented on the FDIC, the Sheila Bair proposal, and I appreciate your comments. I have certainly expressed myself at several hearings on that idea. But as we saw yesterday, Secretary Paulson-while it was dressed up in a way of continuing to look at it, the fact is he rejected it flat-out, in my view, and I think that is terribly regrettable, in my view, in light of the potential benefit here. But I would like to ask the other panelists to comment specifically on that proposal as to whether or not you think it has merit and whether or not your institution would be supportive of such a move. And I realize there are details to everything, so I am not expecting you to sign off on details. But the overall thrust, in light of the fact that the voluntary program, the very meeting we had here 2 years ago in this room in which I begged the institutions and they promised they would, setting up principles to do workouts, then it was the voluntary Hope for Homeowners, then it was the Hope for Homeowners Act we passed—and all of these measures, frankly, have not produced anywhere near the results we all had hoped they would.

And I do not disagree, by the way, the bankruptcy provision. And if we got a chance next week, I may off that on the floor of the Senate as part of a package out here. Senator Durbin of Illinois deserves great credit for having raised this issue for a long time. I do not know how my colleagues feel about it, but we have a chance we may raise that one.

But in light of that—I do not know whether that would work or not—this does not require action by the Congress to do what Sheila Bair has suggested. It takes cooperation from the Treasury to make this happen. So I would like to know from the other witnesses here how you react to that proposal. We will begin with you, Mr. Zubrow.

Mr. ZUBROW. Yes, Senator. JPMorgan Chase is certainly very supportive of the types of programs that Chairwoman Bair at the FDIC has proposed. We think that there is a lot of merit in some of the suggestions. As you said, there are a lot of very important details that need to be worked out, and we are certainly actively interested in engaging in discussions with her as well as with the Committee on those details.

I do think that, you know, we certainly think that the efforts that we have also taken voluntarily on loan modifications are yielding results and are an important part of the effort. But certainly taking it further is very important.

Chairman DODD. One of my colleagues may raise the issue of, boy, this gets into a very—but I recall a lengthy debate we had here over the issue of contracts and trust arrangements when it comes to securitization. And this really does get esoteric, but at some point I hope we would get back to that discussion on securitization and whether or not the contracts or the trust arrangements pose the problem of new statutory authority. But I gather your answer is that basically you think the Sheila Bair idea has merit and should be pursued. Is that a fair analysis?

Mr. ZUBROW. That is correct, and we are certainly happy to also talk about the securitization point.

Chairman DODD. I appreciate that.

Mr. Palm.

Mr. PALM. As I indicated at the beginning, since we are not really a significant mortgage originator—I think our subsidiary is the 30th largest loan servicer—probably anything I have to say on this topic should be taken as from a level of being a novice at some level. But I would say two different things.

One, I think I referred to our subsidiary, Litton——

Chairman DODD. You did.

Mr. PALM [continuing]. Which was a family business created back in 1988, and the current CEO who still runs it is the son of the original founder. They believe very strongly that loan modifications are a way to actually benefit the investor as well as the homeowner, because foreclosures really are not the most economically best thing to do.

Having said all that, and, again, not being an expect in the program that has been announced—and as Mr. Zubrow has indicated, there are a lot of details—I think, you know, we are impressed by the fact that there is a program that looks as though it may be helpful and, indeed, be supplemental to some of the other actions and activities being taken.

I cannot say that Goldman Sachs is, you know, standing here supporting it because it is just not—we are not not supporting it, either. It is just that we have looked at it. We would be happy to be involved in further commentary and happy to provide people to you since, as my colleague Mr. Litton, for example, I know is testifying tomorrow before one of the House committees, and he truly is the expert in this area.

Chairman DODD. I am sure Barney Frank will ask him the question, and you can tell him to get ready for it.

Mr. PALM. Pardon me?

Chairman DODD. Tell him to get ready for Barney's question.

Mr. PALM. Oh, OK. Thank you very much.

Chairman DODD. Yes, Ms. Wachter, Dr. Wachter.

Ms. WACHTER. Yes, obviously, I am speaking personally based on economic incentives. I do think that Sheila Bair's plan absolutely needs to be tried, and I must say I am puzzled by why it appears as though the Treasury has, in fact, rejected it. I do not quite understand. It seems to me that this will provide incentives, it will provide risk sharing, and it will at least move toward the resolution of our major problem, which is un-economic foreclosures, foreclosures that should not take place for the investor or for the borrower or for the neighborhood.

That is not the entire solution, but I do think it needs to be tried. Again, the details matter and I am not completely familiar with the details.

Chairman DODD. Ms. Finucane.

Ms. FINUCANE. Thank you, Chairman Dodd. I think we are directionally positively disposed. I would say this: that there are some of us who have gone ahead with our own programs that are very comprehensive and far reaching. So, clearly, we are on this path already. And to the degree that we can understand the details—the concept is out there, but the details are critical for us. I think we are generally positively disposed, and, clearly, the more we can do systematically to deal with this issue, the sooner, the better.

Chairman DODD. Mr. Campbell.

Mr. CAMPBELL. We would agree with the context that we need to do something more broadly than is currently being done. A lot of us have done a lot of things, but in terms of a systemic response, there is still much to do.

Chairman DODD. And this proposal?

Mr. CAMPBELL. At this point, while we have not seen all the details, clearly the things that we have worked hard on in our own programs, one of you raised in your opening comments about the issue of redefault. And so as we look at the detail, what we will clearly want to focus on are the criteria and standards being set in whatever large-scale program is set actually set up a mechanism that results in long-term sustainable homeownership as opposed to modifications that fall apart in a short period of time because all the considerations were not made at that time.

Chairman DODD. I thank you very much.

Senator Crapo.

Senator CRAPO. Thank you very much, Mr. Chairman.

I am going to direct my first question also to the bank witnesses. Secretary Paulson said that the Treasury Department is exploring the development of a potential liquidity facility—and I do not know that we know what the details are there—for highly rated, AAA, asset-backed securities. He said that he believes this effort would draw private investors back to that market and increase the availability of consumer credit. I just would like to ask those who are banking witnesses to comment on this proposal.

Do you think it has merit? Mr. Zubrow?

Mr. ZUBROW. Thank you, Senator. I believe that the Secretary introduced those ideas in statements yesterday, and there are not a lot of details around exactly how he envisioned the program might work. So I think it is a little bit difficult to really comment on whether or not it will work until there are more details.

I do think that it is important that we find mechanisms to bring investors back into the marketplace for asset-backed securities. Certainly right now, to the extent that we are continuing and do make credit card loans, other types of loans that can be securitized, those loans right now are residing on our balance sheet, and certainly for the long-term health of the financial system we need to re-attract long-term investors into structures. And certainly anything that the Treasury Secretary, either in conjunction with the Fed or others, can do to encourage investors to come back into that marketplace, it will be very helpful.

Senator CRAPO. Thank you.

Mr. Palm.

Mr. PALM. The reopening of a market for asset-backed securities of whatever type, whether you are talking about the credit cards area or whether you are talking about, you know, simply mortgages themselves, because it is quite clear that, you know, the banks at this table themselves do not have the capital for those who are in the business to extend all home loans that are actually necessary in this country; and those markets have to be open.

Having said that, you know, we read yesterday that announcement, too, and we are not aware of any of the details yet or exactly how it would work. But it certainly is something that really has to be explored because the capital necessary to support the extension of credit, whether it is consumer credit, whether it is credit to businesses, whether it is credit to homeowners through mortgages, in essence, has to be supported by a much broader range of investors as opposed to just bank deposits, for example.

So we have to do something to reopen those markets, which, as you know, have been almost totally shut.

Senator CRAPO. Yes. Thank you.

Ms. Finucane.

Ms. FINUCANE. Well, I think we are all a little bit new to this insomuch as he made these announcements yesterday. There was not a preamble to it. I think I mentioned earlier in my opening remarks that we are ourselves back into the secondary markets, purchasing mortgage-backed securities. We see the problem that he has outlined, particularly with credit cards, the securitization of credit cards and moving that debt.

So the issue is clear. I think we would like to understand better specifically what he means. So I think you are hearing from all of us that conceptually it is interesting. We have no sense of what the details are.

Senator CRAPO. Thank you.

Mr. CAMPBELL. I would say the same. Obviously, we have not seen the details. Wells is a bit different in one way, and clearly, as it relates to the mortgage market, having a securitized market is critical because we cannot fund all of those mortgages.

As it relates to credit cards and student loans, we have not securitized those assets. Those are assets that we have chosen to hold in our portfolio, and so as it relates to us specifically, it would not do much for us, at least in two categories. Clearly on the mortgage product, it is very important that those markets function effectively.

Senator CRAPO. Thank you. What I hear from all four of you, basically, though, is that the notion of going into some type of development of a liquidity facility for these highly rated, AAA, asset-backed securities is an important focus that we should be taking with our efforts right now. Is that correct? Did I misunderstand that from any of you?

[No response.]

Senator CRAPO. I will take that as acknowledgment.

Is there a no here? Mr. Eakes, would you like to respond to that?

Mr. EAKES. I wanted to put in a word of caution. I think until we fix the problems that we have with asset-backed securities, we should be careful about trying to promote its regrowth. So the ratings agencies were a problem in rating AAA paper. We are basically talking about setting up a Government-owned structured investment vehicle, SIV, that got Citibank into trouble. We need to think about the regulatory structure. We need to make sure that the loans that are made cannot be passed into a structure without responsibility or liability passed back to the people who originated it.

And, finally, I think that by putting $250 billion of equity into the banking system, normally that should leverage $10 to $12 for every dollar of equity, so we have basically enhanced the balance sheet capacity of the banks in America by $2.5 to $3 trillion that they can add. The whole credit card market, the entire credit card market in America is about $1 trillion. So we have the ability to have, as the Wells representative mentioned, the ability to hold much of these assets on bank balance sheets because of the equity we have invested.

So I just think we have some significant problems in the asset-backed market as we have heard the technical discussions about how do you modify loans once they are in there, what can you do; and we have in no way fixed those problems yet.

Senator CRAPO. Those are good cautions. Your answer to the question raises another point, though. You indicated that the injections of liquidity should have a 10 to 12 factor of leveraging in the marketplace. And I would just like to ask any of our witnesses: Has that, in fact, occurred? Have we seen that kind of——

Mr. EAKES. It will take time, but that is the normal leverage level for banking equity.

Senator CRAPO. But we are not seeing it right now.

Ms. FINUCANE. Could I just——

Senator CRAPO. Yes.

Ms. FINUCANE. I think it is still premature. We received this money a week ago. The investments were made literally a week ago. So I think it is premature to be thinking what has the effect been other than you are seeing movement, and I think that is a positive.

Senator CRAPO. And we are seeing the movement.

Ms. FINUCANE. Well, we are seeing the early stages of some movement, but it is just so early, 1 week in.

Senator CRAPO. All right.

Mr. CAMPBELL. I think the other thing——

Mr. EAKES. The combination of equity and raising the deposit insurance means that over time there will be a growth of balance sheet capability by the banks who have received these equity injections.

Senator CRAPO. OK. I assume what I am hearing is that we are seeing movement and that that is positive movement. Mr. Campbell.

Mr. CAMPBELL. The only caution I think we all have to remember is that there are two sides of this equation. There is clearly the capability that our balance sheets now have, but there also needs to be economic stimulation that requires the need for borrowings as well. And so I think clearly the capacity side has been addressed. I think one of the economic issues that we as a country struggle with is how do we move from a stagnant environment to a growth environment that then can utilize the capacity that has been generated.

Senator CRAPO. Well, thank you. I see my time has expired.

Chairman DODD. Thank you very much, Senator.

Senator Johnson.

Senator JOHNSON. For the four representatives of financial institutions, beginning with Mr. Zubrow, does your institution intend to use capital purchase funds for investor dividends or to acquire other institutions?

Mr. ZUBROW. Thank you very much, Senator, for that question. Obviously, the money has gone into our capital base. We pay dividends out of our retained earnings. So far this year, JPMorgan Chase has had profitable quarters in each of our quarters, and we anticipate that will be the case for the fourth quarter. And so we would anticipate that dividends will continue to be paid out of our earning stream and not out of our capital base.

Obviously, we recognize that there is a restriction in the CPP which limits our ability to increase or change our common dividend policy, and certainly we have no intentions of doing that until the funds are repaid.

Senator JOHNSON. Do you intend to purchase other organizations?

Mr. ZUBROW. You know, I think that there has been a lot of debate in the press about, you know, whether or not the CPP is going to be used to somehow purchase healthy organizations. And I think that, you know, we obviously have participated in two very important acquisitions during this year, you know, very much in conjunction with Federal regulators, both the acquisition of Bear Stearns and the acquisition of Washington Mutual, both of which, you know, we would characterize as acquiring, you know, failing institutions, and through those acquisitions we really think that we helped protect the soundness of the financial system, and certainly in the case of Washington Mutual, prevented the need for any FDIC funds to go into that—you know, against the Deposit Insurance Fund.

So, you know, when we think about acquisitions, right now, you know, it is very much in line with those types of situations where we think that we can be helpful to the safety and soundness of the system.

Senator JOHNSON. There is no intention to purchase healthy institutions?

Mr. ZUBROW. Right now, you know, we obviously are presented with a number of different types of acquisition opportunities, and we will continue to evaluate those based on our historic criteria. But, you know, certainly right now there is not something that, you know, I would characterize as saying we are looking to purchase a healthy banking institution.

Senator JOHNSON. Mr. Palm.

Mr. PALM. First, on the dividend point, I will reiterate much of what JPMorgan has said. We pay dividends out of our retained earnings. We have had earnings in each of the first three quarters this year. We really do not pay dividends in a sense out of a certain amount of the TARP capital that has come into us at all.

I would also just like to mention the fact—I think which others have alluded to, so I will, too—that in advance of the TARP money, we had obviously engaged our own private capital raise of over $10 billion literally a week before so that we have right now a very healthy and highly capitalized balance sheet, which I think, as I said earlier, all augur well for the goal of increasing liquidity and capital committed to markets and what people want to accomplish in business and otherwise. Because one thing I would say is that there is no purpose whatsoever for us to sit on money because we pay out returns to the Government in the case of the preferred that you have purchased, we pay out returns to a variety of other people, and our interest is putting money to work, not sitting on it.

On the topic of acquisitions, I can say two things. One is, as you probably know based on our history, our growth has basically always been organic as opposed to, you know, major acquisitions. We have done a few from time to time, but that is just the way we have developed. The most obvious example would be our asset management business, which, over a period of 10 years, we built from $50 billion in assets to almost $1 billion in assets, and that was all done basically through organic growth.

Now, we have no acquisition on the table right now, you know, involving a healthy bank that we are looking at. In the same way as other institutions here, a variety of proposals no doubt will be presented to us over time, and I think as you also know, we are sort of new to this sector to the extent that we are in the so-called classic banking sector and we are finding our way.

Whether or not, for example, we provide liquidity to the market by purchasing, you know, we will call it deposits from failed institutions or otherwise, I cannot say. But in terms of the acquisition point you make, we have no current plan.

Chairman DODD. Could I just interrupt for 1 second on that point that Senator Johnson has raised? There was a statement put out by Goldman last evening, and it says—was this last evening? A few days ago, excuse me. But it goes on talking about the company, and let me just finish this statement. It is "creating a new one, GS Bank USA, that will have more than $150 billion in assets, making it one of the ten largest banks in the United States, the firm said in a statement last night. The firm will increase its deposit base 'through acquisition and organically.'"

Now, that is the statement from Goldman. I want to raise that with you.

Mr. PALM. I think that the acquisition point does not mean that we are acquiring or have a current plan to acquire, you know, a particular healthy bank. As I think you are well aware, there are a variety of situations now where there are failing institutions and otherwise where their deposit base, in essence, for want of a better word, is being sold. And so we may end up acquiring deposits in that way. But it is not a plan for the use of the TARP money.

Chairman DODD. I apologize, but I just wanted to raise that.

Senator JOHNSON. What does Bank of America have to say?

Ms. FINUCANE. Well, obviously we got the money, and we will use the money to strengthen our capital ratios and to invest and to loan. So we have already—I think I mentioned earlier in my oral testimony that we have already gone into the secondary market, so that is some of how we would deploy the money.

Certainly we would not be using it to increase our dividend. Like the others, we pay dividends on retained earnings.

I think relative to healthy banks, we are in the midst of our Countrywide transition and soon hope to have acquired Merrill Lynch. So I think we are fully engaged, shall we say. I think on the longer term, I think the question is more about are there troubled assets or troubled banks to which these healthier companies can continue to make investments. I think it is—we do not know of any, and it would be inappropriate for me to comment on that. That is the job of our CEO. But there would be no plans in that.

Senator JOHNSON. Mr. Campbell.

Mr. CAMPBELL. Senator, Johnson, three comments. The answer as it relates to dividends is, no, we will not use the CPP funds to pay dividends. The one caution, I think, we all have to be thoughtful on is that continuing to pay dividends at appropriate levels, while we maintain appropriate capital levels, is critical to investor confidence remaining. And so I would just say that while we clearly agree with you that the use of the funds is not for dividends, to consider restricting dividends could have unintended consequences that we all should be thoughtful of.

Point two as it relates to using the funds for acquisitions, just to be clear, we did acquire—we announced to acquire Wachovia. We made an announcement 10 days before the CPP was announced. And so earlier this week we completed our own capital raise to assure that we have the appropriate levels of capital to complete that transaction. So, clearly, we are not using CPP funds to complete that transaction.

And, third, as it relates to our plans for further bank acquisitions, I would be right beside B of A in saying we are fully consumed. It is critical that we do a really good job of transitioning the Wachovia transaction for the good of their customers, their communities, and all of our shareholders.

Senator JOHNSON. My time has expired.

Chairman DODD. Thank you very much, Senator.

Senator Martinez.

Senator MARTINEZ. Thank you, Mr. Chairman.

I want to go back to the issue of your efforts to attempt to solve families' problems and keeping people in their homes, and I specifically want to speak to both of you since you seem to be both having active programs in this regard.

How are you managing or are you able to work out loans in which the paper has been securitized? Have we been able to get to the point where those—not the paper you are holding, but that which has been securitized? Are you working those out?

Ms. FINUCANE. Yes, we are having some luck at that. About 12 percent of our mortgage portfolio we own, and the rest is——

Senator MARTINEZ. Twelve percent you own, so the vast majority of it is in the other category.

Ms. FINUCANE. We feel that we have the covenants to be able to cover about 75 percent of that in terms of in the best interest of both the investors and in the best interest of the homeowner. But we are making progress.

Of course, our program does not fully engage until December 1st, but even heretofore, we have been able to work out about 200,000 homeowners to prevent foreclosure.

Senator MARTINEZ. Mr. Campbell, we welcome you to the State of Florida. What are you going to do for our homeowners that are in trouble?

Mr. CAMPBELL. Let me respond to that. First of all, our portfolio is different than many other peers' portfolios in that it is composed primarily of two categories: our own owned loans, and then a high percentage of loans that we service for Fannie and Freddie. Fortunately, we have not had the same degree of negative amortizing loans and some other problem assets.

Having said that, we have always believed that, to get to your issue specifically, one of the things that had to be accomplished very quickly was to come to some agreement with the people who we service for, and in our case that means Fannie and Freddie. So this week's agreement to the streamlined program with Fannie and Freddie will clearly help us greatly in our servicing responsibility and being able to reach resolutions that are appropriate for those homeowners that we are responsible for the servicing.

Just a couple statistics in our case. It is all about contact. Currently, we are reaching about nine out of every ten customers who are beyond 60 days delinquent, so we are having good connections at the beginning. And then in about seven out of ten situations, they actually do ask us to help them figure out a resolution to their situation. And then in about five out of ten, we are actually able to mitigate foreclosure and enter into some form of modification that we believe increases their long-term sustainability of that homeownership.

Senator MARTINEZ. I guess what you are saying is that you are not being hampered in your ability to do that by the issue of securitization in your situation.

Mr. CAMPBELL. It has been challenging in that we had—for all the things you have heard, we have had to be extremely careful to make sure we were complying with our agreements, which in our case are primarily Fannie and Freddie, and the fact that we now have agreement and we have institutionalized that, it is a strong improvement from where we were.

Senator MARTINEZ. Mr. Zubrow.

Mr. ZUBROW. I think the issue that you raise and others have raised is obviously a very important one across the securitization industry. I would note that in the House hearings yesterday the ASF organization which represents a number of the major investors and securitization pools, you know, indicated that they had a much greater willingness to work with the industry to devise a methodology to address this issue. And so we very much welcome that movement and look forward to working with them on this.

It is absolutely clear that there has to be a balancing of what is the value to the holders of the paper to be able to have a loan modification and an avoidance of foreclosure. We certainly think that that is a balancing which can be done in the appropriate circumstances to the benefit of the securitization holders, and we certainly look forward to working with the different industry groups to devise a much more streamlined process to be able to get to that end.

Senator MARTINEZ. OK. Dr. Wachter, I wanted to ask you if you could tell us your view of the bankruptcy issue. I know that it is appealing to think that a judge could just modify the mortgage. However, my lawyerly sense tells me that if you have a contract and all of a sudden it is going to be dramatically modified by a judicial fiat, there may be something that investors might look askance at, and there may be a liquidity issue going forward in terms of mortgage money.

Can you tell me your view of that? I am trying to stay away from those that obviously have a point of view that may be different and maybe looking to you as an impartial observer. I have no idea. I am violating my own lawyerly world, which is not to ask a question you do not know the answer to. But I have no idea where you are coming from, and I would love to know your thoughts.

Ms. WACHTER. I do believe that the importance of contracts that can be relied on is critical to any system that is a basic capitalist system because you have to rely on contracts in order to determine what the risk is.

On the other hand, as I said in my oral comments, the Nation is at risk, and I do think we need to have loans modified that are economically rational to modify at a much faster pace than is currently occurring. I do think that the Fannie and Freddie announcement yesterday is going to be quite helpful, but it does not get to those securitized loans that Mr. Zubrow just pointed to, and he said that he was looking forward to sitting down and getting some of those issues resolved.

We have been in this crisis for a year now, or more, and it is worsening. We need to have those folks at the table. We need to get those issues resolved. And I think all options have to be at that table in terms of getting people together and incentivized to discuss what will happen going forward.

Senator MARTINEZ. Do you think the IndyMac model that is being utilized by the FDIC would be one that could be——

Ms. WACHTER. Absolutely.

Senator MARTINEZ. [continuing] A more helpful model than a bankruptcy model?

Ms. WACHTER. That absolutely appears to be consistent with current contracts so that is indeed a solution. But the problem is that even that solution does not appear to be formally being adopted. In fact, quite the contrary, it appears to be rejected.

Senator MARTINEZ. Maybe we can work on that one first.

My time is up. Thank you, Mr. Chairman.

Chairman DODD. Thank you very much.

Senator Casey.

Senator CASEY. Mr. Chairman, thank you very much.

I wanted to address my first question to Mr. Eakes, Dr. Wachter, and also Nancy Zirkin, with regard to some of the discussion we just heard in this context, this very simple but important question, I think, in terms of what we are going to do prior to even the next administration.

What should the Congress do this month to take action—which I think there is consensus on, I think it is a strongly held belief that I have—that we cannot, as so many have stated today, deal with this problem adequately unless we address directly the question of foreclosures and modifications of troubled mortgages? But what should the Congress do this month to address that problem?

Nancy, we will start with you.

Ms. ZIRKIN. Yes, it is my pleasure. Thank you, Senator.

I think, first of all, I am very disappointed about the Treasury's decision yesterday because for us, while we do not know everything about Sheila Bair's plan, it sounds promising, and we have to do something. It sounds promising principally because it really gives servicers incentives. It also seeks to change the terms of the mortgage, interest first and then principal if necessary.

I invite you all to read a fascinating study by a professor of law at Valparaiso University—I believe it is unpublished, and I can get you a copy—Alan White. And he makes the point that unless you do these things, that is, restructure either the interest or the principal, then it is just kicking the can down the road. And for our communities they are in desperate straits. We cannot afford to have Congress wait. The Bank of America is doing a really good job, but it is not going to kick in for another month, I am hearing.

And the magnitude of this problem is so huge that what I think Congress ought to do is pressure Treasury into the FDIC plan and pass bankruptcy reform, Senator.

Senator CASEY. OK. Thank you.

Doctor.

Ms. WACHTER. Well, I certainly think we need faster action on the potential solutions that are at the table and perhaps more understanding why they have not been embraced. If there is a good reason, we need to hear it.

We also need to bring the securitization industry to the table to directly ask them the question you have asked us: What will it take?

Senator CASEY. Mr. Eakes.

Mr. EAKES. I know Senator Martinez does not want to hear this exactly because he had very legitimate questions about the bankruptcy provision. But if there was one thing you could do in the next month, it would be to pass that provision, and here is the reason why: It was limited in its effect to loans that are going to go into foreclosure, so it is not going to impact other loans. It is going to only impact those loans that would otherwise suffer the loss to the borrower of being out of their homes and the loss in the neighborhood of having a vacant home. It costs the taxpayer nothing, and actually the State of Florida will be the State that has the largest number of residential units that are underwater—not the real water, but underwater in that their debt will be much higher than the value of the property.

With some of the payment option ARMs, you cannot solve or modify those loans without doing both. You have to lower the interest rate and you have to lower the balance, or you cannot keep the families in those homes. So I think if you had only one shot to make in the next month, that is the one with the protections that are built into that bankruptcy provision.

I would also add that if—when we had the discussion about the equity investment in the banks, no bank is going to use the equity investment to pay dividends or to pay executive compensation. That is not really the right question. Normally, equity invested in a bank has a return in good years of 20 percent; in average years, 15 percent. So if you are only being charged by Treasury 5 percent and you earn an average year on equity of 15 percent, you have got a 10-percent earnings gain. So for one of the banks that received a $25 billion investment of equity, they potentially will have an earnings attribution specifically because of this program equal to $2.5 billion. That would just be sort of standard banking numbers.

So the question would be: Can you use that $2.5 billion that is going to be contributed to your operations to enable you to support this bankruptcy type provision? When I have talked—and I have talked to the CEOs and senior executives of virtually all of the banks and this table, and others, their major concern was not that they would lose money on the homes that would go through the bankruptcy provision, as narrowly as it was drafted. They were worried that the other debts, like credit card debts or car loans that are in trouble, would create an ancillary loss for the bank. My belief, which I believe really strongly is that once you have gotten deposit insurance protection, once you have had all the liquidity benefits that Senator Dodd elicited, and once you have a direct taxpayer investment in the company, it should not be too much to ask for each and every one of these banks to say, "We are going to take a little bit of loss on our credit cards in order to fix the problems that are devastating the coasts of Florida." We are only halfway through the problem of subprime loans alone. You know, the number of loans that have been foreclosed that were subprime is less than the number of seriously delinquent subprime loans that are still outstanding and in trouble. We are only halfway through the subprime, not to mention a third of the way or less with the Alt-A and the payment option ARM. We are nowhere near the end of this tunnel.

So I would say that is the No. 1 thing to do quickly, and then I mentioned earlier the Sheila Bair/FDIC proposal is just an absolute no-brainer. There is just no reason that we should not get that done in the next week.

