

**NOMINATIONS OF: JANET L. YELLEN, PETER A.  
DIAMOND, SARAH BLOOM RASKIN, OSVALDO  
LUIS GRATACOS MUNET, AND STEVE A. LINICK**

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**HEARING**

BEFORE THE

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

**ONE HUNDRED ELEVENTH CONGRESS**

SECOND SESSION

ON

NOMINATIONS OF:

JANET L. YELLEN, TO BE A MEMBER AND VICE CHAIR OF THE BOARD OF  
GOVERNORS, FEDERAL RESERVE

PETER A. DIAMOND, TO BE A MEMBER OF THE BOARD OF GOVERNORS,  
FEDERAL RESERVE SYSTEM

SARAH BLOOM RASKIN, TO BE A MEMBER, FEDERAL RESERVE SYSTEM

OSVALDO LUIS GRATACOS MUNET, TO BE INSPECTOR GENERAL, EXPORT-  
IMPORT BANK, FEDERAL HOUSING FINANCE AGENCY

STEVE A. LINICK, TO BE INSPECTOR GENERAL, FEDERAL HOUSING  
FINANCE AGENCY

JULY 15, 2010

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Printed for the use of the Committee on Banking, Housing, and Urban Affairs



Available at: <http://www.fdsys.gov>

U.S. GOVERNMENT PRINTING OFFICE

63-507 PDF

WASHINGTON : 2011

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For sale by the Superintendent of Documents, U.S. Government Printing Office  
Internet: bookstore.gpo.gov Phone: toll free (866) 512-1800; DC area (202) 512-1800  
Fax: (202) 512-2104 Mail: Stop IDCC, Washington, DC 20402-0001

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**NOMINATIONS OF:**

**JANET L. YELLEN, OF CALIFORNIA,  
TO BE A MEMBER AND VICE CHAIR OF THE BOARD  
OF GOVERNORS,  
FEDERAL RESERVE SYSTEM;**

**PETER A