Senator CASEY. Thank you. I think what we have with the housing market and the foreclosure problem itself is an ever bleeding wound which we have not dealt with. I am out of time, but I do want—just for the record, Mr. Chairman, one of the missing pieces of information here, it seems, is a very definitive number in terms of the number of homeowners that have been helped in the last year or two, with all the efforts that are made, the voluntary efforts by Treasury and the administration, the statutory provisions that you led the charge on and our Committee worked on, as well as the recent Emergency Economic Stabilization Act. There is no—there does not seem to be a fixed number on the record of how many have been helped, and I noticed going through the—I did not have time to ask this, but with regard to the institutions represented here, you go down the list: JPMorgan Chase, Goldman, Wells Fargo, and Bank of America. References in your testimony to how many homeowners have been helped in the last 2 years, the last year, how many projections, how many people are projected to be helped, and they are all over the lot. And one thing, if Treasury is not requiring it, I think this Committee should, in terms of amplification of the record, have each of your institutions submit for the record of this hearing, for this Committee, exactly how many homeowners have been helped and the documentation of that, and then also the projection that you have of the number of homeowners you will help in the next year or 5 years—some kind of very specific report so at least this Committee—if Treasury is not requiring it, as they should, at least this Committee will have an accurate record of what your numbers are, because I see numbers all over the lot: 250,000 families helped, 41,000, all these numbers floating around, and there is no specific reporting requirement.

So, Mr. Chairman, if there is a way to make that part of the record as well as to encourage Treasury to require it——

Chairman DODD. You just did. We will make the request, and this is a formal request now.

Mr. EAKES. Could I add one more point to that question?

Chairman DODD. Certainly.

Mr. EAKES. On page 4 of my written testimony, we talked about—we look at the actual modifications that have been reported through Hope Now, the voluntary industry association. And one of the things I want to emphasize is that we need to have a system that gives you loan by loan, loan-level reporting of the modifications that can be studied, not identifying data, because if someone gave you a report and said here is the number of modifications I made, you have no idea whether that was meaningful or not. So the State Attorneys General have reported that of all foreclosures, 80 percent received no modification whatsoever in the past year. Of the remaining 20 percent, the vast majority of the modifications reported by good lenders—the good guys—were what are called repayment plans, which is where you add to the payment each month and actually increase the monthly payment for the borrower. Only about 290,000, over all of the lenders in the last year, were actually modifications that reduced the payment level.

And so I am optimistic. I think we have tremendously capable banks who have made announcements this week that are very encouraging. But I am also a little bit factual that I have heard pledges, and the problems are just so intractable that if we wait and give it time, 18 more months, Florida is going to be a disaster. I mean, it is already hurting, but it is going to be even worse than it is now. So we just cannot rely on voluntary modifications unless you are going to get the data, you know, in a loan-by-loan fashion that says here is what the payment was before the modification, here is what the interest rate was, here is what the loan balance was, and here is what it is after the modification.

Senator CASEY. I am finished, but I would amend my request to include that kind of information, because I think you are right. Just an assertion of modifications can be, I guess, in the eye of the beholder and depending on what information you convey.

Ms. WACHTER. And if I may just for a moment, I just wanted to encourage that as well. What Mr. Eakes says is absolutely right. There are loan modifications and loan modifications, and they need to be tracked so that we know actually the loan modifications are real.

Senator CASEY. Yes. Thank you.

Chairman DODD. Thank you, Senator Casey.

Before I turn to Senator Brown, I just want to pick up on this bankruptcy provision. I appreciate Senator Martinez's raising it. This Nouriel Roubini is a noted economist, and just to quote him, he said, "When a firm is distressed with excessive debt, it goes into bankruptcy court and gets debt relief that allows it to resume investment, production, and growth. When a household is financially distressed, it also needs debt relief."

The lack of debt relief to the distressed households is the reason why this financial crisis is becoming more severe, and the economic recession with a sharp fall now in real consumption spending is worsening.

The idea that you can go into bankruptcy court and protect your boat, if you want to, your car, and your vacation home—you can do that. Those are all contracts, and you can protect those in a bankruptcy court. But you cannot protect your primary residence. There is something fundamentally false about that notion. Your boat, your car, and your vacation home, I can protect. But I cannot protect your primary residence and let you get back on your feet, work this thing out, and get on your feet again.

So I just hope—and I do not know whether we are going to do it next week or not, but I certainly intend, along with others here, to try and raise this. And I hope in the context—we are talking about distressed mortgages. We are not talking about doing it for a limited period of time. But we ought to be able to build a bipartisan coalition of support. That is the one single thing I know of that I think could make a difference, that we could make a difference on, aside from the efforts by the Treasury to step forward.

Senator Brown.

Senator BROWN. Thank you, Mr. Chairman. Thank you for your passionate and very sensible words there.

Mr. Eakes, I want to follow up on Senator Casey's question to you about the loan modification and the FDIC proposal. Do you believe if Treasury and FDIC and Sheila Bair and the administration can work on that under the provisions that we wrote into the bill a month or so ago, do you think that would deter banks from participating? And if it did have that effect, would it matter? Since this does not seem to trigger Treasury's concern about possible——

Mr. EAKES. What would deter them?

Senator BROWN. Would requiring banks to participate in the Capital Purchase Program, engaging in loan modification similar to the FDIC proposal, would that deter banks from doing it, from participate in the program, in your mind?

Mr. EAKES. I do not think so. I mean, we have seen the banks at this table and others who have announced their own programs. So if I missed your question, I will try to come back. So the Treasury/Sheila Bair proposal is to help induce, so it is offering a benefit that is explicitly tied to doing loan modifications that are deeper than what is becoming the industry standard. Right now we are at a standard that says if a borrower is paying 38 percent of his or her household income for a monthly mortgage payment, that is OK. Well, when I grew up and most of us grew up making home loans, we thought 25 percent was the level that was acceptable for housing payment.

So what is unique in the Sheila Bair plan is that the proposal is you would only get this guarantee or public benefit if you reduced the payment for the borrower down to 31 percent. We have got some lenders whose loans are higher than 38 percent, which is the standard that we have heard this week, as the ratio of payment to income who are making loans now at 50 percent, 45 percent.

So what is going to happen? One month later the borrower is going to come in and say, "Well, how about reducing my payment to 38 percent?"—which we have acknowledged is the affordable level. The banks—unfortunately, the $250 billion is largely already committed, and so it would have to be some sort of renegotiation or jawboning. There is not going to be new banks, I do not think, unless we expand the $250 billion to be a larger share of the $700 billion.

Senator BROWN. OK. Thank you.

Mr. PALM. Senator Brown, could I mention——

Senator BROWN. Sure.

Mr. PALM. There may be an industry standard, but Litton, for example, applies 31 percent and has applied it for a long time.

Mr. EAKES. That is fabulous, and that is why——

Senator MARTINEZ. What is the name of the entity?

Mr. PALM. Sorry. Our subsidiary, they use a 31-percent level, the one that has been referred to, and that is one of the reasons why they think you can actually do something positive for both the homeowner as well as the investor.

Mr. EAKES. And I will bet that Larry Litton's redefault—he is a great guy—that his redefault, once you get a borrower to the 31-percent level, which is more affordable, is much lower than the modification plans that allowed a much higher portion of your monthly income to go to the debt. I bet you——

Mr. PALM. Well, it is conceivable that it would not be much lower simply on the basis that if people do not have the income to pay more than a certain percentage——

Senator BROWN. OK. Let me shift. Ms. Zirkin, in your testimony you discuss the failure of voluntary efforts to provide much relief. You recommend we put in place an affirmative duty on servicers to engage in sensible loan modification. Mr. Eakes pointed out earlier the incentive for them to foreclose. Talk to me about your thoughts there, expanding on that.

Ms. ZIRKIN. What we have seen, Senator, is that the voluntary efforts—and I am just going to say it—have not worked. Martin Eakes has just outlined research that said, as I understand it, very few, relatively speaking, were actually helped.

Senator BROWN. So how do we get servicers to do these loan modifications?

Ms. ZIRKIN. I believe there are two ways. It is the bankruptcy bill, bring them to the table—voluntary has not worked—and the FDIC plan, because there are incentives, as I understand it, in this plan to bring the servicers to the table, because they have incentives, they will be able to modify loans. But it is a very complicated problem in terms of, as we all know, of the securitization problem, and unless people are forced to come to the table with all these intricate loans all intertwined, it is not going to happen. And yet every month, every week, more and more homes are foreclosed on, and I believe at this rate it is already a tsunami. But it is going to affect not just Florida, not just Nevada, not just a few States in major ways, but every single State.

I hope that answers your question.

Senator BROWN. Do you want to say something, Ms. Finucane?

Ms. FINUCANE. Yes, I would. I would just like to say that on behalf of the banks, or at least sort of directionally speaking, first of all, it is true that traditionally the interest rate modifications were not part of these workouts, but they are now, and they have been there the vast majority of the workouts now, one.

Two, at least in our case, even though we have not launched the $8.4 billion program for what we think will be 400,000 homeowners, we already have in this year been able to prevent 200,000 people from foreclosure. So if we had a foreclosure potentially of about 300,000, 200,000 of those did not go into foreclosure, and the vast majority of those are interest rate modifications.

So I just want to speak on that I think the progress being made in the last year is enormous, and I just do not want that to go unnoticed.

Senator BROWN. OK. Thank you.

Let me finish with asking a question of the three bank witnesses, Mr. Zubrow, Mr. Campbell, and Ms. Finucane. It is a follow-up of Senator Johnson's question an hour or so ago.

Since none of you, you say, the three banks here, have plans to acquire a healthy bank, would you object to a prohibition on that activity for CPP recipients? Mr. Zubrow.

Mr. ZUBROW. I think, Senator, one of the issues that, you know, obviously has to be considered is that any sort of prohibition is, you know, hard to figure out in its actual application as to what you would call a healthy bank versus an unhealthy bank, and whether or not the funds that were going to acquire that were coming from the CPP or from other funds, you know, that the banking organizations already have.

So, you know, I think that while we have certainly made it clear that, you know, our interest is, you know, focused on the work that we have already done with the unhealthy banks, it is hard to figure out how such a prohibition would actually be applied.

Senator BROWN. Ms. Finucane.

Ms. FINUCANE. Yes, I am not sure we understand exactly what the concern is insomuch as obviously that is not where we have put our attention. We are in the middle of two acquisitions we have made with companies that I think you would consider less than healthy, one.

Two, prospectively, we have talked about that we will put this money to work both for our capital ratios for lending and for investment in the secondary market.

So it is just very hard to anticipate what over the next 5 years might come and whether you would not actually encourage us to do that.

Senator BROWN. Mr. Campbell.

Mr. CAMPBELL. I would say that clearly the intent at Wells Fargo is to use that capital to continue to lend and lend more, as well as to help remedy the crisis that exists in the home mortgage business. And as a result of that, to put other provisions on us that would not allow us to pursue normal activities that we have pursued over the years, I think we would probably would not be in favor of that kind of prohibition, because just like others here, while we are currently not in a position because of decisions we made to pursue acquisitions, in 3 or 4 years we may very well be in a position where we would like to do that, and then having agreed to a provision that would not allow us to do it would certainly not be something we would like.

Senator BROWN. OK. Thank you.

Thanks, Mr. Chairman.

Chairman DODD. Thank you very much, Senator Brown.

Let me ask you, I have just been going over the numbers for our lending institutions that are here that the capital infusion allows. In the case of Wells Fargo, you will be receiving or have received $25 billion. In the case of Bank of America, it is $15 billion, but I notice that Merrill Lynch is getting $10 billion, so I presume that is $25 billion for Bank of America. Goldman Sachs gets $10 billion, and JPMorgan Chase gets $25 billion.

Just out of curiosity, there are two sets of issues. Obviously, the foreclosure mitigation is a set of issues, and then the question is, of course, getting lending, getting credit out the window.

Have any of your institutions set up Committees, forming any groups at all within your institutions that are out trying to identify creditworthy customers that may be the source of some of these billions of dollars, $125 billion that is going out to nine institutions; for some of them here today I have identified the number. I would be interested in yes or no, we have or we have not. Has there been any effort at all to utilize this money, this pool of money, to go out and identify the kind of borrowers out there that would help begin to release the stagnation that is occurring in the credit markets? Mr. Campbell.

Mr. CAMPBELL. I would be happy to comment on that. Wells Fargo has demonstrated an ability to generate revenues at double-digit levels for long periods of time, and so for us, it is not a new endeavor. Our company has always been about driving our performance through prudent revenue growth, and so for us, this is just what we do for a living. We are constantly seeking to increase the levels of credit that we provide to our marketplaces, and as I said in my testimony earlier, I think we are proud of the amount of lending that we have been able to do during these very unprecedented, difficult times.

Chairman DODD. So there is no new entity that Wells Fargo is creating in light of the $25 billion. How about Bank of America?

Ms. FINUCANE. I think it is a similar answer insomuch as we are focused on what can we do with the $25 billion—or right now it is $15 billion for us. We have obviously already gone out to the secondary markets. We see some other issues, though, Chairman Dodd, which is the interest rates need to come down for the mortgage borrower probably to make it more attractive. That has not happened yet. Second, that the American public really is not borrowing to the degree that it was before because of the credit crunch, because of concerns about unemployment.

Chairman DODD. Is this chicken-and-egg, though? You know, one of the things is they are obviously not borrowing because credit has seized up, and credit has seized up because people are not borrowing. I mean, it seems to me we are going to in a circular motion here. I am looking for some proactive kind of thing that says, you know, here is a new pool of money for us and we are going to go out there and advertise and shop and people step up to the plate here, we are ready.

Ms. FINUCANE. Right. Well, I think that we are ready, and we are certainly there to lend to any creditworthy individual or business, but we have got to do it judiciously, as you would expect us to.

Chairman DODD. Yes. Mr. Palm, or maybe JPMorgan or whoever wants to comment on this.

Mr. PALM. I will go next. We have not established a new committee. However, what I would say, as I indicated earlier, is our whole business is committing capital and using it, and we have got now additional capital, and we have to earn a return on it for all of our shareholders, including the Government. And in that connection, our whole investment banking division is, in essence, there to service corporate relationships all around America. And part of the business model is to help them achieve whatever they are trying to do, and part of that may well be that they have something they need to do which will create, you know, productivity, jobs, innovation, or however you want to describe it, which will require additional capital. If you have more capital now, we will be able to commit some of it. That is a natural activity which, you know, just is a recurring phenomenon. There is nothing new there. But we are certainly active.

Chairman DODD. Mr. Zubrow.

Mr. ZUBROW. We actually have set up some new committees. There are——

Chairman DODD. I should have started with you.

[Laughter.]

Maybe we could have gotten a chain reaction here.

Mr. ZUBROW. I was pleased not to be the first speaker for a change. But, Mr. Chairman, in fact, several weeks ago our Chairman and CEO, Mr. Dimon, tasked two subcommittees of our Operating Committee, which manages all the operations of the bank, to focus on just this very question. You know, how can we much more proactively reach out not only to our existing customer base but to, you know, other parts of the economy in order to utilize this capital, as well as other capital which we have, in order to help stimulate lending activity.

Chairman DODD. OK. Well, that is good news. I appreciate, by the way, some of the steps that JPMorgan Chase has made as well. I should have made that point, as I did about Bank of America earlier.

Let me ask our bankers here as well, you heard the kind of debate and discussion like we had just before you walked back in again on the bankruptcy provision, and you have heard Mr. Eakes describe it. I should have probably done that as well. This is only for distressed mortgages, for a limited amount of time. And I know historically there has been opposition for all the obvious—the cramdowns make you very uneasy, and the point that Senator Martinez raised, the discussion about contract issues and the like.

Tell me how you feel now about this. Obviously, we have got a serious problem on our hands here, and we are looking for ways to move this. Is it still the position of those who are here individually—without trying to speak for the universe of bankers, Mr. Campbell, we will begin with you. Are you adamantly opposed to this idea of trying to do something for a limited amount of time under circumstances that might very well produce the very results that happened in the farm credit areas back a number of years ago? And I understand there are differences. I am not going to try and draw analogies that are perfect. But the idea here that would actually maybe promote the kind of steps that we are all trying to achieve, how do you feel about this now?

Mr. CAMPBELL. Mr. Chairman, I want to start by, again, really confirming that we understand the sensitive nature of this crisis, and it is clearly in all of our best interests to find solutions.

Having said that, our view is still that while it may be an important fix right now, what does it do to the longer-term availability of credit to this market?

Chairman DODD. But assuming we are doing it for a limited amount of time now—this is not in perpetuity. We are talking about 3, 5 years, whatever the number was.

Mr. CAMPBELL. This is a very fragile market, and, frankly, one of the things that we have to consider is we have a very large inventory of foreclosed and unsold property. And so to potentially throw a curve into this segment of the market where potentially one of the outcomes, the likely outcomes to cramdowns, would be that the markets would—since there is less predictability in the market, it is likely that two things are going to happen; investors are going to require two things to happen to try and offset the uncertainties: one, downpayment sum will probably be increased, and, logically, prices would be increased to try and offset some of the uncertainties that exist by contracts being able to be just crammed down.

And so while we have got this inventory and we need to find a way to stimulate the housing market, do we want to put at risk that market by taking that step? is the question I think we all have to step back and carefully and thoughtfully think through.

Chairman DODD. So the answer from Wells Fargo would be no.

Mr. CAMPBELL. No.

Chairman DODD. Ms. Finucane.

Ms. FINUCANE. Well, I think we have similar issues insomuch as I think we have concerns with what the investor community will do if they think they have got a bankruptcy court that can do it judge by judge, district by district. And so the marketplace can have great—the long-term issues may be greater than the short-term gain, one. And it seems like it is a one-by-one—as I said, district by district, judge by judge. And we think there are some very fundamentally big, broad programs that each of the banks here have initiated as well as Chairman Bair's initiatives that she has laid out that collectively may have the greatest impact.

Chairman DODD. Again, maybe I am missing something here, and you folks work at this every day. How do I make the—when one of my constituents says to me, well, you know, the last time I looked, the credit availability for vacation homes was not bad. How do I explain to someone that you can cram down in a bankruptcy proceeding your vacation house and there seems to be credit availability? The institutions have worked that out. But I cannot do it for the primary residence. How do I explain the distinction and difference between one you can work out and the other I cannot, two homes?

Ms. FINUCANE. Well, I think that is a good point, but that is not—I mean, the banks did not set up the bankruptcy laws.

Chairman DODD. But that does not explain the difference why—I mean, I have got a vacation house and I have got my primary residence. Now, one house I can cram down and work out a mortgage on because the bankruptcy courts would allow me to do that. But on my primary residence, I cannot.

Just to pick an example out of thin air, just say I had eight homes, and so seven of them I can protect in a bankruptcy proceeding. But the poor guy with one house cannot. How do you explain that to people? What is the justification?

Ms. FINUCANE. I think you are asking us something about bankruptcy law as opposed to what you began with, which is the issue around do we think that is a good solution to the foreclosure issue. And we can speak to the foreclosure issue, not bankruptcy law.

Chairman DODD. OK. Mr. Palm, same question.

Mr. PALM. Well, I likely misunderstand your question, perhaps given where we are in the food chain, because as I said, we are not a big mortgage originator.

Chairman DODD. I know.

Mr. PALM. I am assuming one of the issues that they have alluded to is simply the issue that the cost of credit to buy your single-family home is dependent on the fact that the lender thinks that, if all else fails, they at least get the property. And I think that is the theory of the lending, which is why rates are whatever they are.

I think for vacation homes, my assumption would be—and you should never assume, I realize—the rates would be at a higher level simply on the basis that you would not have the same type of certainty, and we would perhaps need an economist to verify that fact. And having said that, in general, obviously, people who have multiple homes and vacation homes or whatever—and those are not the people who we are worried about here today—they would normally also have additional other resources, and, therefore, they would probably get—you know, even though the differential in interest is still going to be higher for——

Chairman DODD. I wish Mel Martinez were still here to talk about Florida.

Mr. PALM. No, no. But I think the problem is, you know, as alluded to, there will be an uncertainty created in the market. I cannot say sitting here that you cannot do certain things in emergency situations if you really need to do them. Even if it is only a temporary period of time, the effect on the ultimate investors is something you really have to take into account in weighing the balance.

Chairman DODD. I have saved Mr. Zubrow for last because he is going to surprise us again and tell me I am absolutely right and JPMorgan Chase supports this.

Mr. ZUBROW. I am sorry to disappoint you, Mr. Chairman. I really do not have a lot to add to what the others have said. I would emphasize what, you know, you and others on the Committee have pointed to, which is that we are really in a very fragile market situation today. Notwithstanding all the very good efforts that the Committee and the Government have led in terms of trying to bring stability back into the markets, the marketplace is still extremely fragile. We lack investor confidence in many of the important markets that are required to really re-liquefy the home lending process. And so I think that there is, you know, grave danger to introduce a major change in the balance of outcomes that investors might be worried about through a major change in the bankruptcy provisions, and such change could really elongate the length of time that it takes to bring investors back into this marketplace.

Chairman DODD. I guess my point—and I will end, and I am going to ask other witnesses to comment briefly on this. But the only point I want to make is I just do not see any evidence yet that has been demonstrated to me that allowing a homeowner to take bankruptcy protection for a primary residence affects generally the credit availability for primary residences generally. I mean, that is the argument, and I just do not see the evidence of that yet. And that seems to be the point, that this would harm credit availability generally if you were to make this exception.

So where is the evidence to support that? I do not see it. But I know Ms. Zirkin and Mr. Eakes and you, Dr. Wachter, might want to comment on this.

Ms. ZIRKIN. I will be very brief because I am sure Mr. Eakes has something very important to say.

[Laughter.]

But let me say this: I was going to say, Senator, that there is no evidence, that we have heard this all the time, and I have not seen studies, I have not seen evidence. And we are at a point now, markets are fragile; the entire economy is fragile. We have markets going down every single day, 400 points, 300 points. It is very hard to find your way. And that includes giving $700 billion to the Treasury.

Where I am going with this is that people might say that they know what the effect of a bankruptcy law is. I have not seen any evidence. But we are at the point now where we have to put it in, as you said, Senator, restore it to as it was in the 1970s and 1980s, basically, so that restore it for a year or 2 years, some period of time so that we can have the empirical evidence to see if it works or it does not, because people, as I said and as we all know, are out there suffering.

Thank you.

Chairman DODD. Dr. Wachter.

Ms. WACHTER. We do need more evidence. There is small evidence, but it does not really go to your more major point, I think on your more major point, of what would it do now. We really do not know. I think there are tremendous risks on the side of doing a legislative initiative in this direction.

On the other hand, as I said earlier, the Nation is at risk, and if we do not take effective action that, in fact, leads to a slowdown in foreclosures, this issue will be minor. So we have to have all options evaluated at the table. I think that if there were such an option seriously being evaluated, there might be more movement on other options, such as bringing the servicing industry to the table.

Chairman DODD. Yes. I would just point out that I mentioned at the outset of my remarks that there are over 9,000 foreclosures a day. This is Thursday. We are going to get together here next Wednesday. Between now and next Wednesday, some 50,000 homes we put at risk in the country, 50,000 families adversely affected.

Mr. Eakes, any point on this you want to make?

Mr. EAKES. Yes, with all due respect to my friends on the panel, it is clear to me not a single one of them have read the bill that deals with bankruptcy. Not a single one of them have studied the provisions in the way that they would have studied the TARP provisions. The bill's proposals that have been put forth limit the cramdown, the bankruptcy adjusting the debt secured level down to the market appraised value, only to loans that will be in foreclosure. Every banker here can tell you if they have got the data that less than 1 percent of the loans that are in foreclosure now are going to cure.

So if you are only dealing with the loans that would go to foreclosure and you are going to lose more money and have the costs of a foreclosure in every case, the bank is going to be better off. That is one provision.

The second provision that is in the bill that details matter is that every single lender/servicer has it within their control to prevent this cramdown. If you modify the loan to make it affordable so that the borrower has the ability to pay the mortgage, the provisions in these proposals would not allow a cramdown. You have it within your power as the lender, as the servicer, to prevent the bad effect.

No. 3, there is evidence—between 1978 and 1993 half of the circuit courts in this country used the bankruptcy cramdown because they said this cannot mean what the words seem to say in the Bankruptcy Code; it does not make sense. And there was no difference in the rates charged to borrowers for the first—for home loans between the two different districts between 1978 and 1993.

My good friend Lou Ranieri, who claims to me that he was the person in 1978 that lobbied and helped get this provision instituted, the ban on modifications solely for personal residences in 1978, is now actively saying there is no way to solve the problem of these piggyback second mortgages unless we lift that ban.

So I just crazy, really, when I hear this stuff that is going to disrupt the market. We have had proposals at various debates that said we will only limit it to existing loans, which means that it cannot have any impact on a future loan because it does not apply to them.

So I just—you know, I know I am being overly passionate about this, but, you know, I have been watching the 9,000 per day, 45,000 people lose their home and go into foreclosure every week. We do not have any time to spare. And it just drives me berserk, with all due respect.

Chairman DODD. Well, I wish you would express yourself on the issue.

[Laughter.]

Senator Crapo.

Senator CRAPO. Thank you very much, Mr. Chairman.

Just one last question for Mr. Eakes.

You were talking about the limited terms of the legislation that has been drafted. What is the term of the—isn't there a limitation in the term of the bill?

Mr. EAKES. No. 1, it limits the loans going backwards. I think it was January 1st, 2004 or 2003. So loans that were made after that date. In several of the versions, it limited it to existing loans, which means that you have an inherent sunset because those loans, as they get modified or go through payoff or refinance, there are a new loan. And then there was on top of that a sunset of—I can't remember exactly, but it was 2 or 3 years afterwards. So during the current crisis, it is as narrowly tailored as any piece of legislation could possibly be to this specific problem.

Senator CRAPO. All right. Thank you very much.

In my questions this round, if I have time for it, I want to cover two issues: one, credit default swaps, which I think we can talk about very quickly; and then, second, as I indicated in my opening comments, regulatory reform. But particularly, again, for the banking witnesses, but for anybody who would like to, let me just say I strongly support the efforts of our financial institutions today and our regulators to strengthen the infrastructure for clearing and settling credit default swaps by creating a central clearing system. And recent events in the credit market I think have highlighted the need for greater attention to risk management practices and, in particular, counterparty risk.

A number of private sector initiatives are being developed to diminish counterparty risks to credit default swaps by achieving multilateral netting of trades and by imposing more robust risk controls on market participants. I just want to ask a general question to those who are engaged and would like to respond to this as to how you feel progress is being made here, and when do you anticipate that we might have a central clearing system up and operating. Do you want to start out, Mr. Zubrow?

Mr. ZUBROW. Sure, Senator. Thank you. I think you have summarized very well much of the activity among the major banks participating in the credit default swap market to bring a much more robust process to it. We are an active participant in the Clearing Corporation/IntercontinentalExchange efforts to create a central counterparty, and right now the proposal is being reviewed by both the Federal Reserve Bank in New York, the SEC, the CFTC, and the New York State Department of Banking. Those different regulators have been in a meeting with the leadership of TCC/ICE, and we would expect to hear back from them sometime in the very short future, the next—you know, potentially this week or next week, you know, regarding getting the appropriate regulatory approvals to allow that organization to be up and running as a central counterparty.

So, you know, we very much are in favor of having central counterparty clearing. We think that it will continue to make this marketplace a much more robust and safe marketplace. And while we cannot predict how quickly we will hear back from the regulators, assuming that they do so within a relatively short period of time, we would hope to have this activity up and running by the end of the year.

Senator CRAPO. Thank you.

Anybody else want to elaborate there?

Mr. PALM. Goldman Sachs views this as vitally important that the proposals have been put forward, moved forward. We are involved in all the same discussions regarding the same new institutions, and we think it will be a big assist to the market. Whether it gets done by year-end or not is not, you know, entirely clear, certainly. It is dependent on a lot of things getting done. But it is the thing to do.

Senator CRAPO. Bank of America?

Ms. FINUCANE. Yes, we are all active participants in this, and I think we are all supportive about the procedure and the outcome. And I do not think you will have any disagreement from any of us.

Mr. CAMPBELL. I have to admit that this is beyond my capability, but we would be happy to have the people who are aware report back to your staff, if that is what you would like.

Senator CRAPO. All right. Thank you very much.

The last issue that I want to get into, as I mentioned in my initial comments, is regulatory reform. I have for a long time, even before we got into the thick of this crisis right now, believed that we need significant regulatory reform for our financial system in the United States. And I will not go into all the details for why I believe that, but, you know, our capital markets I think have needed to be served by a much better regulatory system for some time.

Just yesterday, I believe it was, Walt Lukken, the Chairman of the CFTC, made a proposal that we reform and modernize our regulatory system. His approach, which I think is very similar to the one that Secretary Paulson made last March in his framework that he put forward, suggests that we have three regulators: one on systemic risk—by the way, my understanding is that depending on what kind of business you are in in the financial world today in the United States, you could have as many as seven different regulators, and that does not count all the State regulators and States and other potential impacts. And so this proposal is that we streamline it to a system in which we have three regulators, I assume some of them with increased regulatory strength: one for systemic risk, one for market integrity, and one for investment protection.

I for quite some time have been interested in the one-regulator approach that we have seen over in Britain with the FSA, and my question is really a broad, open-ended question, and it has sort of got three parts, but it is all sort of the same question, and that is—and I open this to anyone on the panel who would like to respond. First of all, do you agree that we seriously need a new, modernized regulatory structure? Or is the regulatory structure that we have today one that we can just fine-tune a little bit and keep moving with? And, No. 2, if you do believe that we need to have a significant look at regulatory reform, what do you think of these proposals, the three different regulators or the one regulator based on principles rather than what I call the "gotcha" approach?

I think you are all understanding where I am headed with this, but what are your thoughts as to where we should head in terms of the regulatory system we should have in place for the future for the United States financial system? And you do not have to answer if you do not want to, if you are not engaged on this issue, but I will start here on the left, and we can just move down. Mr. Eakes.

Mr. EAKES. I would think some steps are more urgent than others. So, for instance, the OTS, in my view, has outlived its usefulness. If you look at Washington Mutual, Countrywide, IndyMac, we had institutions that were choosing what they perceived to be the weakest regulator in terms of the lending. If you look even at AIG—so a lot of the crises we have seen have touched through the OTS, and it would not be hard to merge the banks that it supervises into the OCC and merge the holding companies that it tries to supervise but is not really large enough to do into the Federal Reserve supervision.

Even with AIG, it is not really widely reported, but what really brought that company to its knees was the credit default swaps that were traded out of an office in London. That office was able to get exempted from all of the European regulators because nominally AIG's holding company was regulated by the OTS because it owned a $2 billion thrift. So owning a $2 billion thrift enabled this to be—and the OTS is in no way capable of looking at the credit default swaps that AIG had all over the world. So I feel like that is the most critical case.

When the difference between thrifts and banks was established several decades ago, the thrifts were providing 80 to 90 percent of mortgage loans. Now it is exactly the reverse; 70-plus percent, 80 percent of all mortgage loans are made by banks. So the two institutions have converged, and having a choice of regulator, as Secretary Paulson and his staff have said, we should have banks succeed based on their business choices, not based on which regulator they happen to choose.

Senator CRAPO. Thank you. Mr. Zubrow.

Mr. ZUBROW. Thank you, Senator. We certainly agree that there needs to be changes in modernization to the regulatory system in the country. You have certainly highlighted and Mr. Eakes has highlighted, you know, many of the failures of the existing regulatory structure. We very much believe that having a single regulator for the financially systemic important institutions is an important part of how the system might be reformed going forward. We obviously have not had a chance to really go through Mr. Lukken's proposals from yesterday, but I think that, you know, our ongoing view as we, you know, hopefully work with you and others on regulatory reform is to really focus on making sure that there is commonality of regulation for these key systemically important financial institutions so, as the Treasury Secretary has said, we do not end up getting regulatory arbitrage across the different groups.

Senator CRAPO. Thank you. Mr. Palm.

Mr. PALM. Happy to. I think anyone who thinks that the regulatory system in the United States and elsewhere is not in need of reform has not been around for the last 6 months. That would be my first point. We fully support a thoughtful approach to putting together a new regulatory system. Whether that is one super regulator as described, which you mentioned you might be in favor of, or, you know, a tripartite one, one of which consists of investor protection separate from I will call it the soundness of the particular financial institution, et cetera, you know, can be debated. Either system in theory can be made to work. I think the current system—and obviously we are new to being a bank. One of the things that first struck me was the fact that—actually, being a lawyer of sorts, I first got a book out which told me all the different types of organizations you were regulated by if you were in a particular business, and it was mind-numbing, including both regulatory arbitrage as well as—it is not even necessarily arbitrage. It is just people found themselves regulated by different people, having different rules, and so on, and some, from what I can tell, not regulated at all, full stop.

So I think it is very important to modernize and move forward. Certainly, the FSA system in London has lots of positives to it. On the other hand, if you step back for a second, even that system obviously did not save their economy from the consequences of what is going on now.

So I think you want to have functional based regulation, and as I think Mr. Zubrow alluded to, systemic institutions, i.e., institutions who have global scale, you need to really have people who look after them as an entirety and understand their overall operations. We think that is important.

Senator CRAPO. Thank you. Dr. Wachter.

Ms. WACHTER. Yes, it is critically important going forward for the long run to restructure our regulatory system, and there is regulatory arbitrage, and that needs to be part of the issue that is addressed. And I do want to here agree again with Mr. Eakes. The insufficient oversight and lack of reserving for CDS issued by AIG was a critical part of the problem that we are facing today.

I want to make two other points. One point, this is a global phenomenon now. We are going to need global cooperation on regulation, and it cannot just be in one nation because, as we see, capital flows are global.

Second, again, FSA was not a cure-all. The U.K. had over the same period, not as much as we, but erosion of credit standards, and FSA did not see that happening or could not stop it; and at the same time as erosion of credit standards, a housing asset boom. This U.K. crisis is similar to the Japan crisis, is similar to the Asian financial crisis. So it is not just a better environment for regulation, a better structure, but it is better regulation.

Senator CRAPO. Thank you.

Ms. FINUCANE. I think I will just reiterate what I think you have heard from the other banks, which is we do believe that there needs to be greater transparency for a regulator. I am not sure that we would support one super regulator. Maybe there is too much risk in that, and there are complications. Consumer regulation versus capital markets might be too big a breadth, so I think we would consider that.

The last thing I would just say is clearly from the banks, I think the bank holding company structure has been what seems to be victorious in the long run, so we would start from there as well.

Senator CRAPO. Thank you.

Mr. CAMPBELL. I will only add some thoughts that have not been said.

First of all, we agree that there needs to be a revamping of the system. One of the things that I think we all need to be thoughtful of is what is the pace of whatever we go to, so just being thoughtful of the timing.

Second, we would encourage this dialog to give us a chance to look at, in particular, the unregulated lenders that exist. I think that that has proven at this time to have been a category that did not get looked at and I think needs to be looked at. Certainly the point of around a systemic look is also high on our list of things to do.

And, finally, being clear on what the role of the Fed will be in whatever this new regulatory approach might be from our perspective is a very important consideration.

Senator CRAPO. Thank you. Ms. Zirkin.

Ms. ZIRKIN. I will be very brief, because we have, frankly, focused on our communities in distress. Previously, we had called for reform of the problem that has actually caused this, but I would agree with Mr. Campbell in that we must regulate unregulated lenders.

Senator CRAPO. Thank you very much.

Mr. Chairman, thank you for letting me go over.

Chairman DODD. Not at all. Very good points, and it was very worthwhile to hear the testimony.

As I said earlier, Senator Crapo has had a longstanding interest in regulatory reform. This is a major thrust of this Committee's activities in the coming Congress. We have obviously got to grapple with the ongoing situation, but I do not intend to let that overwhelm this Committee's responsibility, because underlying all of that is the issue of whether or not we are going to have a new architecture that reflects the 21st century global economy and obviously the problems we have entered into.

This whole idea of regulatory competition for business I think has been dreadful and has really hurt us terribly in the country, and obviously that is a major point.

I want to also make the point that I think we have been operating under a myth for too long, and I think it has hurt our country, and that is that the notion of consumer protection and economic growth are inherently contradictory. They are not at all. I think what we have learned over the last number of months is that consumer protection and economic growth go hand in hand. In fact, when you fail to do the first, you end up doing severe damage to the latter. And I think we need to get over that notion which too often has been the subject of testimony, that if you are going to protect consumers, it is going to hurt our economy. And I think we have learned, painfully, how false that statement is. So I would just add that element as we look down the road at this effort, and I thank my colleague.

I just want to end on one question. It has been sort of—and I listened to all of you when you talked about the Capital Program and to what extent various things are—whether it is bonuses or dividends or acquisitions. And let me say on my part on the issue of acquisitions, again, my general view is I think if you are talking about purchasing or acquiring a failing institution, as several of you have done, it makes all the sense in the world to me. And the question of what is a failing institution, I realize you get into a gray area, and so you want to be careful about trying to draw too bright a line in that area. But, clearly, I think most of us would agree here that is a proper utilization of these funds. Acquiring healthy institutions with these funds is one that is disturbing.

But this idea that there are retained earnings and private capital coming in, and obviously capital that has come from the Federal Government, I am a little nervous about this distinction, because money is fungible here, money is money. And, obviously, if you are not paying a dividend or you are not out there paying a bonus, that is going to increase the availability of capital in your institutions.

So the notion somehow that I am going to be able to separate out here the money that I am getting from retained earnings or from private investment as opposed to capital coming from the Federal taxpayer worries me a bit here, that in a sense this notion, as I tried to make at the outset in my remarks, it is not just $290 billion. It is over $5 trillion. I asked you the question earlier about these various new instruments and protections and guarantees and so forth. To make my point, the taxpayer is really behind your institutions. I do not know if I would go so far as Martin Eakes to suggest that some of you might not be here today at this table were it not for the fact the American taxpayers contributed significantly to your well-being. And the point here is—and, again, I respect the notion that a dividend is important for investors. But also, we are at such a critical moment that we need capital to go out, and the idea that at this particular moment your investors would be so adverse to the notion that that happen that they would be unwilling to accept the fact that there may be a period of time when a dividend does not go out.

I just want to get over this notion somehow that we can draw these bright lines between private capital, retained earnings, and public monies as we talk about building up our capital requirements here to be able to then engage in the kind of lending practices that all of us need to see if we are going to see the capital and credit markets become unseized and unclogged, as they presently are. I just do not think—it flies in the face of reality that you can somehow draw these bright lines between public monies and private monies and retained earnings when it comes to some of these issues.

I know you are hearing this from others, so I am not saying something you have not heard before, but this notion of responsibility as well—at this critical moment, none of us in this room have ever lived through anything like we are going through, and we bear the collective responsibility of getting it right, not just for us but for that generation coming along. This country deserves far better than it is getting in this deal, and we need to make it work right, and everybody has got to pitch in, including the investor. Including the investor. And I suspect they understand that better than maybe they are given credit for.

So I just urge you today and I thank you immensely for spending a lot of time, going on 3½, almost 4 hours here today, but this is extremely important, as I know you appreciate. And we do not have a lot of time to get this right. The real market, the real economy is suffering.

I had dinner last evening with a very significant retailer in this country, and what is happening to retail sales, when you get 8 and 9 and 10 and 11 percent reduction in retail sales, that is phenomenal in this country. And so it is reaching right down into people out there who depend upon that salary coming in every week to sustain not only their mortgages but their families. And so we have really got to pull together on this now.

I hope you will go back to your respective institutions and share the thoughts we have expressed here today. And I think it has been interesting that you have heard it across these party lines. It is not just Democrats versus Republicans. You are hearing it from Mike Crapo. You are hearing it from Mel Martinez, as well as Sherrod Brown and Bob Casey. Chuck Schumer, by the way, has some additional questions he wanted to raise, as my colleagues may have as well, and we will submit those to you.

Chairman DODD. I thank you for being here today, and we are going to continue calling upon you and asking you for your advice and counsel as to how we proceed. But I thank you.

The Committee will stand adjourned.

[Whereupon, at 1:16 p.m., the hearing was adjourned.]

[Prepared statements and responses to written questions supplied for the record follow:]

Testimony of Martin D. Eakes
Self-Help and Center for Responsible Lending

Before the U.S. Senate Committee on Banking, Housing and Urban Affairs

"Oversight of the Emergency Economic Stabilization Act: Examining Financial Institution Use of Funding Under the Capital Purchase Program"

November 13, 2008

Good morning Chairman Dodd, Ranking Member Shelby, and members of the Committee. Thank you for holding this hearing on the Emergency Economic Stabilization Act of 2008 and for inviting me to testify.

I serve as CEO of Self-Help (www.self-help.org), a nonprofit community development financial institution that consists of a credit union and a nonprofit loan fund. For close to thirty years, Self-Help has focused on creating ownership opportunities for low-wealth families, primarily through financing home loans to low-income and minority families who otherwise might not have been able to get home loans. In total, Self-Help has provided over $5 billion of financing to 55,000 low-wealth families, small businesses and nonprofit organizations in North Carolina and across America.[1]

I am also CEO of the Center for Responsible Lending (CRL) (www.responsiblelending.org), a nonprofit, non-partisan research and policy organization dedicated to protecting homeownership and family wealth by working to eliminate abusive financial practices.

With the constant barrage of statistics and staggering dollar figures that have become commonplace during this financial crisis, it is easy to become numb to the depth and scope of the financial pain American families are experiencing today. However, the numbers paint a picture we cannot ignore. Using recent data from the Mortgage Bankers Association, we calculate that foreclosures on all types of mortgages are occurring at an annual rate of 2.3 million.[2] On subprime mortgages alone, the "spillover" costs are massive. At least 40 million homes—households where, for the most part, people have paid their mortgages on time every month—are suffering a decrease in their property values of $352 billion. These losses, in turn, are infiltrating nearly every part of American life, from police and fire protection to community resources for education.

As we have become accustomed to hearing about the losses stemming from foreclosures,[3] we also hear on a regular basis that the foreclosure epidemic is being addressed through the voluntary efforts of servicers and lenders. Notwithstanding these efforts and results published by HOPE NOW,[4] the foreclosure problem is getting worse, not better. In fact, the voluntary efforts typically *raise* a distressed family's mortgage payment instead of lowering it and result in a temporary fix with a high probability of failure.[5]

The major piece that has been missing from piecemeal efforts to stop the foreclosure crisis is a systematic, large-scale way to stop foreclosures that can be prevented. With wise implementation of the Emergency Economic Stabilization Act (EESA), we now have a chance of real success. Treasury should use the Troubled Asset Relief Program (TARP) to leverage *systematic* approaches to modifying mortgages to sustainable levels.

The most pressing need today is to help homeowners to stay in their homes and, by extension, support their neighbors' property values and the financial system as a whole, since financial institutions will not survive if their loan-related portfolios continue to fail. Yet as administered by Treasury, TARP has to date failed to deal with the root cause of losses by financial institutions, which are excessive foreclosures on owner occupants. Appropriate government action could prevent many of these foreclosures and help to reassure financial institutions that housing values are stabilizing.

We urge this Committee to gauge the effectiveness of EESA by how well it prevents foreclosures that will otherwise continue to batter the nation's economy. By taking meaningful action under the Act to stop the foreclosure epidemic, we can make sure that housing price declines don't overshoot market-stabilized levels, limit losses by financial institutions, and reduce debt burdens on consumers, whose spending power we need to pull us out of this downward economic cycle.

In my testimony today, I will focus on five key points.

I. The injection of capital into banks has helped stabilize the market.

II. Voluntary, loan-by-loan modification efforts are not effectively stemming the tide of foreclosures due to structural, legal, and financial obstacles.

III. Streamlined, broad-based modification efforts are necessary to get ahead of the foreclosure curve, and can – and should – be accomplished through the existing TARP authority.

IV. Several modest legislative initiatives could provide powerful additional tools to increase modifications.

V. Judicial loan modifications can provide a crucial backstop in situations where servicers fail to modify a loan through the streamlined system though the family can afford a market-rate mortgage but is in dire straits under the current mortgage terms, and will provide a strong incentive for servicers and investors to make these programs work.

I. <u>Capital Injections into Banks has Helped Stabilize the Market.</u>

The original TARP proposal to use $700 billion of government funds to purchase "toxic" subprime and distressed asset securities from financial institutions would not have been an effective intervention to stabilize financial institutions or to stem foreclosures. However, the use of some of those same funds to stabilize the balance sheets of financial institutions through equity infusions is a potentially effective, lower risk method for stabilizing the markets and the economy. Ultimately, direct recapitalization of the banking sector has been at the heart of effective financial institution recoveries both in the U.S. and internationally. That said, Treasury should be requiring more from the financial institutions in return for this federal investment, including requiring the establishment of streamlined and affordable mortgage loan modification programs.

After Lehman Brother's bankruptcy, financial institutions were unwilling to lend to each other because they did not know which institution would fail next. This can be seen in various indexes of interbank lending, most notably overnight LIBOR, the rate at which international banks indicate they are willing to lend to each other for a single day. Historically, overnight LIBOR is priced about 1/10th of one percent above Fed Funds. This was true through the Bear Stearns bailout and the seizure of Fannie Mae and Freddie Mac during the first weekend in September. Sharp spikes in LIBOR rates occurred the day after Lehman Brothers was allowed to fail and inter-bank lending activity ground to a halt, followed by modest declines following the government's rescue of AIG. Continuing uncertainty in credit markets prevailed with relatively high LIBOR rates.

Only when the Treasury Department indicated that a primary use of TARP funds would be to inject fresh capital into the banking sector did the money markets began to return to normalcy. On October 14, the morning after Treasury announced capital infusions into the nation's seven largest banks and committed $250 billion total to bank preferred shares, overnight LIBOR tumbled to 2.18%. The following day, FDIC announced a guarantee on all non-interest bearing deposits and most senior unsecured bank debt. Within three days, overnight LIBOR had dropped to 1.67%, a mere 0.17% above Fed Funds. In the last ten days, overnight LIBOR has begun to trade below 1.00%. Other key indexes, such as the Fed Funds Effective rate, and one-month and three-month LIBOR, have moved toward their normal levels.

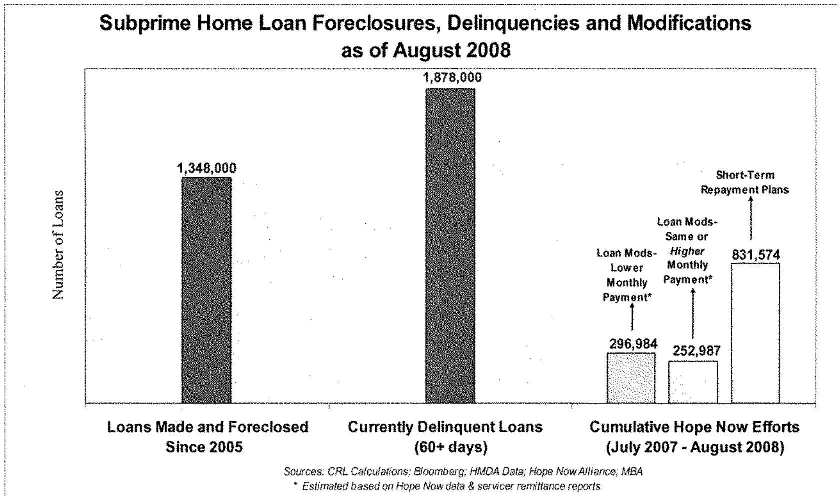
While a more stable LIBOR rate cannot solely be attributed to the bank equity injections and does not necessarily translate into lending by banks to businesses and individuals, it is a positive sign, and one that these actions had a large hand in bringing about.

II. <u>Current modification efforts have failed to stem the tide of foreclosures.</u>

Despite the loss mitigation encouragement by HOPE NOW, the federal banking agencies, and state agencies, the voluntary efforts undertaken thus far by lenders, servicers and investors have failed to stem the tide of foreclosures. Moreover, servicers still face significant obstacles in making modifications.

A. The number of modifications is inadequate.

Seriously delinquent loans are at a record high for both subprime and prime loans,[6] and all available data have consistently indicated that (1) continuing foreclosures far outpace total loss mitigation efforts, and (2) only a small share of loss mitigation efforts result in true loan modifications that are likely to result in sustainable loans.[7]



In October, Credit Suisse reported that only 3.5 percent of delinquent subprime loans received modifications in August 2008.[8] Similarly, the most recent report from the State Foreclosure Working Group of Attorneys General and Banking Commissioners (which covers 13 servicers, 57% of the subprime market, and 4.6 million subprime loans) confirms that progress in stopping foreclosures is "profoundly disappointing."[9] Their data indicate that nearly eight out of ten seriously delinquent homeowners are not on track for any loss mitigation outcome, up from seven out of ten from their last report.[10] Even the homeowners who receive some kind of loss mitigation are increasingly losing their house through a short sale or deed-in-lieu rather than keeping the home through a loan modification or workout.[11]

What's more, when modifications and other workouts are made, they are frequently temporary or unsustainable, leading to re-default and placing homeowners and financial institutions in an even worse economic position than when they started. Data through September 2008 indicate that the large majority of HOPE NOW efforts rely on repayment plans,[12] which typically require financially burdened households to add previously unpaid debt to their current mortgage payments. Not surprisingly, we now see very high rates of re-default on loan modifications, primarily because most loan modifications or workouts do not fundamentally change the unsustainable terms of the mortgage to make the loan affordable to borrowers over the long term. According to Credit Suisse, when interest rates or principal are reduced, the re-default rate is less than half of those for these other modifications.[13]

B. Numerous legal and structural obstacles stand in the way of modifications.

A recent Federal Reserve Staff Working Paper identifies a number of obstacles that limit the scale of modifications.[14] These obstacles help explain why voluntary loss mitigation cannot keep up with demand.

- *Investor Concerns:* Servicers may shy away from modifications for fear of investor lawsuits.[15] While most Pooling and Servicing Agreements (PSAs) provide adequate authority to modify loans, these modifications may cause disproportionate harm to certain tranches of securities over other classes. Investors are also particularly concerned about re-default risk, where their short term losses from modifications will be compounded by future foreclosure costs, which will increase as housing prices continue to fall, if the borrower cannot sustain payments under the modified terms. In addition, when servicing securitized loans, some PSAs do limit what servicers can do by way of modification. For example, some limit the number or percentage of loans in a pool that can be modified.[16]

- *Second Liens:* Additional liens on a property pose a structural obstacle that is often impossible for servicers of the first lien to overcome. Between one-third and one-half of the homes purchased in 2006 with subprime mortgages have second mortgages,[17] and many more homeowners have open home equity lines of credit secured by their home. The holder of the first mortgage will not generally want to provide modifications that would simply free up homeowner resources to make payments on a formerly worthless junior lien, nor to modify a loan where there is a second mortgage in default. But as Credit Suisse reports, "it is often difficult, if not impossible, to force a second-lien holder to take the pain prior to a first-lien holder when it comes to modifications," thereby dooming the effort.[18]

- *Servicer Incentives:* The way servicers are compensated by lenders creates a bias for moving forward with foreclosure rather than engaging in foreclosure prevention. Servicers are often not paid for modifications, but are reimbursed for foreclosure costs.[19] The Federal Reserve concludes, "Loan loss mitigation is labor intensive and thus raises servicing costs, which in turn make it more likely that a servicer would forego loss mitigation and pursue foreclosure even if the investor would be better off if foreclosure were avoided."[20]

- *Limited Servicer Staff and Technology:* With few but welcome recent exceptions, servicers have continued to process loan modifications in a labor-intensive, case-by-case review. While they have added staff and enhanced systems, the lack of transparent, standardized formulas has limited the number of modifications that have been produced.[21]

III. <u>Treasury should use the Troubled Asset Relief Program (TARP) to leverage systematic modification approaches and larger numbers of sustainable modifications</u>.

As noted above, the most pressing need today is to help homeowners to stay in their homes and, by extension, support their neighbors' property values and the financial system as a whole, since financial institutions will not survive if their loan-related portfolios continue to fail. Yet as administered by Treasury, TARP has to date failed to deal with excessive foreclosures. Appropriate government action could prevent many of these foreclosures and help to reassure financial institutions that housing values are stabilizing, thus encouraging increased lending.

Since taking over IndyMac Bank, the FDIC has developed a streamlined and systematic approach to loan modifications for IndyMac's loans. Similar approaches have now been adopted as part of a recent settlement between Bank of America and state Attorney Generals regarding unfair and deceptive lending practices by Countrywide, and most recently by JP Morgan Chase/Washington Mutual and Citigroup. While some aspects of these modification programs are potentially problematic,[22] and while these programs may not be able to reach sufficient numbers of loans held in private label securities where investors withhold their consent, these systematic approaches are a step in the right direction and can serve as a general model for the rest of the industry, with affordability enhancements that can be leveraged through the TARP program.

To facilitate as many loan modifications as possible, Treasury should adopt different strategies for three different categories of loans:

- **Loans in Private Label Securities:** Treasury should adopt FDIC's proposed loan modification guarantee program and provide guarantees to modifications from servicers with streamlined affordable modification protocols based on the FDIC/IndyMac model under the authority provided by Section 109 of EESA.

- **Loans Held By Fannie Mae and Freddie Mac:** As the conservator for the GSEs, the Federal Housing Finance Agency should direct them to facilitate modifications to the greatest extent possible. The recent November 11 announcement is a positive step for these loans.

- **Loans Held in Portfolio by Banks and Thrifts:** Treasury should require banks and thrifts that participate in Treasury's equity investment or asset purchase program to adopt these streamlined loan modification protocols.

A. *FDIC has proposed a loan modification guarantee program through TARP that would create an efficient subsidy for modifications of loans held in private-label securities.*

FDIC has pioneered a promising approach to streamlined modifications in its operations at IndyMac Bank, which it is applying to IndyMac loans held in portfolio and to those it services for private mortgage-backed securities investors, where possible. It has now proposed a Treasury program under TARP that could substantially expand this promising approach and effectively address the existing obstacles to modifications, particularly the obstacles posed by private securitization.

The FDIC/IndyMac model compares the net present value of modifying the loan to foreclosing and losing money reselling the house. As long the modification provides a greater return than foreclosing, the loan can be modified. All loans are converted to fixed rate loans at the Freddie Mac Survey interest rate at the time of the modification, which is currently 6.2 percent. The model establishes a clear affordability target: a 38 percent debt-to-income ratio (DTI) for total housing payments for the IndyMac first mortgage (including mortgage principal, interest, taxes and insurance).

To reach the affordability target based on the income information they have (subject to income verification before being finalized), the model uses a three-step approach:

- Servicers first reduce interest rates for five years, potentially to as low as 3%, to meet the DTI target. Thereafter the rate rises by 1% per year until it reaches a market rate, which is defined as the Freddie Mac survey rate.
- If this rate reduction is not enough to reach the target DTI, the servicer would increase the loan term to a maximum of 40 years from date of origination.
- If the loan still isn't affordable, then a portion of principal would be deferred until the loan becomes due or pays off early, with no interest accruing. Monthly payments would be calculated on the lower balance, which would make the loan more affordable. Deferral, rather than forgiveness of principal, means that investors have the possibility of collecting on the full balance if housing prices recover.

FDIC has also introduced some important procedural changes to try to increase response rates. Where they have income information, they establish a pre-approved modification offer which they send to the borrower via certified mail. To accept, the borrower can return the offer in an enclosed pre-paid envelope, with a signature, a lower payment and current income verification documentation. Where FDIC does not have borrower income information, they have used mail, phone calls and payments to counselors to try to contact borrowers.

Although it is still in its early stages, the FDIC /IndyMac model appears to be increasing modifications substantially and reducing foreclosures on its existing portfolio. So far, there has been a 75 percent response rate where FDIC has income information about the borrower and approximately 5,000 loans have been modified.[23] FDIC officials remain optimistic that this approach can also increase modifications for its securitized loans as well.

The FDIC/IndyMac model has already served as a model for other servicers as a way to expand and streamline loss mitigation efforts. Three other entities have adopted similar approaches: the Bank of America settlement of State Attorneys General lawsuits against Countrywide for unfair and deceptive lending practices, and more recently, voluntary efforts announced by JP Morgan Chase/Washington Mutual and by Citigroup. The Bank of America settlement establishes a lower affordability target of 34% of total housing debt to income.

To use this model to increase loan modifications for securitized loans, Treasury needs to implement a new loan modification guarantee program under TARP for loans meeting stronger affordability targets to share the loss risk from re-defaults between the government and investors.

1. **TARP loan modification guarantee program could guarantee 3,000,000 loans for $50 billion.**

Treasury should implement the new loan modification guarantee program proposed by the FDIC and authorized under Section 109 of the EESA. This program would act as a strong financial incentive for servicers and investors to agree to modify loans to newly established affordability standards, modeled on the FDIC IndyMac modification program. Under such a program, servicers who modified loans to meet certain standards would share the losses that result from future re-defaults of these modified loans.

The appeal of the FDIC proposal is that it could be done on a widespread and streamlined basis and would substantially reduce foreclosures. It would result in sustainable and affordable home loans for families facing foreclosure, because it focuses on debt-to-income ratios and caps final interest rates at a pre-determined, prime rate (in contrast, some voluntary loan modification programs currently offer temporary modifications that subsequently lead borrowers to re-default). In addition, the FDIC model aligns incentives among investors and homeowners to the benefit of stabilizing home values: investors want to see modifications succeed because they share in future losses and the loan must perform for a minimum period before guarantee kicks in. Further, since the guarantee can cover the cost of a re-modification or disposition short of foreclosure, there are substantial incentives for servicers to forego foreclosure

Affordability Standards: Because federal resources would be insuring future performance risk, it would be important to establish strong affordability standards for the initial modifications. IndyMac is using a 38% housing DTI standard without any federal guarantee. However, with taxpayers funding guarantees, we believe that the initial affordability should be set at 31% of income for total housing costs. Experience with IndyMac and with other servicers demonstrates that a housing DTI at this level will be much more effective in reducing redefaults and therefore best protect taxpayer money.

Several additional standards should be required as well. First, the guarantee payments should not be available until the loan has a proven record of six months payments without delinquency after initial modification. Second, the guarantee should be limited to those loans where initial payments are reduced by at least ten percent to ensure that scarce federal guarantees are used only for loans that provide significant relief to borrowers and have a high likelihood of avoiding future re-defaults. Finally, the guarantees should remain in place for at least eight years, which covers the initial affordability period of five years plus the transition to the permanent rate.

Efficient Use of Taxpayer Resources: One of the most important aspects of this proposal is that the return on the government's investment would be substantial. $50 billion would enable this program to assist up to three million borrowers at risk of foreclosures. Structured as a guarantee program, federal costs would only be incurred when modified loans default. These losses would be shared equally with the investors. To arrive at this estimate, FDIC postulates an effort where the government works with servicers to modify and guarantee three million loans with average balances of $200,000. Assuming one-third of these loans re-defaulted and that total losses from these defaults represented 50 percent of the principal balance of the original $200,000, the total loss would be $100 billion in losses. Government would then bear only half of this total, or $50 billion. But the benefit would be keeping two million (hopefully more if the re-default assumptions are conservative) families in their homes and helping to stabilize the housing market. By using government funds as risk capital rather than liquidity, and leaving the loans within private securities, the government can leverage its funding 12 to 1 in loans modified ($50 billion becomes $600 billion of modified loans).

Permitting Loan Modifications Even When a Second Lien Exists. The best outcome for loans that have second liens – often with no value based on current market prices – is to have them paid off with very sharp discounts.[24] However, FDIC's IndyMac and model allows modifications to go forward even with second liens attached in the event that FDIC is unable to negotiate with the holders of the second mortgage to give up its lien interest, and the new loan guarantee program should also take this approach. Leaving the second liens in place is not optimal, but may be a necessary evil since 50% of subprime and Alt A loans currently have piggyback seconds, and these borrowers should not face certain foreclosure just because their out-of-the-money second mortgage investors refuse to release their interests. Many second mortgages will not foreclose, because after the house is sold in foreclosure and foreclosure expenses are taken into account, there would be no funds left to pay the second.

Incentive payments to servicers would increase number of loans modified. As a counterweight to the reality that most servicing contracts compensate servicers more for foreclosure than modification, the FDIC also recommends that Treasury pay servicers approximately $1,000 for each modification that meets the identified affordability standards. Just as Treasury pays investment advisors and other contractors under EESA to structure its equity investments or asset purchases, this program would pay the servicers who will do the work necessary to modify the mortgages under this program. This is an important component for the program.

2. The combination of modification guarantees and servicer incentives would address current obstacles to loan modifications for securitized loans.

The combination of modification guarantees and paying servicers for affordable modifications would address many of the existing obstacles to broader scale modifications.

- *Investor Concerns:* A government guarantee to share the costs of future re-defaults has significant implications for the basic decision about whether a modification generates better returns for investors than foreclosing. Servicers would accept the government guarantee when the net present value to investors is greater to modify under the program than to foreclose, and the guarantee against re-default is likely to tip the scales strongly toward modifying. When the net present value comparison results in this clear positive outcome, the fears about investor lawsuits would be substantially alleviated.

- *Second Liens:* As described above, permitting modifications even if second liens existed will maximize the number of loans that can be modified in a streamlined fashion. When the ban on judicial modifications is legislatively lifted, as is discussed in Section V below, the ability to settle or write-off second liens will be significantly improved.

- *Servicer Incentives:* Paying servicers directly for delivering affordable and sustainable modifications would address the servicer incentive problem. A direct payment should mitigate current incentives for them to opt for foreclosures rather than modifications.

- *Servicer Staffing and Technology:* Adopting a systematic approach based on the FDIC model simplifies and streamlines the work of servicers, limiting staff time per case. The modification analysis can be performed by a simple model and requires much less staff time or expertise than the current labor-intensive process, which requires subjective scrutiny of family debts and budgets. FDIC was able to implement its new approach to modifications within weeks of taking over IndyMac Bank.

B. Treasury and FHFA can prescribe more aggressive modifications for loans held or guaranteed by Fannie Mae and Freddie Mac.

On Tuesday, the GSEs announced a program to provide streamlined modifications for loans they own or that have been placed in Fannie Mae or Freddie Mac mortgage-backed securities that they guarantee. While we need to learn more details about the program, this announcement is an important step forward for conforming loans, which represent over half of all mortgages in the country.[25] Since the GSEs represent just 20% of current foreclosures, however, our other recommendations are still important to address the remainder, particularly subprime and Alt A loans that are held in private label securities.

While private companies, Fannie and Freddie hesitated to purchase a loan that they guaranteed out of securities in order to modify the loan because accounting standards required the GSEs to mark the loan down to its current market value.[26] This caused accounting losses that weakened the firms' publicly presented capital position. While it is understandable that a private company under financial stress would hesitate in this manner, accounting-only losses should not drive substantive policy, particularly when modifying loans will result in lower final losses, which are now backed directly by U.S. taxpayers. We therefore commend FHFA and the GSE's for no longer making the distinction between loans on their portfolio and securitized loans for modifications, as evidenced by Tuesday's announcement.

However, the current Fannie Mae and Freddie Mac guideline that borrowers must be in default before loss mitigation activities may commence, which Tuesday's announcement does not change, has served as an obstacle to modification. Such stipulations have prevented many servicers from initiating timely and cost-effective modifications for borrowers who are likely to default in the future, and create the perverse incentive of having borrowers miss payments and enter default to qualify for modifications.

C. TARP should require participating banks and thrifts to establish systematic loan modification programs for the loans held in their portfolios.

The remaining at-risk loans are held directly by banks and thrifts in their portfolios. There are fewer obstacles from banks modifying these loans than if they were sold, but some obstacles remain from having these loans modified to avoid foreclosures. Most notably, banks may be reluctant to modify such loans because such modifications will require marking down their balance sheets and weakening their capital positions, the same problem faced by Fannie and Freddie.

TARP's equity injection program provides a significant lever for requiring participating banks and thrifts to adopt a systematic loan modification program for their loans held in portfolio. Since the banks would just be recognizing losses they would soon bear anyway, and minimizing losses at that, Treasury should make receipt of equity from the TARP program contingent upon the adoption of a similar loan modification program. The fact that the government is providing equity that can absorb accounting losses should remove this objection. As noted above, JP Morgan Chase/Washington Mutual, Citigroup and Bank of America have announced programs along these lines, and their experience will be instructive.

D. TARP asset purchase strategies should focus strategically on increasing loan modifications.

The immediate priority for TARP to spur greater levels of loan modifications are the "three-bucket" framework I outlined above. There are supplemental approaches TARP might pursue should it proceed to implement a mortgage asset purchase strategy; if it does pursue such a course, it must maintain a clear focus on enhancing loan modifications. Several approaches could be carried out with existing authorities and several, as described below, would require legislative amendments to TARP:

1. Buy servicing rights.

Another way to break the modification logjam is for Treasury to purchase servicing rights where the PSAs provide the servicer with sufficient flexibility to modify. Servicing rights are very inexpensive, and should not cost more than about 1% of the outstanding balance; government funding could therefore be leveraged 100 to one to modify loans. Moreover, they are an eligible "troubled asset" under TARP. Once the government holds the servicing rights, it would be in a strong position—through a contract with a competent private subservicer—to aggressively modify loans within the limitations of the pooling and servicing agreements.

Having the government as servicer would provide a number of advantages over private servicers. First, given EESA's directive in Section 109 for the government to maximizing loan modifications, it would be highly motivated to modify loans when the net present value of modifying exceeds foreclosing. Second, it would be far more difficult for investors to challenge the federal government's use of the pooling and service agreement authority than if a private servicer did the modifications. Finally, government would have fewer financial constraints in paying for staff than highly strapped servicers to process modifications, if necessary.

One issue is that sometimes the net interest margin security (NIMS) insurer needs to agree to modifications beyond certain level, such as 5% of the loans. In these cases, the government might need to buy this insurance policy; while it would certainly be inexpensive, it would require taking on some limited liability for NIMS losses that would need to be calculated.

2. Purchase second mortgages to gain control of them so that they can be consolidated with the first mortgages and restructured.

As noted above, second mortgages are one of the greatest obstacles to modifications because a first mortgage holder will not generally voluntarily reduce interest or principal only to increase return for a second mortgage holder or cure its loan if the borrower is still in default on a second. Yet because most second liens are underwater, Treasury could purchase them very inexpensively, hopefully at not more than five cents on the dollar. If they could be purchased cheaply enough, this is an option worth investigating.

This program will be effective only in concert with a larger modification effort, however, so purchases should be concentrated on second mortgages where the owner of the first mortgage is known and a modification effort is already being made. In addition, it could establish a fund to purchase second mortgages that can then be accessed by servicers who run into the problem of a second mortgage when trying to modify a first mortgage whose owner is already known.

E. Treasury should set specific goals for sustainable modifications with detailed reporting to increase transparency.

I have pointed out a number of ways that servicers lack incentives to aggressively pursue meaningful loan modifications. Another disincentive is a lack of transparency and reporting requirements. Because loan servicers have no obligation to provide specific information on their servicing activities, it is difficult to monitor progress and assess servicing performance. For example, the data from HOPE NOW are aggregate data and not identified either by servicer or loan. This lack of data creates difficulty in ascertaining what is and is not working.

To improve analysis of modifications and to provide an incentive to servicers, Treasury should identify modification activity by individual servicer. Most helpful would be a database like that required by the Home Mortgage Disclosure Act (HMDA), with loan-level data made available to the public.

IV. Additional legislative actions should be taken to incent and facilitate more loan modifications.

A. Change rules governing trusts so that the government can purchase whole loans out of securities.

The biggest problem TARP faces with respect to loan modifications is that 80% of recent subprime and Alt-A loans were securitized, and if the government purchases securities, the government will own just a partial interest in the cash flow generated by loans, giving it no greater rights to modify loans than other owners scattered around the globe. If the government could buy whole loans, it would have the discretion to do modifications similar to what FDIC has done with IndyMac's portfolio or Fannie Mae and Freddie Mac just announced. However, trusts are designed to be passive entities and are not permitted to sell whole loans, even though they have some flexibility to modify the loans or accept a refinance for less than the principal balance.

Congress should pass legislation clarifying that participation in a government-sponsored whole loan purchase program would be permitted under Real Estate Mortgage Investment Conduit (REMIC) tax rules. Congress could further provide that continued REMIC status (and future tax benefits) is contingent on PSAs being modified to permit (but not require) participation in the loan sale process. Finally, Congress, the SEC or Financial Accounting Standards Board would need to ensure that accounting standards change to permit these sales. Clearly, having whole loans that servicers for whatever reason are unable to modify, that will cause needless foreclosures, and that Treasury cannot purchase even though it could restructure the loans to make them affordable to the borrowers and maximize the return to the government, is not socially optimal. There should be no objection to freeing servicers to modify or sell these assets at the direction of a Treasury program.[27]

Once Treasury purchased loans at a substantial discount and modified them to an affordable level, it could resecuritize the mortgages into pools guaranteed by the government. This guarantee would make the securities marketable and allow the government to revolve its funding into new purchases, increasing its impact.

B. Amend TARP to provide for meaningful protection for servicers when they modify loans.

One obstacle to servicers in modifying loans is that they fear lawsuits by investors harmed by their decision; any modification will favor some investors and disfavor others. TARP attempts to deal with this problem by making clear that servicers owe their duty to investors as a whole, not to any particular class of investors who may be harmed by a modification. However, TARP includes the exception "Except as established in any contract." Congress should delete this phrase in order to provide servicers greater comfort.

Alternatively, Congress could enact a narrowly tailored indemnification provision for servicers who act reasonably in modifying or selling any loan under the Treasury program. Either change should increase servicers' willingness to modify in the face of particular investor objections.

C. Ensure income tax burdens do not undermine sustainability of loan modifications.

Right now, when a servicer provides a homeowner with a loan modification containing a principal writedown (the type of writedown contemplated to occur under the new FHA Hope for Homeowners program) or, in certain circumstances, a significant interest rate reduction, the IRS considers the homeowner to have received taxable cancellation of indebtedness income unless the mortgage debt is "qualified" under the terms of the Mortgage Forgiveness Debt Relief Act of 2007 or the homeowner is insolvent. In many instances, especially where the difference between the original loan amount and the current value of the house is large, the prospect of tax liability could discourage homeowners from seeking a modification, or, if such a modification is obtained, the resulting tax liability could cause the homeowner to redefault on the loan. To prevent this perverse result, Congress should amend the Mortgage Forgiveness Debt Relief Act of 2007 in two ways: (1) lenders should not be required to file Form 1099 with the IRS when cancelling any mortgage-related debt; and (2) the definition of "qualified mortgage debt" should be extended to include all mortgage debt, not just acquisition debt.

V. **Congress should lift the ban on judicial loan modifications, which would prevent hundreds of thousands of foreclosures without costing the taxpayer at all.**

It is important also to provide a backstop to protect those homeowners whose lenders cannot or will not agree to voluntarily modify their loans, either through the TARP initiative or otherwise. The best and only solution in these cases – where the homeowner could sustain a market rate mortgage – is to lift the ban on judicial modifications, and allow a bankruptcy court to implement an economically rational solution that otherwise would be lost. This move that can immediately help stem the tide of foreclosures *at zero cost to the U.S. taxpayer.*[28]

Judicial modification of loans in bankruptcy court is available for owners of commercial real estate and yachts, as well as subprime lenders like New Century or investment banks like Lehman Bros., yet it is denied to families whose most important asset is the home they live in. In fact, current law makes a mortgage on a primary residence the only debt that bankruptcy courts are *not* permitted to modify in chapter 13 payment plans.

A small change to the bankruptcy code would provide judges the authority to modify mortgages and, we have estimated, help 600,000 homeowners – maybe more – keep their homes. Current proposals in Congress provide that modifications would narrowly target families who would otherwise lose their homes and exclude families who do not need assistance.[29] These proposals also limit the downside to lenders: interest rates must be set at commercially reasonable, market rates; the loan term may not exceed 40 years; and the principal balance may not be reduced below the value of the property.

This would also have the benefit of incentivizing servicers to participate in the TARP and other voluntary modification initiatives. To be clear, CRL does not want to see hundreds of thousands of homeowners actually file for bankruptcy. It is far preferable for most of these homeowners to receive a sustainable loan modification through a streamlined or individualized program. But if bankruptcy judges could make these modifications, it will help encourage additional voluntary modifications as everyone in the system would know the alternative.[30] Investors would have no reason to sue over a modification if the same or more costly modification could be made by a judge. Bankruptcy judges, who are extremely skilled at debt workouts, could help develop modification templates that could be used by servicers outside of the bankruptcy court context.[31] What's more, as Lewis Ranieri, founder of Hyperion Equity Funds and "the father of the securitized mortgage market," has recently noted, relief in bankruptcy court is the only effective way to break through the problem posed by second mortgages.[32]

VI. **Conclusion**

Today's financial crisis is a monument to destructive lending practices—bad lending that never before has been practiced on such a large scale, and with so little oversight. Unfortunately, the entire country is paying the price. There is no single solution to the challenges facing us today, but any effective policies must seek to maximize the number of families who stay in their homes. In particular, Treasury should ramp up its efforts to do FDIC-like streamlined modifications, Congress should explore additional tools to support modifications, and Congress should lift the ban on judicial restructuring of loans on primary residences.

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[1] Self-Help's lending record includes our secondary market program, which encourages other lenders to make sustainable loans to borrowers with blemished credit. Self-Help buys these loans from banks, holds on to the credit risk, and resells them to Fannie Mae. Self-Help's loan losses have been under 1% per year—and increased these families' wealth.

[2] MBA National Delinquency Survey, 2nd quarter 2008. The 5.5 million reported by survey, divided by 0.85 to scale up to market size (accounting for underreporting), multiplied by 0.047, the 2Q 2008 foreclosure start rate, multiplied by 4 to annualize. Another 1.2 million were delinquent but not in foreclosure, and another 492,000 were sitting in foreclosure from previous quarters' foreclosure starts.

3 On October 16, 2008, Eric Stein, senior vice president of the Center for Responsible Lending, testified before this committee regarding the causes of the crisis. While more details can be found in his testimony, it is clear that dangerous lending greatly inflated the housing bubble, and the resulting foreclosures of patently unsustainable mortgages are magnifying the damage of the bubble's collapse. http://www.responsiblelending.org/pdfs/senate-testimony-10-16-08-hearing-stein-final.pdf

[4] HOPE NOW is "an alliance between HUD approved counseling agents, servicers, investors and other mortgage market participants that provides free foreclosure prevention assistance." *See* http://www.hopenow.com.

[5] "Subprime Loan Foreclosures & Delinquencies versus Lender Workouts," Center for Responsible Lending (September 2008), at http://www.responsiblelending.org/issues/mortgage/quick-references/subprime-loan-foreclosures-delinquencies-versus-lender-workouts.html.

[6] *See* HOPE NOW Data for all periods, *available at* http://www.hopenow.com/upload/data/files/July%202008%20Industry%20Extrapolations.pdf.

[7] See, e.g., "Subprime Loan Foreclosures & Delinquencies versus Lender Workouts," at note 4; also, HOPE NOW Data, July 2008, *available at* http://www.hopenow.com/upload/data/files/July%202008%20Industry%20Extrapolations.pdf (reporting 197,000 foreclosure starts and 192,000 repayment plans initiated and modifications completed, combined in July 2008).

[8] Credit Suisse Fixed Income Research, *Subprime Loan Modifications Update*, October 1, 2008, p.2, *available at* http://www.credit-suisse.com/researchandanalytics.

[9] State Foreclosure Prevention Working Group, *Analysis of Subprime Servicing Performance*, Sept. 2008, at 2, *available at* http://www.mass.gov/Cago/docs/press/2008_09_29_foreclosure_report_attachment1.pdf.

[10] Id. at 6 .

[11] Id at 7-9.

[12] *HOPE NOW Loss Mitigation National Data July 07 to September 08*, p. 9 HOPE NOW Alliance (October 2008) *available at* http://www.hopenow.com/upload/data/files/HOPE%20NOW%20Loss%20Mitigation%20National%20Data%20July%2007%20to%20September%2008.pdf

[13] Credit Suisse, *Subprime Loan Modifications Update*, p.1.

[14] The Incentives of Mortgage Servicers: Myths and Realities, Larry Cordell, Karen Dynan, Andreas Lehnert, Nellie Liang and Eileen Mauskopf, Federal Reserve Staff Working Paper, Finance and Economics Discussion Series, 2008-46.

15 *See* Bajaj, Vikas and Meier, Barry, *Some Hedge Funds Argue Against Proposals to Modify Mortgages*, New York Times, October 23, 2008.

[16] *See* Credit Suisse, *The Day After Tomorrow: Payment Shock and Loan Modifications*, Apr. 5, 2007 (noting specific examples of PSAs with various modification restrictions, including 5% by balance, 5% by loan count, limits on frequency, and limits on interest rate).

[17] Credit Suisse, *Mortgage Liquidity du Jour: Underestimated No More*, March 12, 2007 at 5.

[18] Credit Suisse, *Subprime Loan Modifications Update*, Oct. 1, 2008, at p. 8.

[19] *See* Testimony of Eric Stein Center for Responsible Lending, Before the U.S. Senate Committee on Banking, Housing and Urban Affairs, October 16, 2008, at fn 30, *available at:* http://www.responsiblelending.org/pdfs/senate-testimony-10-16-08-hearing-stein-final.pdf .

[20] The Incentives of Mortgage Servicers: Myths and Realities, Larry Cordell, Karen Dynan, Andreas Lehnert, Nellie Liang and Eileen Mauskopf, Federal Reserve Staff Working Paper, Finance and Economics Discussion Series, 2008-46, at p. 15.

21 Id. at pp. 3, 9, 23.

[22] The preferred outcome for loans where property values have fallen and the house is worth less than the principal balance outstanding on the loan is to reduce principal to the current appraised value of the property, which provides the homeowner with the ability to accumulate equity through appreciation and the flexibility to sell their house and move if necessary. The FDIC and streamlined bank approaches defer rather than reduce principal.

[23] Christopher Palmieri, *IndyMac's Fast Track Mortgage Modification Program*, Business Week, October 8, 2008

[24] The FHA's new Hope for Homeowners program takes this approach, although it is too early to tell whether it is feasible on a large scale.

[25] For example, it's unclear how the "borrower hardship" requirement will be implemented, or what level interest rates will be permitted to rise to if they have been reduced for five years.

[26] AICPA Statement of Position 03-03, Accounting for Certain Loans or Debt Securities Acquired in a Transfer (SOP 03-3).

[27] See Center For American Progress, Issue Brief: Overcoming Legal Barriers to the Bulk Sale of At-Risk Mortgages, April 2008, available at http://www.americanprogress.org/issues/2008/04/reimc_brief.html.

[28] For a detailed discussion of judicial loan modifications, *see* Statement of Eric Stein, Center for Responsible Lending, U.S. Senate Judiciary Committee, Dec. 5, 2007, *available at* http://www.responsiblelending.org/pdfs/stein-statement-to-senate-judiciary-looming-foreclosure-crisis.pdf.

[29] Under current proposals, loan modifications would be available only where the homeowner's income is insufficient, after deducting for modest IRS-approved living expenses, to cover the mortgage payments. In addition, there is a good faith requirement that allows courts to exclude anyone who wrongly makes it through existing hurdles.

[30] The same phenomenon occurred when Chapter 12 was passed to modify loans on family farms in the late 1980s.

[31] See statement by J. Rich Leonard, US Bankruptcy Judge, Eastern District of North Carolina, at http://www.responsiblelending.org/pdfs/leonard-letter.pdf

[32] *Lewis Ranieri to deliver Dunlop Lecture on Oct. 1, Harvard University Gazette, Sept. 25, 2008,* available at http://www.news.harvard.edu/gazette/2008/09.25/06-dunlop.html; Ranieri, "Revolution in Mortgage Finance," the 9th annual John T. Dunlop Lecture at Harvard Graduate School of Design, Oct. 1, 2008, *available at*: http://www.jchs.harvard.edu/events/dunlop_lecture_ranieri_2008.mov (last visited Oct. 13, 2008).

Testimony of Barry L. Zubrow,
Executive Vice President and Chief Risk Officer,
JPMorgan Chase & Co.

Before the Senate Committee on Banking, Housing and Urban Affairs

"Oversight of the Emergency Economic Stabilization Act: Examining Financial Institution Use of Funding Under the Capital Purchase Program"

November 13, 2008

Chairman Dodd, Ranking Member Shelby and Members of the Committee on Banking, Housing and Urban Affairs, good morning. I am Barry Zubrow, Executive Vice President and Chief Risk Officer of JPMorgan Chase & Co. On behalf of the firm, I thank you for inviting us to participate in today's hearing on the use of funding received under the recently established Capital Purchase Program. We appreciate Congress' important oversight role, and the role of this Committee in particular, in connection with the United States Treasury's direct investments in financial institutions like those represented here today under the Emergency Economic Stabilization Act enacted by Congress just a few weeks ago.

JPMorgan Chase is a global financial services firm and one of the largest financial institutions in the United States, with approximately $2.3 trillion in assets. The firm is a leader in investment banking, financial services for consumers and businesses, financial transaction processing and asset management. Under the JPMorgan and Chase brands, the firm serves millions of customers in the U.S. and abroad, including individual consumers, small businesses, large corporations and state and local governments.

On October 28, 2008, the U. S. Treasury purchased 2.5 million shares of the firm's fixed rate cumulative perpetual preferred stock and a warrant to purchase up to 88.4 million shares of the firm's common stock for aggregate consideration of $25 billion. As this committee is well aware, the government's investments in financial institutions were conditioned on a number of restrictions on the firms' activities, including restrictions on the payment of dividends, repurchase of shares, and compensation of senior executives.

The $25 billion in capital we received under the Capital Purchase Program enhanced JPMorgan Chase's already strong capital position. All of our capital ratios were significantly in excess of the benchmarks established by the Federal Reserve for *well capitalized* bank holding companies, even before the Treasury's direct investment. Specifically, as of September 30, 2008, we had total capital of $159 billion and Tier 1 capital of $112 billion. Our total capital ratio was 12.6%, our Tier 1 capital ratio was 8.9% and our leverage ratio was 7.2%. Indeed, consistent with our continual emphasis on maintaining a "fortress balance sheet," during the first nine months of the year and prior to the Capital Purchase Program, we independently raised $21.9 billion in the public markets, had net income of $4.9 billion, and generated additional capital of $4.3 billion in connection with employee plans and the acquisition of Bear Stearns.

Although we did not seek the capital provided by the Capital Purchase Program, we believe the Program is well-conceived and support it. To be sure, the circumstances of each institution receiving capital are different. However, we recognize the importance of supporting the uniform application of this Program so as to promote stability and confidence in the financial markets.

The capital we have received through the Capital Purchase Program is being deployed in a manner consistent with the purposes of the Program, among other things, to expand the flow of credit to creditworthy U.S. consumers and businesses on competitive terms and to work diligently to modify the terms of residential mortgages to strengthen the U.S. housing market. At the same time, the decisions on capital usage must be consistent with prudent business practices and underwriting standards, appropriately mindful of market and credit risks and in the best interests of all of our shareholders in maintaining a strong and vibrant JPMorgan Chase.

What does this mean in practice?

Mortgage loan modifications

On October 31, we announced multiple new initiatives within our Chase home lending business designed to keep more families in their homes through a significantly expanded loan modification program. The program, part of our recently announced "The Way Forward" effort, is expected to help an additional 400,000 families – with $70 billion in loans – during the next two years. Since early 2007, Chase has helped about 250,000 families avoid foreclosure, primarily by modifying their loans or payments. Through the significant expansion of our loan modification program, we will also be reaching out to the customers of Washington Mutual and the EMC unit of Bear Stearns, which are now part of JPMorgan Chase.

With these proactive and systemic steps, we are redoubling our commitment to help homeowners stay in their homes. In total, we anticipate that these programs will allow 650,000 families to remain in their homes as we modify approximately $110 billion in mortgages.

How do we plan to do that? We will:

- Open 24 regional counseling centers to provide borrowers with face-to-face help in high delinquency areas;
- Hire 300 additional loan counselors (bringing our total to more than 2500) so that homeowners can work with the same counselor from start to finish;
- Proactively reach out to borrowers to offer pre-qualified modifications, such as interest rate reductions and principal forbearance;
- Expand the range of financing alternatives offered to enhance affordability, eliminate negative amortization and otherwise modify the pay-option ARMs that

we inherited as part of our acquisition of the mortgage portfolios of WaMu and EMC; and

- Commence a new process to provide an independent review of each loan before moving it to the foreclosure process.

We expect to fully implement these changes within 90 days. In the interim, we have stopped foreclosure proceedings on any additional loans on owner-occupied properties with mortgages owned by Chase or its affiliates. We have worked and will continue to work diligently with investors to get their approval to bring these enhancements to the loans we service on behalf of others. We want our efforts to have the broadest possible impact. We also plan to offer a substantial discount on or donate 500 homes to community groups or through non-profit or government programs designed to stabilize communities.

<u>Lending Activities</u>

Our core business is supporting our customers through our lending operations. We continue to provide credit to our customers, whether they are consumers, small businesses, large corporations, not-for-profit organizations or municipalities.
We are extending:

- billions of dollars in consumer loans, including home mortgages, home equity loans, student loans and auto loans;
- billions of dollars in credit card account lines and line expansions to assist millions of consumers;
- billions of dollars in new loans to middle-market corporate customers, state and local governments, and non-profit organizations, including hospitals; and
- billions of dollars in loans to large corporate clients.

Throughout the past year, during some of the most turbulent and difficult conditions many of us have ever witnessed, we have prided ourselves on continuing to be there for our clients – whether by making markets and committing capital to facilitate client business, investing in infrastructure and other projects, or making loans to creditworthy borrowers. In short, we have been open for and remain open to new business.

<u>Executive Compensation</u>

We take very seriously our responsibility to all of our shareholders to ensure that our compensation practices are appropriate for the complexity and scale of our business. Simply stated, we believe that compensation should be based on performance (measured over time) of our businesses. Performance of the firm, the business and the individual are all taken into consideration when making compensation decisions; our emphasis is on profits and risk-adjusted returns, rather than revenues, and we also consider other factors such as risk management, client satisfaction, support of the firm's values and the need to attract outstanding, diverse talent. Since almost two months remain in 2008, we are not in a position to provide specific information regarding 2008 compensation. But given the type of year we are currently experiencing, even though we have produced profitable results in each quarter to date, I have little doubt that employees and executives will make substantially less this year than they did in 2007. I also want to note that the funding received through the Capital Purchase Program will have absolutely no impact on the compensation decisions for JPMorgan Chase employees or executives.

We believe that compensation should not incentivize excessive risk-taking, and the more senior the executive, the more important it is that compensation be disciplined and not formulaic. Under the Capital Purchase Program I recognize my responsibility to work with the Board's Compensation & Management Development Committee to review the incentive compensation arrangements of our senior executive officers to ensure they do not encourage excessive risk taking.

Let me add a general note about our compensation practices; we tie compensation to long-term performance of the firm by providing a large percentage of compensation in equity awards that vest over multiple years. We also require senior executives to retain at least 75% of all equity awards that are granted to them.

JPMorgan Chase does not provide senior executives with employment contracts, change-in-control agreements or merger bonuses. There are no "golden parachutes," and top executives are subject to the same severance programs as other employees. In addition, even prior to the Capital Purchase Program, the firm had in place a bonus recoupment policy. We have supplemented this policy with the recoupment policy specified under the Capital Purchase Plan and have measures in place to ensure we are in full compliance with the Program's requirements.

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We are keenly aware of the responsibility undertaken by any firm in which the government invests taxpayer funds. We fully intend to honor that responsibility by promoting the goals of the Capital Purchase Program while also acting prudently and sensibly.

JP Morgan Chase will continue to operate in a manner consistent with safe and sound banking practices. We want to be there – we have a responsibility to be there – for the customers of tomorrow as well as for the customers of today. Many believe that irresponsible lending was one of the causes of the current distress in the financial markets. No one wants a repeat of those mistakes. Every day, we seek to strike the appropriate balance as we work to serve our customers through economically viable and appropriate lending activities while honoring the goal of the Capital Purchase Program to get the economy back on track by making capital available to American businesses and consumers.

John Pierpont Morgan once said that he wanted to do first class business in a first class way. That remains our goal and our commitment, to our customers, our shareholders, our employees and the taxpayers of this nation.

Testimony of Gregory K. Palm Esq.
Executive Vice President and General Counsel, The Goldman Sachs Group, Inc.
Before the Senate Committee on Banking, Housing and Urban Affairs
November 13, 2008

Chairman Dodd, Ranking Member Shelby, and Members of the Committee: My name is Greg Palm and I am the Executive Vice President and General Counsel of The Goldman Sachs Group, Inc. and a member of the firm's management committee.

I appreciate the invitation to appear before you today to provide information with respect to the mortgage market and loan servicing and both our role in the capital markets and our compensation philosophy in the context of the TARP Capital Purchase Program.

Clearly, the last several months have been an extraordinary and unsettling time in financial markets, and the economy generally. The actions taken by the Congress, regulators and the Administration to address the market dislocation have been significant and decisive. We also recognize that much remains to be done and hard and thoughtful work will be required by all of us. We look forward to working with all concerned parties to work our way through the current crisis and to identify and address the failings that have led to this difficult situation.

About Goldman Sachs

Goldman Sachs is a bank holding company whose principal businesses are investment banking, securities and investment management. We provide a wide range of services to a diverse and significant client base that includes corporations, institutions, governments and high net-worth individuals.

Our activities are divided into three general areas:

Our investment banking business provides strategic corporate services, matching the resources of the firm to specific client needs. This frequently means combining advisory, finance and co-investment capabilities. We help clients tap the equity and debt capital markets, restructure balance sheets, manage assets and liabilities and assess strategic options for M&A, divestitures, corporate defense activities and spin-offs. Through our merchant banking activities, we create and manage investment funds consisting of our own and third party money which invest in a variety of business and levels of the capital structure.

Our sales and trading business facilitates customer transactions for corporations, financial institutions, governments and individuals through market making and trading of fixed income, equities, currencies, commodities and derivatives on such products.

Our asset management and securities services businesses help public and private pension funds, corporations, non-profit organizations and individuals plan, manage and invest their financial assets. We also provide these entities as well as mutual funds and hedge funds with prime brokerage, securities lending and financing services.

The TARP Capital Purchase Program And Our Role in the Capital Markets

The Committee asked us to discuss our plans for the use of funds provided under the CPP. As I indicated at the outset, a number of Goldman Sachs' core businesses require the commitment of capital.

In investment banking, offering strategic advice remains at the center of what we do. But clients frequently expect our advice to be accompanied by access to the capital necessary to make that advice actionable and practical. In a variety of circumstances, we not only provide strategic advice but also a significant financing commitment – which may be critical to the feasibility of any plan.

This evolution in our business manifests itself in other ways as well. For example, we often provide back-stop or contingent credit, such as a commitment to make a bridge loan until other sources of more permanent capital can be arranged. In short, our value to clients depends not only on the quality of our advice, but on our willingness to draw on both our expertise and balance sheet to help finance transactions or support a company's strategic direction.

More specifically, in one of our platforms that extends credit through unfunded revolver commitments to clients of the firm, in 2008, we made over $2 billion in new loan commitments and refinanced more than $4.6 billion of previous commitments. Combined, through this avenue, we made underwriting decisions on nearly $7 billion of loan commitments to borrowers. A larger capital base will allow us to continue to provide capital to more of our corporate clients.

Goldman Sachs also plays a very significant role as a market maker. As you all know, market making is essential to the liquidity, efficiency and stability of financial markets. While this function is not new, the extent to which our clients look to us to execute transactions is.

Our securities sales and trading businesses include dozens of distinct areas from equities and fixed income to currencies and commodities—and each of these businesses has many sub-businesses around the world. They allow us to provide our investing and corporate clients with liquidity, capital, market access and knowledge as well as risk management expertise.

Our clients expect us to provide the necessary liquidity, as a market maker, to ensure that buyers and sellers can complete their trades. In doing so, sometimes we either opt, or are forced by market conditions, to hold positions in the near term, while a client's transaction, the underlying reason for the trade, is completed.

In dislocated markets, the role we play as a market maker on behalf of our clients can be challenging. Illiquid markets and the resulting lack of price discovery produce volatility. Having the ability to take the other side of a client's transaction and establish a price for an instrument contributes to the broad functioning of markets.

In recent months, this has been especially true as we have helped our corporate and investing clients manage their exposure to interest rate risk, swings in commodity prices and movements in currencies. The ability to help our clients effectively manage their risk requires capital.

With the $10 billion in capital received through the TARP Capital Purchase Program, Goldman Sachs, through our roles as an advisor, financier and market maker, has additional capacity to inject capital and liquidity, which will contribute to not only the stability of financial markets, but their vitality and growth.

In addition, we play an important role as a co-investor with our clients. Goldman Sachs has and will raise funds to inject capital across the corporate capital structure. These funds will extend needed capital to a variety of companies whose growth opportunities would otherwise be limited.

For example, earlier this year, we recently established a $10.5 billion senior loan fund that makes loans to companies in need of capital. The fund invests both our own capital and that of our clients. This is significant because the normal market mechanisms to facilitate the extension of credit in many areas have broken down. Investors are wary of credit ratings and are reluctant to invest their own money directly. They are looking for some assurance of quality before they are willing to commit capital. Through this fund, each dollar that Goldman Sachs commits is multiplied many times over as we attract capital from our clients. Already, the fund has made several billions in loan commitments to companies.

The strength of our track record and reputation attracts investment funds to us. Our willingness to make tough credit judgments and to commit our own capital has always been a hallmark of our firm.

In the next year, Goldman Sachs expects to launch additional funds and through our global franchise and reputation will deploy additional capital to various parts of the market.

More generally, we are in the business of identifying places where capital can be put to work to generate returns for our shareholders and to increase economic activity. The proceeds from the TARP Capital Purchase Program will be put to work consistent with our mandate to meet the advisory, financing and investing needs of our clients to fund innovation and growth.

Compensation Philosophy and the TARP Capital Purchase Program

You have asked us to discuss our compensation philosophy in the context of the executive compensation standards for financial institutions that participate in the TARP Capital Purchase Program ("CPP"), and how we align compensation with performance.

First, a perhaps obvious point – since the year is not yet finished, no financial compensation decisions have been made at Goldman Sachs. We are only now in the process of reviewing performance and making recommendations for year-end compensation for all our employees. In that connection, the Compensation Committee of the Board of Directors, which is comprised solely of independent directors, determines the appropriate compensation for Goldman Sachs' executive officers and that determination is approved by the independent members of our Board of Directors. (For a detailed explanation of the Fiscal 2007 compensation paid to our CEO, CFO and three most highly compensated NEOs, please see our March 7, 2008 shareholder proxy statement.) The Board Compensation Committee also approves the individual compensation of each of our Management Committee members, as well as the several hundred most senior employees of Goldman Sachs who constitute our "partner" group.

Second, we have complied and will comply with all executive compensation standards and restrictions imposed as a result of participation in the CPP. In that connection, the CPP

Executive Compensation requirements will be a focus at our Board Compensation Committee meeting next week.

Third, and most importantly, I want to make clear that the firm's bonuses for 2008 will be paid only out of the firm's earnings for 2008, not its capital. Employee compensation will be dramatically affected by changes in the overall economic and financial environment and our performance for the full year, but it certainly will not increase as a result of receiving TARP funds.

Since we became a public company, we have had a clear and consistent compensation policy. We pay our people based on three factors (1) the performance of the individual; (2) the performance of the business unit; and (3) the performance of the firm as a whole.[1]

We believe this approach has incentivized our people to act in a way that supports the firm as a whole and not be parochial or narrow minded about their specific division or business unit. More broadly, it has produced a strong relationship between compensation and performance, which I will detail shortly.

We do not set aside an actual bonus pool during the course of any fiscal year. Instead, we accrue on our balance sheet a line item for compensation-related expenses for each of the fiscal quarters. Through the first three quarters of fiscal 2008, the amount accrued has been 48% of net revenues for each quarter. This accrual reflects not just potential end of year payments, but also cash compensation paid during the year, expense amortization of prior years' equity-based awards, payroll taxes, healthcare and other benefits, as well as retirement plan and pension fund expenses.

Beginning in the fourth quarter, the firm uses a bottom-up approach to setting year-end compensation. No employee's total compensation is set by formula. As I indicated earlier, bonuses reflect, first, current year individual performance, which is assessed through a robust 360 degree feedback process that includes reference to compliance, teamwork, and corporate citizenship; second, firmwide performance; and, third, divisional operating results.

Compensation for each employee is comprised of salary and bonus. The bonus is paid in cash and/or an equity-based award, depending on the total compensation level of the employee. Generally, the percentage of the discretionary bonus awarded in the form of equity increases significantly as an employee's total compensation increases. In fiscal 2007, for example, the equity portion of our senior most executives compensation was 60%.

All of the equity rewards are subject to future delivery and/or deferred exercise. This aligns employees with the long-term interests of our shareholders. In that connection, I would also note that each of our CEO, CFO, COOs and Vice Chairmen are required to retain at least 75% of the equity they have received (less allowances for the payment of any option exercise price and taxes) as compensation since becoming a senior executive officer.

We believe our compensation policy, which is consistently and rigorously applied no matter how good or bad the market environment, has produced a strong record of aligning performance with compensation.

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[1] *A small number of employees, who are in our Private Wealth Management business, are paid on a commission basis.*

Since 2000, Goldman Sachs has exhibited a correlation between changes in net revenues and compensation of over 98%. Since going public through fiscal 2007, Goldman Sachs has produced a compounded annual growth rate of 21% in earnings per share, 20% in book value per share and 17% in net revenues. Adjusted for increased head count over the period, aggregate compensation expense has increased 10% per year.

All that said, while we are on track to deliver positive results for year-end 2008 despite remarkably challenging markets and events, net revenue for the year will be far lower than in recent years. As such, compensation also will be down very significantly this year across the firm, particularly at the senior levels.

Mortgage Servicing:

Goldman Sachs has never been a significant originator of residential mortgage loans. In March 2007, the firm acquired full ownership of a relatively small mortgage originator called Senderra, which had commenced operations in 2006. Since 2007, it has originated approximately 6,300 loans aggregating $1.2 billion. Senderra primarily originates loans that can be purchased by the GSEs and insured by the FHA. Through our principal bank we also have arranged, commencing in August 2007, the origination and purchase of approximately 350 mortgage loans.

A Goldman Sachs affiliate, Litton Loan Servicing, services residential mortgage loans. As of March 2008, Litton ranked 30th in terms of dollar amount of U.S. mortgage loans serviced. The firm acquired Litton a little less than a year ago. Litton services mortgage loans for loan owners, but it does not own the loans. As servicer, Litton has contractual duties to loan owners that it is obligated to fulfill.

As part of its work, Litton expends significant resources to identify homeowners who may be in danger of losing their homes and works with them on potential solutions, like loan modifications, that allow the homeowners to stay in their homes. Over time Litton has been able to demonstrate to loan owners that loan modifications very often produce lower losses than foreclosures.

Litton has a long track record in modifying loans. Even before the current crisis, Litton began to streamline its programs for modifying at-risk loans. This approach, for example, has allowed Litton in the last twelve months to modify in excess of 41,000 mortgage loans totaling approximately $7.5 billion in principal balance. This amount represents approximately 12% of Litton's total loan portfolio and more than 38% of its 60-plus days delinquent portfolio over the past 12 months. This is approximately a 400% increase in modifications over the previous year.

With these modifications, Litton has written down approximately $246 million in debt and waived approximately $17 million in fees for homeowners, resulting in an average monthly payment reduction of 10%-15%. These modifications changed the terms of the original loan and in most cases included one or more of the following: waiver of all or part of arrearages, forgiveness of fees and charges, principal reductions, decreases in interest rates and/or term extensions.

Litton has recently commenced efforts to inform our customers about the new Hope for Homeowners program. As a servicer of mortgages, Litton cannot offer homeowners a Hope for Homeowners loan, but it is actively building relationships with mortgage originators who can. As part of an on-going, collaborative dialogue, Litton, as well as other mortgage servicers, have agreed with Maryland, Minnesota and Ohio to take certain measures designed to avoid foreclosure and preserve homeownership . Litton has also established constructive relationships with housing counselors and local community groups to connect with homeowners to offer mortgage solutions.

Many homeowners are currently facing significant economic headwinds in the form of higher unemployment, wage compression, high debt load and other issues. Litton recognizes this and is committed to doing all that it can to identify "solutions" that both fulfill its duties to loan owners and help homeowners stay in their homes wherever possible.

Although modifications to existing mortgage terms are not a magic panacea that will cure all that ails the current housing market, we believe that thoughtful restructuring of existing arrangements to provide homeowners with payment relief is a positive step toward combating its decline.

Conclusion:

Mr. Chairman, we look forward to working with you and the Committee to accomplish the important tasks set out in the Emergency Economic Stabilization Act. Vibrant, liquid, capital markets are an important part of a strong economy, and are a necessary component to the stabilization of communities and greater economic opportunities for all. Thank you.

"Stabilizing the Housing Market"

Testimony prepared for

HEARING TITLED

"OVERSIGHT OF THE EMERGENCY ECONOMIC STABILIZATION ACT: EXAMINING FINANCIAL INSTITUTION USE OF FUNDING UNDER THE CAPITAL PURCHASE PROGRAM"

ON

NOVEMBER 13, 2008,

BEFORE

THE COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,

U.S. SENATE

WRITTEN TESTIMONY OF DR. SUSAN M. WACHTER
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The Wharton School, University of Pennsylvania, Philadelphia, Pennsylvania

I: Introduction

Chairman Dodd, Ranking Member Shelby, and other distinguished members of the Committee:

Thank you for the invitation to testify at today's hearing on "Oversight of the Emergency Economic Stabilization Act: Examining Financial Institution Use of Funding Under the Capital Purchase Program." It is my honor to be here today to provide my perspective on the ongoing mortgage crisis along with how and why stabilizing the housing market is essential to stabilizing the broader U.S. economy. In particular I will address how stabilizing the housing sector can promote growth in the broader economy and the importance of efforts to insure that loan modifications are available to borrowers facing foreclosure. My testimony is based on studies that I and others have authored on the causes and consequences of the credit crisis.

II: Deflating Housing Market Bubble

The ongoing crisis in our housing and financial markets derives from an expansion of credit through poorly underwritten and overly risky mortgage lending. Interest only loans, sub-prime loans, negative amortization loans, low or zero-equity loans, and teaser-rate adjustable rate mortgages (ARMs), all funded through secondary markets, became increasingly prevalent in the U.S. after 2003 and today account for over half of all foreclosures. Early in the 1990 decade, nonprime lending was insignificant; by 2006 non-prime lending constituted 47% of mortgage originations. The unprecedented expansion of poorly underwritten credit induced and supported a U.S. housing asset bubble beginning in 2003 of similarly unprecedented dimensions. Worldwide, low interest rates were associated with global house price inflation beginning in 2000. Nonetheless, since 2003, housing value increases in the U.S. departed from and exceeded those of our global peers due to a massive erosion of underwriting standards in the U.S. This weakening of lending standards, coupled with increased production, resulted in mortgages which were structured to fail, even in the absence of intent or fraud. However, fraudulent lending also did increase. Eventually, this process became unsustainable, price increases halted, and the poorly underwritten loans could not be rescued by high and ever increasing prices. This led to today's system breakdown.

The result, as we have seen, has been the massive failure of these loans. By the second half of this year delinquencies reached a postwar historic high of 6.41%, and 2 million foreclosures are expected within the next two years. Recent data released by the Mortgage Bankers Association reveals that in the second quarter of 2008, 6.3% of the adjustable rate mortgages extended to subprime borrowers started the foreclosure process, up 61 basis points from the first quarter of 2008. The 90 day delinquency rate for these mortgages was higher than 20%. For prime loans, the foreclosure inventory rate increased 20 basis points to 1.42%, and increased 107 basis points for subprime loans to 11.81%.

The economic downturn could become ever more severe due to the interaction of financial market stress with declines in house prices and a worsening economy all feeding back into an adverse loop; we have the potential for a true economic disaster. In particular, let us remind ourselves that that the problem came from housing. Even with the efforts to solve our banking liquidity problems, we will not solve the prevailing problem if the housing downturn continues and the housing market decline shows no sign of abating. Moreover, despite bank recapitalization and rescue efforts, economically rational loan modifications that would help stabilize the market are not occurring. We must directly address the need for economically rational loan modifications and the barriers to them in order to halt the downward spiral in mortgage markets and the economy.

III: Housing Market Overcorrection

It is critical to bring stability to the housing market. And while prices today may not be far from fundamental levels, just as they overinflated going up, housing prices appear to be in process of overcorrecting on the downside. Can we rely on market forces and the interventions to date to equilibrate housing markets? As prices decrease in a market downturn, the result is that supply declines, demand increases, and markets clear. However, in our current situation, as prices fall, market dynamics give rise to further expectations of price declines limiting demand and supply actually increases due to increased foreclosures. All of these factors cause prices to decline further. A deflationary environment with demand decreases due to expectations of further price decline was in part responsible for Japan's "lost decade" of the 1990s.

We cannot rely on a price decrease floor at currently market-justified fundamental levels if we rely on market forces alone, even if augmented by the aggressive interventions of the Federal Reserve and Treasury to date. In fact, 2008 home inventories are higher than last year. Even though new construction is now limited, foreclosed homes have come onto the market putting upward pressure on supply. In some markets where predatory lending was most prominent, up to half of the inventory of homes are being sold through foreclosures at fire sale prices increasing supply and weighing down prices. The Case-Shiller National House Price Index reflects this massive deterioration of housing wealth as well. Since their peak in 2006, housing values have fallen over 20% so far. While another 10% fall brings the index to 2003 levels, price declines may far exceed this decline, projected by the Federal Reserve Board and others, as the price decline itself undermines consumer confidence, decreases household wealth, and worsens the system wide financial stress.

While banks have been recapitalized through the Capital Purchase program there is discussion of the use this funding for acquisitions and as yet little evidence that bank lending has expanded. In order for the overall economy to recover and for conditions not to worsen, prudent lending to credit worthy borrowers needs to occur. Without financing for everyday needs, for education, small business investment and health, American families are at risk. And today the US economy and the global economy are depending on the stabilization of their financial well being.

Clearly markets fail. A number of plans have been put in place by the current administration to address the banking crisis. However, these plans do not appear to be leading to the modification of loans at the scale necessary in order to assure a market turnaround at fundamental levels instead of a severe overcorrection. Loan modifications, particularly for loans in private label securities that funded the credit for risky mortgages, which are most at need of modification, appear not to be occurring, even when economically rational. Barriers to this appear to include conflicting interests, poor incentives, and risks of litigation to modify loans deriving from mortgage servicing agreements. Voluntary efforts are not working. The rules of the game need to change. For example, economic incentives need to be put into place, perhaps through the TARP, so that banks will recognize losses now that will enable loan modifications to occur. There also need to be incentives for mortgage servicers to do it "right," including covering costs of modifications with a bounty for performing successful modifications.

Given the freefall in housing markets and its implications for credit conditions and the overall economy, there is a need for policy to address the role of the financial sector and the mortgage servicing industry role in limiting the tsunami of impending foreclosures.

It is both necessary and possible to take action now. While housing values may not be far from fundamental values today, following the deflation of the credit bubble, as housing values fall, resolving the problem becomes increasingly difficult and costly. Thus, solutions that are now possible may not be available going forward. Without expeditiously and directly addressing the housing market mortgage crisis, the nation is at risk.

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Testimony of

Anne Finucane

Global Marketing and Corporate Affairs Executive

Bank of America

Before the

Senate Committee on Banking, Housing and Urban Affairs

The United States Senate

Washington, DC

November 13, 2008

Chairman Dodd, Ranking Member Shelby and members of the Committee, my name is Anne Finucane and I am here today to discuss the Emergency Economic Stabilization Act and Bank of America's participation in the Treasury Department's Capital Purchase Program. We appreciate your concerns over the use of the TARP investment, and we share your desire to ensure that the funds are deployed to strengthen the economy in these difficult times.

Let me begin by providing you some facts about Bank of America's financial condition and the cash investment we received from the Department of Treasury and the preferred stock we issued for that investment. I will then turn to the question of how this investment has affected our operations, in particular lending and compensation.

Performance

Let me start with performance. Our net income was $5.80 billion through the first three quarters of 2008, making us one of the most profitable financial services companies in the world. We earned $1.18 billion in the most recent quarter. While this year has offered significant challenges, Bank of America has served as a source of stability to the financial system.

Bank of America has used its strong financial condition to act constructively in the current financial crisis.

- In the third quarter, Bank of America completed the acquisition of Countrywide Financial Corporation, an acquisition encouraged by the federal government but consummated without any taxpayer support. We are also working hard to help customers who may be in trouble. We have developed important programs that are projected to modify over $100 billion in loans; enough, over three years, to help keep up to 630,000 borrowers in their homes.

- On September 15, 2008, Bank of America announced its acquisition of Merrill Lynch, an acquisition also encouraged by the federal government but executed without the promise or expectation of any taxpayer assistance.

The Treasury Investment

On October 13th, the Treasury Department convened a meeting with nine banks and presented them with the terms for investment by the Treasury Department in these institutions through its Capital Purchase Program. Bank of America did not need such an investment, and did not seek such an investment. In fact, Bank of America had raised $10 billion by issuing common stock to investors one week before being informed that the Treasury would be investing in the company. The Treasury insisted upon universal acceptance of its investments to prevent the market from viewing acceptance of the investment as a sign of weakness. Bank of America agreed to the investment to support a broader effort to resolve the financial crisis, and we are comfortable with that decision.

Pursuant to the agreement negotiated with Treasury, on October 28th Bank of America Corporation received $15 billion from the Treasury Department in exchange for 600,000 shares of Fixed Rate Cumulative Perpetual Preferred Stock, on which Bank of America will pay dividends of 5% per year for the first five years and 9% per year thereafter. Bank of America also issued a warrant to purchase 73,075,674 shares of common stock at $30.79 per share with a 10-year term. The government will have the option to buy common stock through this warrant up to 15% of the value of its investment after five years. We fully expect that this investment will be a profitable one for the Treasury, and ultimately for the taxpayers.

Effect on Treasury Investment on Compensation and Lending Practices

Let me now discuss our lending and compensation practices, and how they have been affected or unaffected by the Treasury's preferred stock investment.

Lending

Policymakers have expressed concern that consumer credit is drying up, and that reduced access to credit will dampen consumer spending and exacerbate the current recession. These are significant concerns, and we share them. Others have gone further, however, to suggest that banks that received an investment from the Treasury Department should be encouraged – or even required – to lend the full amount of that investment. Here, the reality is far more complicated.

Banks receiving an investment from Treasury are prohibited from returning those funds -- and any other funds, including earnings -- to shareholders through increased dividends or share repurchases; as I will describe in a moment, Bank of America (and I assume other banks) will not be distributing that money to employees through excess compensation. Thus, banks are left with two basic choices.

First, they can hold the preferred stock as capital, making them more safe and sound and better insulated against loss. The financial regulators have urged all institutions that they oversee to improve their Tier 1 capital positions, either by raising capital or shrinking their balance sheets (that is, for a commercial bank, lending less). Through private sector capital raising, the Treasury investment, and diligence in reducing under-earning assets, we have over the past few months improved our Tier 1 capital ratio from 7.5% to more than 9% -- prudently above the regulatory minimum for being considered well capitalized.

Second, banks can deploy Treasury funds by lending or engaging in other capital-intensive forms of credit intermediation. As with any other bank, Bank of America has every incentive to do so, as lending is our core business and a crucial component of our business. Thus, our shareholders' interests are clearly and closely aligned with those of policymakers.

In other words, we are open for business.

Business lending remains strong and we have continued making loans to states and municipalities in a time of extraordinary uncertainty. We have lived up to our commitments to fund capital markets transactions. We have put our capital at risk both to earn returns for our shareholders and to help stabilize the financial system.

Most importantly, in our consumer business, we originated more than $50 billion in mortgage loans in the third quarter of 2008, as well as more than $7 billion in home equity loans. In just the three months since the merger with Countrywide was finalized, we have helped more than 250,000 Americans purchase a home or save money on the home they already own.

We also have been purchasing significant amounts of mortgage-backed securities in the market. This activity is providing liquidity to the market, and ultimately helping to assist the mortgage market.

That said, we are lending less than we were a year ago. Consumer demand for lending has decreased, as consumers are de-leveraging. And one clear lesson from the recent mortgage crisis is that neither consumers nor banks benefit when banks ignore or misjudge risk and make loans that consumers are unable to repay. Indeed, doing so is an unsafe and unsound banking practice, rightfully discouraged by banking regulators. In the current recession, we have seen delinquency and default rates on credit card and other types of unsecured consumer lending rise significantly. The same is true in small business lending. And mortgage lending obviously is very challenging. This economic reality requires that we continue to underwrite to ensure that we are lending only to those who can afford it, at rates that compensate us for higher risk of default.

Keeping People in their Homes

Finally, in addition to new lending, I should also note that Bank of America is taking major, industry-leading steps to work out troubled loans and keep people in their homes. As I noted at the outset, we have developed important programs for customers in trouble that are projected to modify over $100 billion in loans -- enough, over three years, to help keep up to 630,000 borrowers in their homes.

The latest program, announced on October 6th, was developed together with several State Attorneys General and is designed to achieve affordable and sustainable mortgage payments for borrowers who financed their homes with subprime loans or pay option adjustable rate mortgages serviced by Countrywide. Foreclosure sales will not be initiated or advanced for borrowers likely to qualify until Bank of America has made a decision on the borrower's eligibility.

The centerpiece of the program is a proactive loan modification process to provide relief to eligible borrowers who are seriously delinquent or are likely to become seriously delinquent as a result of loan features, such as rate resets or payment recasts. In some instances, innovative new approaches will be employed to include automatic streamlined loan modifications across certain classes of borrowers. The program utilizes an affordability equation to qualify borrowers for loan modifications at a targeted first year mortgage debt to income ratio of 34%.

We expect this new program to provide up to $8.4 billion in additional interest rate and principal reductions for up to 400,000 Countrywide Financial Corporation customers nationwide (if all eligible borrowers choose to participate).

While this new program promises significant benefits for homeowners, I should stress that Bank of America has already taken significant steps in this area. *Right now*, we have over 5,600 home retention staff working with borrowers. In the first ten months of 2008, the Home Retention Division completed over 214,000 retention workouts, a 214% increase over the first 10 months of 2007. We are working out two troubled loans for every one on which we foreclose.

Compensation

Let me say a few words about compensation at Bank of America. It is a story of which we are proud.

The Directors' Compensation and Benefits Committee is responsible for setting the compensation of the senior leadership of the Bank. The Compensation Committee has established a pay-for-performance mandate, resulting in a compensation program that (i) aligns our executive officers' interests with those of our stockholders, (ii) provides pay that varies depending on performance; and (iii) can be easily understood by our stockholders.

Some have asked whether money from the Treasury investment will be used to pay compensation to employees. It will not. First, Bank of America has sufficient earnings to pay its employees without government support. Second, the amount of that compensation will not rise (or fall) as a result of that investment.

Not only can Bank of America therefore afford to pay compensation without government assistance, the Treasury's investment will not affect the compensation paid. Our compensation process looks to the results of the company – that is, the income statement, not the balance sheet – in determining compensation.

Employee compensation for 2008 will be determined in the same way it would have been in the absence of the Treasury's investment: based on the performance of the individual employee, the employee's business unit, and the company as a whole.

Let me illustrate how this works at Bank of America. Net income in 2007 was significantly below plan at Bank of America. As a result, total compensation for performance year 2007 for our executive officers was down approximately 30% to 50% compared to performance year 2006.

Compensation for 2008, including bonuses for executive officers, has not been finalized yet, as fourth quarter results need to be considered. You can rest assured, however, that the presence or absence of a preferred stock investment will not affect the incentive compensation our executives and employees receive.

If our financial results for 2008 are below the results for 2007, it is reasonable to conclude that our incentive awards will be less for 2008 than for 2007, consistent with our pay-for-performance principles.

Conclusion

I appreciate the opportunity to appear before the Committee, and welcome any questions you might have.

Bank of America

October 6, 2008

Bank of America Announces Nationwide Homeownership Retention Program for Countrywide Customers

Nearly 400,000 Countrywide Borrowers Could Benefit After Program Launches December 1

CALABASAS, Calif., Oct. 6 /PRNewswire/ -- Bank of America today announced the creation of a proactive home retention program that will systematically modify troubled mortgages with up to $8.4 billion in interest rate and principal reductions for nearly 400,000 Countrywide Financial Corporation customers nationwide.

The program was developed together with state Attorneys General and is designed to achieve affordable and sustainable mortgage payments for borrowers who financed their homes with subprime loans or pay option adjustable rate mortgages serviced by Countrywide and originated prior to December 31, 2007. Bank of America acquired Countrywide July 1, 2008.

"We are confident that together with the Attorneys General we have developed a comprehensive program that provides more solutions than ever before to assist troubled borrowers and put them back on the path to sustained home ownership," said Barbara Desoer, president, Bank of America Mortgage, Home Equity and Insurance Services. "Since acquiring Countrywide in July, we have committed significant resources and developed innovative programs to help as many Countrywide customers as possible stay in their homes."

Countrywide mortgage servicing personnel will be equipped to serve eligible borrowers with new program elements by December 1, 2008 and will then begin proactive outreach to eligible customers. Foreclosure sales will not be initiated or advanced for borrowers likely to qualify until Countrywide has made an affirmative decision on the borrower's eligibility.

The centerpiece of the program is a proactive loan modification process to provide relief to eligible borrowers who are seriously delinquent or are likely to become seriously delinquent as a result of loan features, such as rate resets or payment recasts.

Various options will be considered for eligible customers to ensure modifications are affordable and sustainable. First-year payments of principal, interest, taxes and insurance will be targeted to equate to 34 percent of the borrower's income. Modified loans feature limited step-rate interest rate adjustments to ensure annual principal and interest payments increase at levels with minimal risk of payment shock and redefault. Modification options include, among others:

-- FHA refinancing under the HOPE for Homeowners Program;

-- Interest rate reductions, which may be granted automatically through streamlined processing; and

-- Principal reductions on Pay Option adjustable rate mortgages that restore lost equity for certain borrowers.

The program applies to eligible mortgage loan customers serviced by Countrywide and who occupy the home as their primary residence. Under the national program, Countrywide will not charge eligible borrowers loan modification fees, and Countrywide will waive prepayment penalties for subprime and pay option ARM loans that it or its affiliates own. Some loan modifications will be subject to compliance with servicing contracts and some will require investor approval.

"Now more than ever homeowners and home buyers are looking to Bank of America as the lender they trust and as a leader that can renew America's confidence in home ownership," said Desoer. "Combined with our strong track record in responsible lending and previously announced lending practices commitments, this bold new program makes it clear that Bank of America is committed to be the leader in responsible mortgage lending practices."

As part of agreements to resolve outstanding claims against Countrywide by certain states, borrowers in participating states will additionally be eligible to access their share of:

-- A Foreclosure Relief Program of $150 million on a nationwide basis for payment to eligible Countrywide servicing customers who suffered foreclosure or are currently at serious risk of foreclosure having made only minimal payments since the time their mortgages were originated by Countrywide; and

--An additional program, projected to make payments up to $70 million to support customers with loans serviced by Countrywide who face imminent foreclosure, providing financial assistance with their transition from home ownership.

As part of the state agreements, Countrywide is further committing to eligible borrowers in participating states, it will waive late fees associated with a borrower's default in finalizing modifications under the program.

In addition, states that have not yet become participants in this program will be provided an opportunity to do so, which would enable their residents who are eligible Countrywide borrowers to become eligible for these benefits.

"Our program represents principal and interest reductions over time to borrowers on loans Countrywide owns and on loans Countrywide services on behalf of investors," said Joe Price, Bank of America Chief Financial

Officer. "By taking projected foreclosure losses and instead directing those funds into these proactive foreclosure prevention efforts, we create a solution in the best interests of both our customers and the investors whose loans and securities we service. Of the eligible loans, about 12 percent are now held by Bank of America. The cost of restructuring these loans is within the range of losses we estimated when we acquired Countrywide."

Bank of America is one of the world's largest financial institutions, serving individual consumers, small and middle market businesses and large corporations with a full range of banking, investing, asset management and other financial and risk-management products and services. The company provides unmatched convenience in the United States, serving more than 59 million consumer and small business relationships with more than 6,100 retail banking offices, more than 18,500 ATMs and award-winning online banking with more than 25 million active users. Bank of America offers industry leading support to more than 4 million small business owners through a suite of innovative, easy-to-use online products and services. The company serves clients in more than 150 countries and has relationships with 99 percent of the U.S. Fortune 500 companies and 83 percent of the Fortune Global 500. Bank of America Corporation stock (NYSE: BAC) is a component of the Dow Jones Industrial Average and is listed on the New York Stock Exchange.

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Testimony of

Jon Campbell
Regional Banking President
Wells Fargo & Company

Before the

Senate Banking Committee
United States Senate

November 13, 2008

Mr. Chairman and Members of the Committee, I am Jon Campbell, Executive Vice President of Wells Fargo's Regional Banking. Thank you for allowing me to comment on Wells Fargo's participation in the Capital Purchase Program (CPP).

Wells Fargo believes that our financial system is more important than any one individual company. We believe the Capital Purchase Program is a positive step toward stimulating the United States' economy. It is Wells Fargo's intention to use the CPP funds for additional lending and to facilitate appropriate home mortgage solutions.

Wells Fargo continues to be one of the strongest and best capitalized banks in the world. The investment from the United States Government adds to our already strong balance sheet and will enable Wells Fargo to offer appropriately priced credit at a time when several sectors of the financial industry have shut down.

Since mid-September when capital markets froze, Wells Fargo has led the industry in lending to existing and new creditworthy customers. During this time nonprofit organizations, hospitals, universities, municipalities, small businesses, farmers and many others had no where to turn when their existing capital market channels vanished. We were there to provide credit so they could continue to offer the services that our communities depend on.

We are able to lend through these difficult times because of our emphasis on prudent and sound lending which includes understanding what our customers do and what their financing needs are. As demonstrated over the past several years, we are willing to give up market share if a product is not in the best interest of our customers. And simply put, those companies who didn't put the customer at the center of every decision are no longer here today.

We intend to expand lending in all of our markets. As demand warrants, we will have more than adequate capital to lend to creditworthy customers in an appropriate manner, and as required, will pay back the CPP investment with interest.

Wells Fargo remains a strong lender in areas such as small business and agriculture. By volume, we are the number one commercial real estate lender. In fact, we grew commercial real estate loans 37 percent year to date in 2008. And, our middle market commercial loans – made to Fortune 1500 sized companies across the country – are up 24 percent since this time last year.

The Committee has asked whether CPP funds would be spent on executive compensation. The answer is no. Wells Fargo doesn't need the government investment to pay for bonuses or compensation.

Wells Fargo's policy is to reward employees through recognition and pay based on their performance in providing superior service to our customers. That policy applies to every single employee, starting with our Chairman and our CEO. For example, the disclosures in our 2008 proxy statement show that the bonuses for all Wells Fargo named executive officers were reduced based on 2007 performance.

Mr. Chairman, since the middle of 2007 when you convened your Housing Summit, Wells Fargo has implemented the principles you laid out by working with borrowers at each step of the mortgage crisis. With the changes in our economy and continuing declines in property values across many parts of the country, even more people need our help.

As a number of new foreclosure relief programs require capital to implement, the availability of CPP funds will make it easier to successfully reach delinquent homeowners. This capital leveraged with the announcement this week of a streamlined large scale loan modification process that applies to loans serviced for Fannie Mae and Freddie Mac, will enable Wells Fargo to utilize a variety of programs quickly and also institutionalize an approach that servicers can rely on going forward.

The strength of our franchise, earnings and balance sheet positions us well to continue lending across all sectors and satisfying all of our customers' financial needs, which is in the spirit of the Capital Purchase Program.

Mr. Chairman and Members of the Committee, thank you and I would be pleased to answer questions.

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STATEMENT OF
NANCY ZIRKIN, EXECUTIVE VICE PRESIDENT
LEADERSHIP CONFERENCE ON CIVIL RIGHTS

"OVERSIGHT OF THE EMERGENCY ECONOMIC STABILIZATION ACT:
EXAMINING FINANCIAL INSTITUTION USE OF FUNDING
UNDER THE CAPITAL PURCHASE PROGRAM"

COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS
UNITED STATES SENATE

NOVEMBER 13, 2008

Chairman Dodd, Ranking Member Shelby, and members of the Committee: I am Nancy Zirkin, Executive Vice President of the Leadership Conference on Civil Rights (LCCR). Thank you for giving me an opportunity to testify in today's hearing on the implementation of the Emergency Economic Stabilization Act of 2008 ("EESA").[1]

LCCR is the nation's oldest and most diverse coalition of civil and human rights organizations. Founded in 1950 by Arnold Aronson, A. Philip Randolph, and Roy Wilkins, LCCR seeks to further the goal of equality under law through legislative advocacy and public education. LCCR consists of approximately 200 national organizations representing persons of color, women, children, organized labor, persons with disabilities, older Americans, LGBT Americans, and major religious groups. I am privileged to represent the civil and human rights community in submitting testimony for the record to the Committee.

I would like to start with a quick overview of why the staggering number of foreclosures nationwide, which ultimately led to the enactment of EESA, is of such critical importance to LCCR and the communities we represent. Simply put, expanding and preserving the right to the American Dream of homeownership has always been one of the key goals of the civil rights movement. It is vital because homeownership is the means by which most Americans build wealth and improve their own lives and the lives of their families, and homeownership is essential to the development of stable, healthy communities that make all Americans proud. For decades, the civil rights community has struggled to break down the barriers to fair housing itself, as well as the barriers to the credit that most Americans need to obtain housing. The resistance that racial and ethnic minority communities have faced in obtaining fair and sustainable mortgage loans, from the practice of redlining to the scourge of predatory lending, lies very much at the root of the crisis in which we now find ourselves today.

For years, civil rights and consumer protection groups argued that the modern system of mortgage lending was profoundly flawed, that countless numbers of irresponsible and abusive

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[1] Pub. L. 110-343.

loans were being made, and that without swift regulatory action, the consequences for both individual homeowners and the economy at large would be drastic.

Well before the foreclosure crisis erupted into the public eye and began to dominate news headlines throughout the country, LCCR and other groups pleaded with Congress, the Administration, and the financial services industry to quickly take sweeping measures to keep borrowers in their homes. After months of denial by many, I think it is now obvious to all that the mortgage crisis is anything but "contained" and that it merits aggressive action. To date, however – and despite the best efforts of you, Mr. Chairman, and many of your colleagues – the collective response, based on purely voluntary industry-led efforts, has done little to turn the tide.

While estimates of potential home foreclosure rates have varied widely as our economy continues to weaken, one thing remains fairly certain: they will be staggering. The ongoing wave of foreclosures will have an especially harsh impact on racial and ethnic minority homeowners who, according to several studies, were roughly two to three times more likely to be steered into high-cost loans than white borrowers – with strong disparities persisting even after credit factors were taken into account.[2] As such, LCCR and its member organizations have a tremendous stake in policies that will mitigate this crisis. I would like to focus my testimony today on two policies in particular.

<u>The Continuing Need for "Mandatory" Foreclosure Relief</u>

While there are encouraging signs of progress in industry-led foreclosure prevention efforts, particularly the FDIC proposal that I will discuss below, LCCR strongly believes that the best way to promptly reduce foreclosures is to give homeowners the chance to have their loans modified in Chapter 13 bankruptcy proceedings. To this end, and while I recognize that this particular bill lies outside of the jurisdiction of your committee, LCCR has strongly urged Congress since last fall to enact S. 2136, the "Helping Families Save Their Homes in Bankruptcy Act of 2007." S. 2136 would give desperate homeowners badly-needed leverage to negotiate with loan servicers and therefore be able to obtain a voluntary modification outside of bankruptcy, and it would provide them with an important last resort when servicers are unwilling or unable to provide lasting, sustainable alternatives to foreclosure.

While Chapter 13 bankruptcy is obviously a drastic step, we believe, for several reasons, that there are several key advantages to making it available. One key benefit – especially as we face an economic slowdown of still-unknown proportions – is its cost. Because loan modifications in bankruptcy court do not involve the use of public funds, S. 2136 does not amount to a controversial "bailout" or raise moral hazard issues. Indeed, for people who wish to turn to

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[2] *See, e.g.* Debbie Gruenstein Bocian, Keith S. Ernst, and Wei Li, *Unfair Lending: The Effect of Race and Ethnicity on the Price of Subprime Mortgages*, at 19 (available at http://www.responsiblelending.org/pdfs/rr011-Unfair_Lending-0506.pdf), May 2006; National Community Reinvestment Coalition, *Income is No Shield Against Racial Differences in Lending: A Comparison of High-Cost Lending in America's Metropolitan Areas* (available at http://ncrc.org/pressandpubs/documents/NCRC%20metro%20study%20race%20and%20income%20disparity%20July%2007.pdf), July 10, 2007; Rich Brooks and Ruth Simon, "Subprime Debacle Traps Even Very Credit-Worthy," *Wall Street Journal*, December 3, 2007 at A1.

bankruptcy court to save their homes, it comes with serious enough consequences – monetary and otherwise – to encourage wiser financial decisions in the future.

At the same time, S. 2136 would greatly benefit other homeowners and our economy at large. As you know, every home that gets saved from foreclosure – or from abandonment by borrowers who anticipate foreclosure after borrower-servicer negotiations fail – helps to protect the value of surrounding homes from being eroded. This means that neighboring homeowners become less likely to find themselves "upside down" on their own mortgages – a vicious cycle that, if left unchecked, can lead to even more foreclosures.

We recognize that S. 2136 has faced very strong opposition from the financial services industry – a rather ironic stance, given the number of lenders that have themselves sought bankruptcy protection in the past several years. In particular, opponents argue that making Chapter 13 bankruptcy relief available for home loans would make investors hesitant to provide liquidity to the marketplace, thereby limiting "access to credit" for underserved populations such as the ones that LCCR represents.

Appeals to the need to preserve "access to credit" have long been popular within the financial services industry, particularly in opposition to the sensible regulation of credit and lending practices. On the surface, such arguments do sound compelling, given our nation's long and unfortunate history of racial and ethnic discrimination in credit markets. Yet if the mere prospect of bankruptcy relief should somehow curtail "access" to the kinds of reckless and predatory "credit" that has routinely been extended to minority communities in recent years, rest assured that you will not hear any complaints from us.

Instead of saddling borrowers with higher costs or refusing to provide them with credit altogether, out of concern that troubled loans might be eventually modified in bankruptcy proceedings, perhaps lenders could simply be more careful. For example, they could:

- Carefully verify that borrowers have enough income to repay mortgages on a long term basis;
- Eliminate yield-spread premiums, which encourage brokers to steer borrowers into more expensive loans than their credit records would warrant;
- Eliminate prepayment penalties, which make it harder for borrowers to refinance into loans that might save their homes;
- Closely scrutinize home appraisals before approving loans; and
- Escrow necessary expenses such as taxes and insurance.

As one prominent mortgage industry blogger has pointed out, the prospect of Chapter 13 relief for home mortgage loans served quite well as a "brake on lender stupidity"[3] before it was eliminated by the Supreme Court in 1993. Given the widespread abandonment of the above types of common-sense, responsible lending practices in recent years, such a brake might have been enormously helpful.

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[3] Tanta, "Just Say Yes to Cram Downs," *Calculated Risk*, Oct. 7, 2007, available at http://calculatedrisk.blogspot.com/2007/10/just-say-yes-to-cram-downs.html.

There are other steps that can also level the playing field between borrowers and loan servicers. For example, while many loan servicers do make good faith efforts to engage in loss mitigation, it would be helpful if Congress imposed an affirmative duty for all servicers to do so. Given the trouble that many borrowers have in simply communicating with servicers, we would also support requiring servicers to respond to information requests from homeowners in a timely manner, and also requiring them to provide better information about just what types of mitigation efforts are actually taking place.[4]

Mr. Chairman, we have been encouraged to learn that since your last oversight hearing on EESA in late October, several of the nation's largest banks and the GSEs have announced plans to aggressively ramp up their loan modification programs. The plans appear to be very similar to the Federal Deposit Insurance Corporation's (FDIC) ongoing program to modify loans held by IndyMac Federal Bank.

We applaud any and all voluntary industry efforts to stave off foreclosures. Every home that is saved from foreclosure is a step in the right direction. To date, however, and despite the best efforts of many lenders and loan servicers, industry-led loss mitigation efforts have not provided enough struggling borrowers with affordable, sustainable alternatives to foreclosure.

This is due, to a great extent, to the extremely complicated nature of modern lending practices. In particular, the majority of troubled mortgage loans in recent years have been sold into highly-complex securities, which have themselves been carved up and sold to thousands of investors around the world. In such cases, voluntary modifications usually cannot take place unless the pieces of these securities can be reassembled into individual, whole loans. Loan servicers often have insufficient authority, on their own, to substantially modify loans on behalf of investors. In addition, many borrowers have "piggyback" loans or second mortgages, which create inherent conflicts with primary mortgage holders that also prevent meaningful loan modifications.

We hope that the industry will continue finding ways to get around such obstacles. But until voluntary industry-led efforts result in long-lasting modifications on a very widespread scale, we believe they cannot in any way be a substitute for meaningful, broad-based legislative remedies that provide homeowners with the tools to protect themselves from preventable foreclosure. The stakes for our communities and our economy are simply too high.

The FDIC Plan

While I am disappointed that efforts to open up Chapter 13 relief to homeowners have been stymied so far this year, I am encouraged by some of the discussions and news reports that have arisen in the past several weeks, following the enactment of EESA. While we were critical of the law because it did not spell out explicit measures to help struggling homeowners at the same time that it helped Wall Street, EESA does appear to be opening the door to more promising measures.

[4] *See, e.g.*, H.R. 5679, "Foreclosure Prevention and Sound Mortgage Servicing Act of 2008."

In particular, we have been following with great interest the discussions led by you and FDIC Chairman Sheila Bair to establish a new mortgage loan guarantee program under Section 109 of the Act.

As we understand it, the proposed plan would provide new incentives for loan servicers to make currently-troubled mortgage loans more affordable for many homeowners. Servicers would attempt to reduce outstanding monthly mortgage payments for struggling borrowers to a thirty-one percent debt-to-income ratio ("DTI") through a series of steps:

- First, servicers would lower the interest rate on the loan to three percent for five years, followed by annual one-percent increases to no more than the market rate (currently 6.5%).
- If this rate reduction is not enough to reach the target DTI, the term of the loan would be increased to a maximum of 40 years from the date of origination.
- If the loan is still not affordable, servicers would defer enough of the loan principal, without charging interest on that portion, until the remaining balance of the loan fell within the appropriate DTI.

If these modification efforts result in a loan that can be successfully repaid for at least six months, the government would guarantee against losses on the new loan, on a 50/50 basis, for the following eight years. Informal estimates have suggested that such a plan could spare as many as three million homeowners from otherwise-certain foreclosure, at a cost of approximately $50 billion – a sum that would be allocated from currently-unused EESA funds.

We believe that if the plan can be implemented quickly – and, just as importantly, if it is quickly utilized by loan servicers, it would represent a major improvement over any other existing foreclosure-prevention strategies that have been attempted to date:

- It would provide loan servicers with significant incentives to modify loans, incentives that currently do not exist in private, voluntary foreclosure-prevention efforts such as the "Hope Now Alliance."
- Unlike foreclosure moratorium proposals,[5] the plan offers the hope of a lasting, sustainable solution to troubled loans – as opposed to what could be, without vital loan servicing reforms, a mere delay of the inevitable for most borrowers.
- By focusing on a borrower's first mortgage debt-to-income ratio, it would be much simpler for servicers to implement than the recently-enacted "Hope for Homeowners Act,"[6] and would not require the deep discount to current market value.

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[5] *E.g.*, California Gov. Arnold Schwarzenegger has proposed a 90-day stay of the foreclosure process for owner-occupied homes subject to a first mortgage, following the filing of a Notice of Default. Press Release, "Governor Schwarzenegger Prescribes Solutions to Keep Californians in their Homes," Office of the Governor, Nov. 5, 2008, at http://gov.ca.gov/press-release/10959/

[6] Division A, Title IV of the "Housing and Economic Recovery Act," Pub. L. 110-289. The Hope for Homeowners Act allows the Federal Housing Administration to insure up to $300 billion of loans that are refinanced to no more than 90% of the currently-appraised value of a home, in cases where a servicer or lender agrees to forfeit the remainder of a prior loan.

- By utilizing a target DTI of 31%, modifications under the plan are more likely to succeed – and therefore less likely to cost taxpayers – than the FDIC's highly-lauded modification plan for mortgages held by IndyMac Bank.[7]

Furthermore, by focusing on the root cause of our ongoing economic crisis – widespread foreclosures – the plan strikes me as a particularly wise use of taxpayer funds allocated to EESA. This is especially true given the controversies that have already erupted over how federal "bailout" funds are being utilized by some recipients on Wall Street.[8]

For these reasons, LCCR strongly believes that the FDIC plan is very much worth a try – but we urge that it be adopted as quickly as possible this fall. For one, based on nationwide foreclosure trends, hundreds of thousands of additional borrowers will be in danger of losing their homes – with continued devastating consequences for our economy. In addition, while details of the plan can be calibrated over time, it is vital that the Treasury Department set aside adequate EESA funds before they are used on other, less-effective economic recovery programs.

We are somewhat concerned that the FDIC plan could take a significant amount of time to get up and running. In addition, as is the case with other foreclosure-prevention efforts that have been initiated to date, it relies on the voluntary agreement of loan servicers, who still may or may not be willing – or even able, due to securitization issues – to agree to significant loan modifications. These concerns, however, do not in any way diminish our support for the plan, and we are very grateful to you, Mr. Chairman, and FDIC Chairman Bair, for your tireless efforts to help as many homeowners as possible in the midst of this crisis.

<u>The Critical Role of Fair Housing Laws in Loan Modification Efforts</u>

Before I conclude, and particularly in light of the fact that we commemorated the 40th anniversary of the Fair Housing Act this year, I would like to briefly underscore the need to ensure that any measures to implement EESA are done in a manner that is fully consistent with all applicable civil rights laws.

As you know, the ongoing mortgage crisis has profound underlying fair lending dimensions. It is imperative that any response addresses the significant disparate impact on communities of color and single female-headed households. To this end, we hope that in your oversight of EESA, you will help ensure that data on the progress of the Treasury Department's modification efforts is made publicly available. It is also vital that the Department's response is formulated and implemented in a manner that affirmatively furthers fair housing.

Federal law requires that all expenditures of federal funds for housing-related purposes be done in compliance with the Fair Housing Act. This means that under EESA, the Department must put in place comprehensive measures, for example, to ensure that:

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[7] *E.g.*, Renae Merle, "FDIC Restructuring Some IndyMac Loans," *Washington Post*, Aug. 21, 2008 at D01.
[8] See, e.g., Amit R. Paley and Binyamin Appelbaum, "Waxman Seeks Bank Data on Use of Bailout Funds," *Washington Post*, Oct. 29, 2008 at D03; Binyamin Appelbaum, "Banks to Continue Paying Dividends," *Washington Post*, Oct. 30, 2008 at A01;

- Its efforts to provide loan modifications for homeowners facing foreclosure are available without regard to protected class status;
- Any institution in which the government acquires an ownership stake, or provides other assistance under EESA, is not in violation of fair housing and fair lending laws with respect to loans that it makes or services; mortgage-backed assets in which it is involved as an issuer, underwriter or investor; loan modification efforts in which it engages; or marketing of its REO properties; and that
- Loan modifications are sustainable for long-term ownership.

Mr. Chairman, thank you again for the opportunity to speak today. I look forward to answering any questions you may have.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR SCHUMER FROM BARRY L. ZUBROW

Q.1. "As you can see, many members of this panel are concerned that in spite of fresh government capital, banks are pulling back and reducing lending at a time when the country is already facing a potentially deep and long recession. How do your loan volumes for this year compare to the past few years?"

A.1. As you are aware, economic conditions in the US and globally have continued to deteriorate since the passage of the Emergency Economic Stabilization Act (EESA): the US lost more jobs in 2008 than in any year since 1945, home values are down 13% in the last year alone, and the stock market is down 21%.

Despite these challenging economic conditions, JPMC continues to provide significant levels of credit, and we at JPMC have dedicated ourselves to being there for our clients—whether by making markets and committing capital to facilitate client business, investing in infrastructure and other projects, or making loans to creditworthy borrowers. At the same time, lending decisions must be consistent with prudent business practices and underwriting standards, appropriately mindful of market and credit risks. Lending activity of all types must be conducted according to prudential risk management standards, and the challenging economic conditions only elevate the importance of operating in a safe and sound manner. We are currently gathering data and hope to present information on lending activities to the Committee in short order.

Q.2. "Are you pulling back active lines of credit from businesses and consumers? If so, why?"

A.2. In the normal course of business, lenders continually evaluate not only whether to make new credit available, but also whether to re-examine existing facilities for both businesses and consumers. This is particularly true during the type of economic circumstance in which we now find ourselves. We take seriously our fiduciary responsibility to the funds we have received from the taxpayers, as well as all shareholders, and we take seriously our obligation to protect these funds from losses, which may require that in certain cases we reduce lines or exit market segments. Most of small business lines were underwritten based on the borrower's stated income. We have reached out to borrowers and asked them to supply us with updated financials that support their income and their ability to manage their existing lines. If borrowers do not provide us with their updated financials, or their financial situation has deteriorated significantly, lines may be reduced.

Q.3. "There is a lot of concern on this panel that the banks are planning on hoarding rather than deploying this capital. What are your forward plans for the use of the TARP funds?"

A.3. TARP funding has helped to bolster JPMC's Tier 1 capital ratio, which was already well above regulatory minimum capital levels, but has risen following the government's October 28, 2008 purchase of JPMC preferred shares. This capital position has allowed us, notwithstanding deteriorating economic conditions and shifting demand patterns, to serve our customers through a very broad range of financial activity. Our capital position has also allowed us to intensify our efforts to modify the terms of residential mortgages to strengthen the US housing market by keeping hundreds of thousands of families in their homes.

We believe strongly that American taxpayers deserve to know how banks that accepted TARP funding through CPP have been operating since October 24, 2008, and for as long as the government holds its preferred stock shares. We are currently developing metrics to demonstrate JPMC's lending and market activity. We are committed to transparency and accountability, and look forward to providing Congress, regulators and the American people with regular updates about what JPMC is doing to merit the trust that has been placed in us through the Capital Purchase Program.

Q.4. "We have been hearing from SBA that the number of banks participating in the 7(a) and 504 loan programs has been dropping significantly, partly because of a lack of liquidity and partly because the fees and cost of funds SBA lenders can't break even. What do you see as the main reasons for the decline in the number of participating lenders?"

A.4. A lender's ability to originate SBA loans at break even or better has been adversely impacted by the SBA's increased fees such as Lender Oversight Fees and Yearly Fees (basis point remittance). In addition, due to the combination of increased funding costs as a result of the disruption in the capital markets and the SBA's cap above the base interest rate, the lender's interest margin over its cost of funds is shrinking.

Q.5. "If all of the SBA lender and borrower fees for both the 7(a) and 504 loan programs were completely eliminated for a period of time—not reduced, but completely eliminated—do you believe that this would help spur additional lending activity in the small business" marketplace?

A.5. Yes, because borrowers would find SBA loans more affordable. In addition, lenders would have an increased chance of breaking even on the loan due to no Lender Oversight Fees or Yearly Fees.

In addition, there are other actions that we believe could stimulate SBA lending such as:

- Increase the SBA 7(a) loan limit from $2,000,000 to $3,000,000 and the maximum guarantee from $1,500,000 to $2,250,000.
- Increase the SBA Express loan limit from $350,000 to $1,000,000 and the maximum guarantee to $500,000.
- Increase the SBA 7(a) guarantee percentage from 75% to 90% and the SBA Express guarantee percentage from 50% to 75%.
- Create separate mutually exclusive 7(a) and 504 program limitations.
- Change the SBA 7(a) size standards to mirror the current 504 size standards.

Q.6. "Loan modifications continue to be one of the most difficult aspects of this crisis. I's like to ask the entire panel, what are the most significant obstacles standing in the way of broader loan modifications, especially to the securitized loans that no single person really controls, and what steps can Congress and the Administration take to overcome them?"

A.6. Until recently, the largest single impediment was the inability to provide principal forbearance in GSE loans. Another impediment is the requirement by some investors that only delinquent loans can be considered rather than loans where default is reasonably foreseeable. For portfolio loans owned by Chase, rather than serviced for others, we enjoy more flexibility because, as the ultimate investor, we can readily consider more options and make judgments for ourselves unimpeded by contractual servicing obligations. While we have the ability today to modify and do modify investor owned loans, we need to be mindful of our contractual obligations.

Chase currently is rolling out a consistent loan modification toolset across the Chase, EMC and WaMu servicing platforms. When the rollout is complete, we will have the ability to assess the affordability and NPV of affordable modification options versus foreclosures in an automated fashion. We will strive to make modifications on those loans that we believe are affordable and sustainable to the borrower and represent the best NPV alternative to Chase.

The GSEs have provided a tool for their recently announced Streamlined Modification Program (“GSE SMP”) that we are in the process of implementing for their loans.

Programs that promote the use of a standard set of assumptions, affordability parameters and NPV analysis will be very valuable in accelerating loan modifications.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR CASEY FROM BARRY L. ZUBROW

Q.1. Which homeowners are eligible for the institution’s loan modification program?

A.1. Chase currently modifies loans of borrowers who are owner occupants; however, there are different facets to the program that require different qualifications. For example, Chase currently modifies owned subprime hybrid adjustable rate mortgages (“ARMs”) to the initial interest rate, but the borrower must have a history of on-time payments to verify that it is the rate shock that may cause delinquency and the current payment is in fact affordable.

Chase is also modifying loans serviced by others and is committed to expanding its Foreclosure Prevention program to include loans for individual investors or pooled for trusts placed in securitization, to the extent allowed by applicable servicing agreements. We are pleased to say Chase will be actively participating in the new “Streamlined Modification Program” and “Early Workout” programs recently announced by the Government Sponsored Enterprises (“GSE”) Fannie Mae and Freddie Mac.

We are also developing a more efficient process that should further accelerate the pace at which we can modify loans.

Q.2. How is success through the program defined? What does it mean that a certain number of homeowners have been “helped” through a loan modification program?

A.2. Chase believes in tracking success of our loan modification programs by focusing on foreclosures prevented, not just modifications made. (This could include a “non retention” cure such as short sale, which is sometimes the best option if a borrower has no income or sufficient income to afford a reasonable modification.) Chase also tracks efforts to reach borrowers as well as actual foreclosure prevention actions taken. This is an important metric because one of the most difficult problems we have in helping borrowers is actually communicating with them. Accordingly, Chase tracks outreach efforts—including borrowers dialed, and mail sent, and will begin tracking inbound visits to each of our 24 Chase Homeownership Centers set to open in early 2009.

Most of the activity Chase will track is likely to arise from loan modification activities. We will track loan modifications by type of borrower (current or delinquent borrower) and type of modification. Chase is placing a strong emphasis on making only loan modifications that result in a new payment level that is affordable to each borrower. Chase will be tracking the re-default rate, the rate at which borrowers that have been modified default on the loan modification that was granted, to ensure that our programs permanently help borrowers rather than postpone inevitable outcomes.

Loan modifications are not the only strategy that Chase will be pursuing. Chase believes that for a number of distressed homeowners, a refinance into a fully-amortizing FHA- or GSE-insured loan with lower payments may be a better alternative. So we will track refinances for borrowers we believe are at risk of default or are already delinquent, as well as the economic incentives (such as principal forgiveness, principal forbearance or rate subsidization) required to refinance these borrowers.

In addition, Chase will track other foreclosure prevention tactics, such as payment plans (where a borrower agrees to pay back arrearages over time), deferments (where a borrower agrees to make late payments in the future), borrower stipulations (where a borrower agrees to make a set of payments, often as a prelude to a modification), and short-sales/settlements (a form of principal forgiveness where Chase agrees to accept less than the amount of the mortgage in exchange for the underlying property or the proceeds of the sale of the underlying property). Although short sales and settlements do not result in borrowers keeping their home, this may be an appropriate solution when the borrower has no interest in remaining in the home or where the borrower has had a financial hardship permanently impairing the borrower's ability to make any payments, even those reduced by a modification. Lastly, Chase will track borrowers who become seriously delinquent or enter foreclosure but improve their situation by curing their delinquency or paying off the loan in full through working with our Homeowners Assistance Department.

Q.3. If your program has already been implemented, how have you calculated the number of homeowners assisted through the programs?

A.3. For our existing programs, the number is calculated based on the actual number of homeowners that are assisted through loss mitigation efforts which include both home retention efforts as well as other foreclosure prevention techniques that can assist consumers exit a difficult financial situation without impairing future credit. These are further described in the response immediately above.

Although we have been actively performing many of the foreclosure prevention tactics discussed above, Chase is currently rolling out the program to each servicing platform (Chase, Washington Mutual, and EMC Mortgage, formerly of Bear Stearns) and extending outreach efforts to borrowers who are not yet delinquent but may become so in the future. By the time the program is fully established, Chase will provide reporting on the number of homeowners helped.

Q.4. If your have more than one loan modification program for distressed borrowers, please provide details on each.

A.4. We expect to broaden the loan modification alternatives that Chase already offers as part of our Foreclosure Prevention program. The enhanced loan modifications tool set will allow for more flexibility based on the borrower's current loan type and the borrower's specific financial situation. Chase is working to finalize the offers and outreach strategy for both delinquent and current borrowers, but the offers are likely to include those described further below.

Chase will identify owner-occupant borrowers we believe can benefit from a refinance into an FHA or GSE insured loan. These borrowers may qualify for principal forbearance, principal forgiveness, or below-market rates as part of their refinance. Eligible borrowers must be current and have reasonably good payment histories, except that delinquent borrowers will be screened to see if they qualify for the Hope for Homeowners product.

For owned subprime hybrid Adjustable Rate Mortgages (ARMs) scheduled to reset for the first time, those loans will remain at the initial rate for life of the loan. To qualify for this program, borrowers must have a 2 or 3 year hybrid ARM and have a clean payment history. Borrowers do not need to contact Chase to benefit from this program—the rate lock will happen automatically.

For subprime hybrid ARMs serviced but not owned by Chase scheduled to reset for the first time, we will also use the ASF Fast Track program to reduce payment shock. Qualifying borrowers will have their initial ARM rate frozen for five years.

For borrowers whose loans are either owned by the GSEs or in their securities and that meet the GSE's Streamlined Modification Program, Chase will offer a pre-approved modification. Similar to the Chase program, term extensions, rate reductions and principal forbearance will be used to achieve an affordable monthly payment. Borrowers must be 90-days or more delinquent, in an owner-occupied single family home, and have a current loan amount of more than 90% of the current value of the home.

Borrowers not eligible for any of the systematic modification programs described above are reviewed on case by case basis to determine the suitability of a modification or other foreclosure prevention tactic. For example, borrowers not eligible for SMP because they are only in early stage delinquency, may qualify for the Early Workout Program offered by Fannie Mae.

Loan modifications under the Chase programs are evaluated by developing an estimated target affordable payment of 31–40% of the borrower's gross income. The percentage depends on the borrower's income level—higher income borrowers are allowed to have higher percentages. This target payment amount is subject to a minimum disposable income requirement. Once the target payment is calculated, the borrower is run through a payment "waterfall" where each modification option is tested to see if it can meet the affordable payment requirement. Concurrently, each modification option is subject to a Net Present Value analysis to confirm that the value of the modification exceeds the value of pursuing a foreclosure. The modification option at which an affordable payment is first reached, if yielding a positive Net Present Value to the loan, will result in a recommended borrower modification.

Chase's modification product hierarchy is currently being implemented for delinquent borrowers. Chase will be proactively reaching out to those borrowers in the coming months with an appropriate offer. The components of the modification hierarchy may include:

- Elimination of negative amortization for pay option ARMs.
- In addition to the above, reducing the interest rate to achieve a sustainable payment.
- In addition to all of the above, establishing payments based on a new loan term as long as 40 years.
- In addition to all the above, reducing rate to as low as 3%. This rate is frozen for three years and then increases a maximum of 1% per year until it reaches the prevailing market rate at the time of the modification.
- In addition to all of the above, principal forbearance to as low as 90%–95%. This forbearance does not accrue interest but is due upon maturity or prepayment of the loan.
- In addition to all of the above, introduction of a 10-year interest only period on the loan.
- Other rate reductions and principal forbearance as necessary to meet affordability standards as long as it is NPV positive.

In the near future, Chase expects to issue a similar hierarchy for borrowers who are current on their payments but are facing imminent financial distress. The modification hierarchies will be the basis for a loan-by-loan review of our portfolio to develop an offer that can be proactively presented to the borrower.

Q.5. How many homeowners do you project will be assisted through your institution's loan modification programs, and what information do you use to arrive at that calculation.?

A.5. We anticipate our program will prevent 400,000 foreclosures in the next two years. We base this estimate on our historical volume of helping approximately 250,000 homeowners over the past two years as well as additional volume expected as a result of our Foreclosure Prevention program. These projections were developed by looking at populations we expect will qualify for the programs, estimating how many of those we will be able to contact, and of those borrowers that we are able to contact, how many will be able to take advantage of the program.

Q.6. Please also provide samples of the records and documentation you maintain regarding loans that are modified through your institution's loan modification programs, with appropriate redactions to protect confidential information.

A.6. Please see attached a sample of our reporting format for data we provide to the OCC (Attachment 1), a sample modification agreement through which we document our agreement with the borrower (Attachment 2) and a sample blanket modification letter (Attachment 3). Offer letters for the expanded program are not yet finalized.

Q.7. Please describe in detail the outreach efforts you have made to distressed homeowners to inform them of their new options for loan modification under the programs you administer. Specifically, what additional measures have you taken since the implementation of the program?

A.7. As noted above, we are working to implement enhancements to our overall Foreclosure Prevention Program. Since the initial announcement, we conducted a national print and radio advertising campaign and established a website featuring a toll-free number for borrowers seeking information and assistance. We have identified the locations of our regional homeownership centers and are in the process of hiring staff to roll out the openings over the next quarter. We began to contact customers eligible for the SMP recently announced by the GSEs.

There are still instances when borrowers contact us and expect to learn of an appropriate solution but one is not currently available. In these instances, we are recording the borrowers' information and will reach out to them when an appropriate solution is available. During the implementation period of the new initiatives, we have not made any new referrals to foreclosure. New program outreach efforts for delinquent borrowers will begin in January 2009 and for current but at-risk borrowers in February 2009.

OCTOBER 31, 2008

CHASE FORECLOSURE PREVENTION PROGRAM

STRICTLY PRIVATE AND CONFIDENTIAL

CHASE

Chase already is helping families avoid foreclosure

Borrower outreach

- Active borrower outreach targets all borrowers with adjustable-rate mortgages (ARMs), including pay-option ARMs
- Working one-on-one with homeowners to understand their unique financial situations and develop viable, sustainable solutions
- Working with Hope Now and other members of the industry to increase borrower awareness of available resources

Proactive modifications / refinance offers

- Systematically modifying interest rates on subprime ARMs owned by Chase
- Participating in national projects, including Fast Track and Project Lifeline
- Piloting proactive refinance offers for borrowers; offers may have Chase-paid costs, below market rates and/or principal deferment

Chase announces new actions to help families stay in their homes

- Systematically review the entire mortgage portfolio to determine proactively which homeowners are most likely to require help - and try to provide it before they are unable to make payments.
- Proactively reach out to homeowners to offer pre-qualified modifications.
- Establish 24 new regional counseling centers to provide face-to-face help.
- Add 300 more loan counselors so that delinquent homeowners can work with the same counselor throughout the process. Will add more counselors as needed.
- Create an independent process within Chase to review each mortgage before it is sent into foreclosure -- to validate each borrower was offered appropriate modifications.
- Not add any more Chase owned loans into the foreclosure process while implementing enhancements.
- Disclose and explain in plain and simple terms the refinancing or modification alternatives for each kind of loan, including using in-language communications.
- Expand the range of alternatives offered to modify pay-option ARMs.
- Offer discounts on or donate 500 homes to community groups or government programs.
- Use more flexible eligibility criteria and modification terms.

Chase offers new alternatives for pay-option ARMs

Choices for pay-option ARMs modification

Option 1: Refinance into FHASecure / Conventional	Option 2: Principal Forbearance / Rate Modification	Option 3: Interest-only Period	Option 4: Hope for Homeowners (not yet available)
■ New 15- or 30- year fully amortizing mortgage ■ Requires reasonably good payment history ■ Borrowers in owned portfolios may qualify for lender-paid closing costs and / or principal forbearance	■ Eliminate negative amortization; fully amortize over 30 years ■ Provide principal forbearance to as low as 95% loan-to-value ■ Reduce rate to as low as 2.0%-3.0% to meet target ratio of housing payment to income of 31-40% (capped at 50%) ■ Step rate up to market in five years ■ Create trial period	■ Same as option 2, but if required by affordability test, reduce payment to ten-year interest-only ■ Reduce rate to as low as 3.5%	■ Requires elimination of second lien and principal write-down to 90% loan-to-value ■ More stringent eligibility criteria than other modifications ■ More time-consuming process for borrower

CHASE

Chase offers alternatives for subprime hybrid ARMs

Choices for subprime hybrid ARMs modification

Option 1: Refinance into FHASecure / Conventional	Option 2: Rate Modification	Option 3: Rate Reduction / Term Extension	Option 4: Hope for Homeowners (not yet available)
■ New 15- or 30- year fully amortizing mortgage ■ Requires reasonably good payment history ■ Borrowers in owned portfolios may qualify for lender-paid closing costs and / or principal forbearance	■ For owned loans, Chase unilaterally locks in initial interest rate for life of loan ■ Similar program executed for investors at their request ■ ASF Fast Track program freezes pre-reset rate for five years for securitized loans	■ Analysis completed to determine affordable payment based on target ratio of housing payment to income of 31-40% (capped at 50%) ■ Rate set to meet affordable payment ■ Can be combined with term extension ■ Income subject to verification	■ Requires elimination of second lien and principal write-down to 90% loan-to-value ■ More stringent eligibility criteria than other modifications ■ More time-consuming process for borrower

CHASE

Chase offers alternatives for subprime fixed rate loans

Choices for subprime fixed rate modification

Option 1: Refinance Into FHASecure / Conventional

- New 15- or 30- year fully amortizing mortgage
- Requires reasonably good payment history
- Borrowers in owned portfolios may qualify for lender-paid closing costs and / or principal forbearance

Option 2: Rate Reduction / Term Extension

- Analysis completed to determine affordable payment based on target ratio of housing payment to income of 31-40% (capped at 50%)
- Rate set to meet affordable payment
- Can be combined with term extension
- Income subject to verification

Option 3: Hope for Homeowners (not yet available)

- Requires elimination of second lien and principal write-down to 90% loan-to-value
- More stringent eligibility criteria than other modifications
- More time-consuming process for borrower

What a Chase loan modification might look like

ILLUSTRATIVE

Example proposed Chase-owned loan modifications	Subprime ARM	Pay Option ARM
Home value at origination	$200,000	$500,000
Current home value	$170,000	$425,000
Original loan amount	$160,000	$400,000
Current loan amount (including negative amortization)	$156,632	$460,000
Current interest rate / option ARM payment rate	7.00%	1.25%
Interest rate after reset	9.00%	5.75%
Current monthly payment[1]	**$1,064**	**$1,623**
New payment[1]	**$1,279**	**$2,757**
Payment amount increase ("shock")	**$214**	**$1,134**
Principal deferred by Chase	$0	$56,250
Principal amount that payment is calculated on	$156,632	$403,750
Modified rate	7.00%	5.00%
Modified payment[1]	$1,064	$2,167
Payment savings	**$214**	**$590**

[1] Interest and any principal only. Subprime modification assumes no term extension and 2/1 Hybrid ARM.

CHASE

RESPONSE TO WRITTEN QUESTIONS OF SENATOR SCHUMER FROM GREGORY PALM

Q.1. Loan modifications continue to be one of the most difficult aspects of this crisis. I'd like to ask the entire panel, what are the most significant obstacles standing in the way of broader loan modifications, especially to the securitized loans that no single person really controls, and what steps can Congress and the Administration take to overcome them?

A.1. In Litton's experience, the most significant obstacle to its loan modification efforts has been lack of customer response. Litton expends significant time and resources in attempting to communicate with homeowners. Litton reaches out to homeowners through numerous telephone calls and letters, as well as by often dispatching a representative to the customer's home—all in an attempt to engage the homeowner in ways to try to save the home.

Despite these efforts, over the past 12 months at least 25% of the loans Litton services that go into foreclosure are vacant, which is a 100% increase from 12 months ago. Many times these homeowners did not respond to loan modification offers and have simply walked away from their homes. In order to reduce these numbers, Congress and the Administration should encourage struggling homeowners to contact their servicer to attempt to work out a solution. Additionally, Litton has found that local community groups and other housing-focused organizations are often able to help homeowners reach a solution with their servicers and Congress and the Administration should support this type of local advocacy.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR CASEY FROM GREGORY PALM

Q.1. All four of your testimonies mentioned the efforts your financial institutions are making to systematically modify mortgage loans to prevent foreclosures and keep homeowners in their homes. Several of the witnesses, with the exception of Mr. Campbell, supplied estimates of how many mortgage owners have been helped or are projected to be helped through these loan modification programs. I ask that each of the witnesses provide more details on these calculations, specifically:

- Which homeowners are eligible for the institution's loan modification program?
- How is success through the program defined? What does it mean that a certain number of homeowners have been "helped" through a loan modification program?
- If your program has already been implemented, how have you calculated the number of homeowners assisted through the programs?
- If you have more than one loan modification program for distressed borrowers, please provide details on each.
- How many homeowners do you project will be assisted through your institution's loan modification programs, and what information do you use to arrive at that calculation?

A.1. Litton Loan Servicing LP (Litton), a Goldman Sachs affiliate, services approximately 440,000 residential mortgage loans. Over the past 12 months, Litton has modified more than 40,500 loans, representing approximately 11.3% of Litton's average portfolio and 35.5% of its average loan population that were 60 days or more past due. Litton services these loans but it does not own the loans. The responses to your specific questions below reflect Litton's experiences as a residential mortgage loan servicers.

Q.2. Which homeowners are eligible for the institution's loan modification program?

A.2. Litton offers loan modifications and loss mitigation opportunities to homeowners throughout the delinquency period. Litton does not, however, require a homeowner to be delinquent to discuss loss mitigation options. In order to identify issues as early as possible and to examine potential workout solutions, Litton encourages homeowners to discuss changes in their status or circumstances, including loss of income or other hardship that may affect their ability to make payments. Additionally, Litton does not preclude homeowners whose mortgages have been previously modified from requesting additional modifications.

Q.3. How is success through the program defined? What does it mean that a certain number of homeowners have been "helped" through a loan modification program?

A.3. A successful loan modification program reduces monthly mortgage payments to a sustainable level that allows homeowners to remain in their homes whenever possible. When Litton modifies loans, it considers writing down principal, waiving all or part of arrearage, decreasing the interest rate and extending the loan term, among other efforts designed to create a sustainable workout solution for the homeowner.

Historically, Litton's average modification involved a payment reduction of approximately $200 per month, which resulted in an average housing debt-to-income (DTI) ratio of 39%. However, in response to deteriorating macroeconomic conditions and a weakened housing market, Litton has implemented a new DTI standard of 31%, which is consistent with FHA guidelines for new loans. Litton expects that after a period of making payments on the loan modification many of its customers will be able to refinance into a fixed-rate FHA loan. Using this standard will allow Litton to do more loan modifications with greater payment relief to the homeowner, thus providing a more sustainable solution. Furthermore, investors will still benefit from modifications which yield a better outcome than foreclosures.

Q.4. If your program has already been implemented, how have you calculated the number of homeowners assisted through the programs? If you have more than one loan modification program for distressed borrowers, please provide details on each.

A.4. Litton has implemented multiple loan modification programs that seek to help at-risk homeowners stay in their homes. In order to pursue any of the loan modification programs described below, Litton, as servicer for loan investors, must demonstrate that the modification results in a greater net present value to investors than a foreclosure.

For ARM loans in which the homeowners is current but Litton believes is at risk of imminent default, Litton begins a streamlined modification offer campaign six months prior to a scheduled interest rate reset. These modifications extend the original terms of ARMs up to 60 months at the introductory rate.

Customers with ARM loans that become 60 days delinquent as a result of an interest rate reset will receive a modification that locks in the introductory rate of the ARM for the remaining term of the loan. This type of streamlined modification is offered both to customers with whom Litton has active communication as well as those who have proved difficult to contact.

If after receiving either of these types of modifications a homeowner experiences hardship in paying the monthly mortgage payment at the introductory rate, Litton will evaluate the homeowner's specific situation to attempt to create a customized modification for that homeowner using the 31% DTI standard discussed above.

For fixed-rate delinquent loans where Litton has active communication with the homeowner, Litton comprehensively evaluates the homeowner's specific financial situation including income and DTI ratio to develop a tailored modification plan for the homeowner that attempts to solve for affordability. The custom modification will include one or more of: waiver of all or part of arrearages, principal reductions, decreases in interest rates and term extensions, among other efforts designed to modify the loan to achieve a 31% DTI.

Litton also offers a streamlined loan modification program for fixed-rate delinquent loans for homeowners that have not responded to its loss mitigation offers. After 60 days of delinquency, these homeowners are sent a modification offer that is subject to three conditions: (1) sign and return the modification offer, (2) promptly provide Litton with proof of current income (such as a pay stub), and (3) make one payment at the new, lower, modified payment. If a customer meets these conditions, that customer has achieved a loan modification. If a homeowner responds to the offer but needs further payment relief, Litton will evaluate the homeowner's specific financial situation and attempt to create a customized loan modification as described in the paragraph above.

Q.5. How many homeowners do you project will be assisted through your institution's loan modification programs, and what information do you use to arrive at that calculation?

A.5. Next year, Litton anticipates to continue, if not increase, the number of modifications, but given the extraordinary market conditions surrounding the housing market and the unprecedented pressures on Litton's customers, it is difficult to project the number of loans that Litton will modify in the coming months and years. Litton has proven and remains committed to constantly examining and re-examining its modification programs to best address both the needs of the individual homeowner and investors. Additionally, it will continue to seek partnerships with strategic community organizations, including housing counseling and foreclosure prevention programs, to increase its outreach to homeowners.

Q.6. Please also provide samples of the records and documentation you maintain regarding loans that are modified through your institution's loan modification programs, with appropriate redactions to protect confidential information.

A.6. Please see the attached sample modification letter.

Q.7. In over a decade of serving in state and federal government, I have learned that even the best consumer programs are useless if those they target for assistance do not know they exist. Please describe in detail the outreach efforts you have made to distressed homeowners to inform them of their new options for loan modification under the programs you administer. Specifically, what additional measures have you taken since the implementation of the program?

A.7. Litton expends significant time and resources to communicate with homeowners. Litton contacts homeowners whose mortgage payments are past due, whose loans are scheduled for a rate reset, as well as those who are not in default but Litton believes are at risk for imminent default. Some of Litton's strategies include early and active contact with the homeowner through telephone calls, letter campaigns, home visits, participation in foreclosure avoidance fairs and collaborations with nonprofit housing counseling organizations.

LLS Litton Loan Servicing®

4828 Loop Central Drive
Houston, TX 77081
Telephone (800) 548-8665
Fax (713) 966-8844
www.littonloan.com

«RUN_DATE»

«BORR_NAME»
«COBORR_NAME»
«UDM_LOAN_BORROWER_ADDR1»
«UDM_LOAN_BORROWER_ADDR2»
«UDM_LOAN_BORROWER_CITY», «UDM_LOAN_BORROWER_STATE»
«UDM_LOAN_BORROWER_ZIP»

Re: Loan #: «LOAN_NUM»
Property: «L_PADDR»
«UDM_PROP_INFO_CITY», «UDM_PROP_INFO_STATE»
«UDM_PROP_INFO_ZIP»

Dear Borrower(s):

Litton Loan Servicing LP ("Litton") would like to take this opportunity to extend to you a loan modification offer and express our sincere hope that you take advantage of our generous offer today. Please review the following information regarding your loan.

Present Loan Information

- Current Principal Balance: «UPBA»
- Current Interest Rate: «L_RATE»
- Current Principal and Interest Payment: «PANDI»
- Current Total Payment [including escrow]: «PITI»
- Delinquent Interest Owed: «ACCRUED»
- Outstanding Servicer Advances: «CORP_ADV»
- Outstanding Escrow Advances: «L_ESCROW»

- Total Amount Owed as of «RUN_DATE»: «L_TOTAL_DEBT»

As indicated above, outstanding servicer and escrow advances are due. Details of the amounts owed and how they will be collected upon execution of the Loan Modification Agreement are provided below.

Servicer Advances

- «CORP_ADV» Due for unpaid servicer advances that may include attorney fees and costs, property preservation expenses, inspections, and other expenses
- «ca_unforgiven» Servicer advances capitalized and added to the new principal balance
- «ca_forgiven» Servicer advances you owe that are being waived

Any uncollected and unbilled advances you owe as of the date of this approval will remain due upon completion of this modification.

Escrow Advances

- «L_ESCROW» Due for unpaid escrow advances
- «neg_esc_unforgiven» Escrow advances capitalized and added to the new principal balance
- «neg_esc_forgiven» Escrow advances you owe that are being waived

Your escrow advance balance, if applicable, will be brought to $0.00 as part of this loan modification. Future escrow advances may cause a payment increase to your loan. If your loan is non-escrowed, you are responsible for the prompt payment of real estate taxes and property insurance as part of your original obligation on your Note and Mortgage.

Below are several ways the loan modification program benefits you.

- Litton will bring your loan contractually current.
- Litton will begin reporting your loan as current to the credit reporting agencies and will continue to do so as long as you meet your monthly obligation to Litton.
- Your new interest rate will be «new_rate».
- Your new maturity date will be «new_maturity_date».
- Your new loan balance will be «mod_bal».
- Your new monthly payment will be «new_PITI» (subject to any new escrow analysis).
- The new monthly payment will begin «first_pmt_due».

The loan modification program requirements are simple.

1. Sign the enclosed Loan Modification Agreement, have it notarized, and return it to Litton at the address provided below.

2. Provide one (1) month of your most recent pay stubs or two (2) months of your most recent bank statements, accompanied by the completed Financial Information Form. Upon receipt and review of your financial information, we will send you confirmation that the modification is approved and being processed.

3. Include an initial contribution of «new_pmts_for_start», in certified funds, made payable to Litton Loan Servicing LP. This contribution may be applied to any outstanding amounts you owe, at Litton's discretion. Time is of the essence. If foreclosure action has begun, the foreclosure proceedings will continue until you meet all of the requirements indicated above. Please return all items to Litton by «RETURN_BY»:

Litton Loan Servicing LP
Attention: Loss Mitigation Department
4828 Loop Central Drive
Houston, TX 77081

This loan modification has been specifically designed for your benefit. We strongly encourage you to participate today. Please fill out the enclosed agreement or contact Titanium Solutions at (800) 500-1733 should you have questions. The loan modification program is available for a limited time only, so please do not delay.

Sincerely,

Loss Mitigation Department

Enclosures: Loan Modification Agreement

LITTON LOAN SERVICING LP IS A DEBT COLLECTOR. THIS LETTER IS AN ATTEMPT TO COLLECT YOUR DEBT AND ANY INFORMATION OBTAINED WILL BE USED FOR THAT PURPOSE.

__________________Space Above This Line For Recording Data__________________

LOAN MODIFICATION AGREEMENT

This Loan Modification Agreement ("Agreement"), made this **«RUN_DAY»** day of **«L_RM»** between **«BORR_NAME» «L_COBORR»** ("Borrower") and **«FC_BENEFICIARY»** ("Lender"), amends and supplements

1. The Mortgage, Deed of Trust, or Deed to Secure Debt (the "Security Instrument"), dated «ODATE».

2. The Note bearing the same date as, and secured by, the Security Instrument, which covers the real and personal property described in the Security Instrument and defined therein as the "Property," located at **«L_PADDR», «UDM_PROP_INFO_CITY», «UDM_PROP_INFO_STATE» «UDM_PROP_INFO_ZIP».**

   The real property described being set forth as follows:

   In consideration of the mutual promises and agreements exchanged, the parties hereto agree as follows (notwithstanding anything to the contrary contained in the Note or Security Instrument):

1. As of «START_DATE», the amount payable under the Note and the Security Instrument ("Unpaid Principal Balance") is U.S. **«mod_bal»**, consisting of the amount(s) loaned to the Borrower by the Lender and any interest capitalized to date.

2. The Borrower promises to pay the Unpaid Principal Balance, plus interest, to the order of the Lender. Interest will be charged on the Unpaid Principal Balance at the yearly rate of **«new_rate»**, from **«start_date»**. The Borrower promises to make monthly payments of principal and interest of U.S. **«new_PANDI»**, beginning on the **1st** day of **«L_FPD»** and continuing thereafter on the same day of each succeeding month until principal and interest are paid in full. If on **«new_maturity_date»** (the Maturity Date), the Borrower still owes amounts under the Note and the Security Instrument, as amended by this Agreement, the Borrower will pay these amounts in full on the Maturity Date.

   The Borrower will make such payments at Litton Loan Servicing LP, Attention: Loss Mitigation Department, 4828 Loop Central Drive, Houston, TX 77081 or at such other place as the Lender may require.

3. If all or any part of the Property or any interest in it is sold or transferred (or if a beneficial interest in the Borrower is sold or transferred and the Borrower is not a natural person) without Lender's prior written consent, the Lender may, at its option, require immediate payment in full of all sums secured by this Security Instrument.

   If the Lender exercises this option, the Lender shall give the Borrower notice of acceleration. The notice shall provide a period of not less than 30 days from the date the notice is delivered or mailed within which the Borrower must pay all sums secured by this Security Instrument. If the Borrower fails to pay these sums prior to the expiration of this period, the Lender may invoke any remedies permitted by this Security Instrument without further notice or demand to the Borrower.

4. The Borrower also will comply with all other covenants, agreements, and requirements of the Security Instrument, including without limitation, the Borrower's covenants and agreements to make all payments of taxes, insurance premiums, assessments, escrow items, impounds, and all other payments that the Borrower is obligated to make under the Security Instrument; however, the following terms and provisions are forever cancelled, null, and void as of the date specified in paragraph No. 1 above:

   a) all terms and provisions of the Note and Security Instrument (if any) providing for, implementing, or relating to any change or adjustment in the rate of interest payable under the Note; and

   b) all terms and provisions of any adjustable rate rider or other instrument or document that is affixed to, wholly or partially incorporated into, or is part of, the Note or Security Instrument and that contains any such terms and provisions as those referred to in (a) above.

5. Nothing in this Agreement shall be understood or construed to be a satisfaction or release in whole or in part of the Note and Security Instrument. Except as otherwise specifically provided in this Agreement, the Note and Security Instrument will remain unchanged, and the Borrower and Lender will be bound by, and comply with, all of the terms and provisions thereof, as amended by this Agreement.

«BORR_NAME» «COBORR_NAME»

«FC_BENEFICIARY»

By: ______________________________

______________________Space Below This Line For Acknowledgments______________________

STATE OF ______________________

COUNTY OF ____________________

This instrument was acknowledged before me on the ______ day of______________________________

20____, by _«BORR_NAME»____.

NOTARY PUBLIC

My commission expires: ________________________

STATE OF ______________________

COUNTY OF ____________________

This instrument was acknowledged before me on the ______ day of______________________________

20____, by _«COBORR_NAME»____.

NOTARY PUBLIC

My commission expires: ________________________

STATE OF TEXAS

COUNTY OF HARRIS

This instrument was acknowledged before me on the _______ day of ____________________________

20 ____, by __________________________________ of «FC_BENEFICIARY».

NOTARY PUBLIC

My commission expires: ________________________

RESPONSE TO WRITTEN QUESTIONS OF SENATOR SCHUMER FROM SUSAN M. WACHTER

Q.1. Professor, in your testimony you mention bank mergers as a less than ideal use of the TARP funds. What do you think of giving Treasury the authority to approve mergers in order to ensure that TARP is only subsidizing mergers that improve systemic stability and/or increase lending to consumers and businesses?

A.1. Lending is necessary. However, what is necessary to assure lending will be long run profitability and financial stability. Getting from where we are now to financial stability is critical and the role of directive lending, while seemingly helpful, could be counterproductive.

Q.2. Professor, you also discuss the need for banks to continue lending to creditworthy borrowers. Do you think the Administration has done enough to encourage banks to do this lending in a difficult environment?

A.2. No, I do not think the administration has done enough to encourage banks to lend in this difficult environment. The administration has not taken the necessary steps to avoid severe housing price overcorrection which will interact with the recession in an adverse feedback loop for both.

Q.3. What additional steps do you think the Administration could take?

A.3. Similar to the plan Paulson has discussed in the Wall Street Journal on Dec. 3rd, it is necessary to lower mortgage rates and increase lending through Fannie Mae and Freddie Mac. However, I believe it will be beneficial to extend these lower rates to refinancing for existing loans, as well as mortgages for new home purchases. By reducing mortgage rates, the government will provide an opportunity for many to buy into the housing market and to purchase a home at low mortgage rates and an incentive to pay existing, refinanced mortgages even if the home is underwater as opposed to letting the home go to foreclosure. This shift would break the cycle of unsold inventory and decreasing demand causing house prices to fall.

Q.4. Loan modifications continue to be one of the most difficult aspects of this crisis. I'd like to ask the entire panel, what are the most significant obstacles standing in the way of broader loan modifications, especially to the securitized loans that no single person really controls, and what steps can Congress and the Administration take to overcome them?

A.4. There are legal and incentive barriers to optimal loan modifications inherent in contractual private label servicing agreements. These barriers, both legal and incentive based, need to be addressed. Useful steps would be to adopt a plan similar to that proposed by the FDIC for IndyMac (along the lines suggested by Sheila Bair) and also to implement REMIC legislation that has been discussed. Solutions that provide incentives and raise the cost to servicers of not optimally modified loans through penalties are both needed to stem the adverse loop that leads to further foreclosures and a worsening housing market outlook.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR SCHUMER FROM JON CAMPBELL

Q.1. As you can see, many members of this panel are concerned that in spite of fresh government capital, banks are pulling back and reducing lending at a time when the country is already facing a potentially deep and long recession. How do your loan volumes for this year compare to the past few years?

A.1. Wells Fargo has been one of the few banks to continue lending through the credit crisis. At the end of the third quarter 2008, average loans were up 15% from the previous year and 13% (annualized) from the previous quarter. We were able to generate such strong growth because of our prudent credit discipline and by thoroughly understanding our customers' financial needs. After our release of fourth quarter 2008 earnings on January 28, 2009, we will be able to provide more updated information.

Q.2. Are you pulling back active lines of credit from businesses and consumers? If so, why?

A.2. Through our ongoing customer management programs, and our adherence to prudent lending principles, we modify lines of credit on a case-by-case basis and only make reductions when we feel it is warranted.

Q.3. There is a lot of concern on this panel that the banks are planning on hoarding rather than deploying this capital. What are your forward plans for the use of the TARP funds?

A.3. We are scheduled to release our fourth quarter earnings on January 28, 2009 but before that time we cannot provide any forward looking guidance on our lending for the fourth quarter or beyond. We can tell you that we intend to use the Capital Purchase Program funds to make more loans to credit-worthy customers and to find solutions for our mortgage customers late on their payments or facing foreclosures so they can stay in their homes. As indicated previously, through the third quarter of 2008, Wells Fargo had increased loans by 15% from the previous year, strong evidence of our commitment to continue lending through this challenging cycle.

Q.4. As you all know, small businesses are the lifeblood of our nation's economy. I have been hearing from a number of companies in my state that the credit crisis is really hurting them not only because they can't get new loans, but also because their lines of credit are drying up and they are finding it difficult to make payroll. The SBA made a couple of important technical changes suggested by Senator Kerry and me in a letter last week, but we need to do a lot more to spur lending in this sector, or millions more jobs could be in jeopardy.

A.4. We believe the point of the statement is what needs to be done to get SBA loans moving again and below are three areas that if the changes were implemented could result in an increase in loan activity:

7a loans

- Raise the threshold to $3 million—the borrowing needs of small business have gone beyond the old limit of $2 million.

- Raise guaranty to 85% for 7a loans no matter the size of the loan as added incentive for lenders.
- Adjust the 7a size standards to match 504 program standards—this would make more small businesses eligible for SBA loans.
- Raise spread over index (Libor or Prime) to match SBA Express limits from 2.25/2.75% to match limits set for SBAExpress loan program. The current SBAExpress limits are 4.5/6.5%.

SBAExpress

- Raise guaranty from the current 50% to 75% for all lines and loans. This would encourage banks to make more use of the line of credit feature of this product. This is especially critical now since many small businesses suffer from a lack of working capital.
- Raise the current threshold from $350,000 to $1 million.

Other

- SBA current program for micro-loan funding is inadequate for the borrowers under $35,000. This has been a long-time source for the funding of very small businesses using non-traditional community based lenders as the distribution network. The funding organizations provide needed technical assistance coupled with the loans.

Q.5. We have been hearing from SBA that the number of banks participating in the 7(a) and 504 loan programs has been dropping significantly, partly because of a lack of liquidity and partly because the fees and cost of funds SBA lenders can't break even. What do you see as the main reasons for the decline in the number of participating lenders?

A.5. The issue of cost of funds is significant. We and other lenders are seeing loan spreads (profit) decline since the cost of money has been high/volatile and the interest rates we are able to charge on SBA loans are too low.

—The lack of liquidity in the market is a major problem. The secondary market for SBA loans has not been a reliable option for most of 2008. Wells Fargo does not sell SBA loans, however many lenders rely solely on the secondary market to generate the liquidity necessary for making more loans. These lenders are now caretaking portfolios and are out of loan origination.

—Fees do continue to be a problem. In particular, the ongoing portfolio servicing fee which is currently set at .55 bps is a big expense for all lenders. Layering on top of this are large annual lender oversight fees, for example Wells Fargo paid $123,000 in 2008. The combination of these fees does give all lenders pause, but it truly pushes many mid-size and small lenders out of the SBA program.

—More and more lenders are getting frustrated with the difficulties of collecting on loan guaranties from the SBA. The Herndon Center is unpredictable when considering lender liquidation requests. Lenders are being second-guessed and minor issues are often being used as the basis for refusing payment of a loan guaranty. Lenders are questioning the value of the guaranty. Many do not want to go through the hassle of offering SBA loans because they feel that future collection on an SBA loan guaranty is too unreliable.

Q.6. If all of the SBA lender and borrower fees for both the 7(a) and 504 loan programs were completely eliminated for a period of time—not reduced, but completely eliminated—do you believe that this would help spur additional lending activity in the small business marketplace?

A.6. Yes, anything that can be done to reduce the cost of capital via the elimination of fees would provide a significant psychological boost for SBA Lending. Right now both borrowers and lenders need incentives to once again get money flowing. This would be especially helpful for businesses in need of working capital, those purchasing existing businesses and for commercial real estate transactions. But the elimination of fees is only one piece of the puzzle—we need a holistic approach that can really give the industry a true shot in the arm.

Q.7. Loan modifications continue to be one of the most difficult aspects of this crisis. I'd like to ask the entire panel, what are the most significant obstacles standing in the way of broader loan modifications, especially to the securitized loans that no single person really controls, and what steps can Congress and the Administration take to overcome them?

A.7. Yes, it would be very helpful for Congress to provide clear authority to HUD to allow the agency to implement the Section 601 Accelerated Claim Disposition Program. This program is under review at HUD and would enable servicers to take a troubled loan out of a Ginnie Mae pool, apply a loan modification to keep the borrower in their homes and replace the newly modified loan back into the securitized pool. This procedure would be on par with what is permissible for conventional loans and would be a very useful companion to the Hope for Homeowners program.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR CASEY FROM JON CAMPBELL

All four of your testimonies mentioned the efforts your financial institutions are making to systematically modify mortgage loans to prevent foreclosures and keep homeowners in their homes. Several of the witnesses, with the exception of Mr. Campbell, supplied estimates of how many mortgage owners have been helped or are projected to be helped through these loan modification programs. I ask that each of the witnesses provide more details on these calculations, specifically:

Q.1. Which homeowners are eligible for the institution's loan modification program?

A.1. We have a wide array of various loan modification programs. Each has varying eligibility requirements. There are very few loans that we service that once the loan is in default is not eligible for some form of loan modification. Many "eligibility" requirements relate to specific "automatic" or "streamlined" loan modification programs. Again, the eligibility requirements can vary based on investor or specifics of the program. With respect to loans owned by

Wells Fargo Home Mortgage, we recently announced a streamlined loan modification program. To be eligible for this program a borrower must be 90 days or more past due, the borrower must own and occupy the home, the property must be a single family residence, and the borrower can not be in bankruptcy.

Q.2. How is success through the program defined? What does it mean that a certain number of homeowners have been "helped" through a loan modification program?

A.2. Wells Fargo Home Mortgage considers a customer "helped" through a loan modification program if a loan is brought out of default status while finding an affordable payment that the borrower is able to support on a long-term basis. Success is helping eligible borrowers achieve this, reducing the number of loans that proceed to foreclosure sale while minimizing losses.

Q.3. If your program has already been implemented, how have you calculated the number of homeowners assisted through the programs?

A.3. The streamlined program applicable to loans owned by Wells Fargo Home Mortgage was implemented on December 15, 2008. That is, we put certain foreclosure sales on hold and commenced efforts to contact and notify eligible borrowers. It is too early to calculate the number of successful loan modifications.

Q.4. If you have more than one loan modification program for distressed borrowers, please provide details on each.

A.4. As indicated previously, we have and will continue utilizing our case-by-case loan modification program. In addition to the streamlined loan modification program for loans owned by Wells Fargo Home Mortgage, we have implemented a number of programs for loans we service for others. That would include the ASF Streamlined loan modification guidance, Fannie Mae and Freddie Mac's Streamlined Modification Program. The criteria for these programs is similar to what was implemented for the Wells Fargo Home Mortgage owned loan program.

Q.5. How many homeowners do you project will be assisted through your institution's loan modification programs, and what information do you use to arrive at that calculation?

A.5. We estimate that approximately 7 of every 10 borrowers are eligible for a Wells Fargo Home Mortgage owned loan modification—and that would include the streamlined loan modification process. We base this on an analysis of loan level data, and an estimation of the number of borrowers who will respond to the program.

Q.6. Please also provide samples of the records and documentation you maintain regarding loans that are modified through your institution's loan modification programs, with appropriate redactions to protect confidential information.

A.6. Yes, we are mailing you a packet regarding loan modifications and will provide that to you directly.

In over a decade of serving in state and federal government, I have learned that even the best consumer programs are useless if those they target for assistance do not know they exist. Please describe in detail the outreach efforts you have made to distressed homeowners to inform them of their new options for loan modification under the programs you administer.

Q.7. Specifically, what additional measures have you taken since the implementation of the program?

A.7. We send out multiple letters of notification providing the borrower with information about the program and urging them to contact us. We send tens of thousands of letters each month urging borrowers to contact us. Additionally, we attend borrower outreach events sponsored by non-profit and other agencies.

We make over 2 million outbound telephone calls each month in an attempt to reach borrowers. For customers who do not respond to the letters, we follow up with multiple telephone calls at various times of the day again advising the customers of the program and determining their level of interest in the program.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR SCHUMER FROM NANCY M. ZIRKIN

Q.1. Nancy and Martin, you both spent a considerable portion of your time on the bankruptcy issue, so I don't want to make you repeat yourselves, but I just want to emphasize one point. Isn't it true that despite some improvements, and major new programs announced by several lenders at the witness table today, that investors and 2nd mortgage holders continue to present major obstacles to loan modifications?

A.1. That is correct. For example, many loans are broken apart and spread across various tranches of complicated investment securities, which means that a wide number of people have often-conflicting interests in a loan when a borrower cannot afford the payments. The only way to modify such loans, without court intervention, would be to put the entire loan back in the control of one person who can make the necessary decisions—which, in the case of securitized loans, has often been compared to trying to unscramble an egg.

Q.2. And isn't it also true that the only way to overcome those obstacles in a broad-based fashion is through bankruptcy? That the bankruptcy courts are the only entity with the power to overrule the objections of either group?

A.2. That is also correct. While I'd certainly be interested in any alternatives that industry opponents of the bankruptcy bill might have for overcoming those obstacles, those opponents still haven't proposed any.

Q.3. Loan modifications continue to be one of the most difficult aspects of this crisis. I'd like to ask the entire panel, what are the most significant obstacles standing in the way of broader loan modifications, especially to the securitized loans that no single person really controls, and what steps can Congress and the Administration take to overcome them?

A.3. The key obstacles are—as you noted—the modern securitization process, and the complications in many cases brought on by the use of piggyback loans. Not all loan modification efforts face these obstacles, which is why efforts like Hope Now, Hope For Homeowners, and—even better—FDIC Chairperson Sheila Bair's loan guarantee idea are all very important. But in most case, voluntary modifications just don't work, because it takes permission from too many people—making the bankruptcy route, which doesn't rely on permission, an absolutely essential part of the response.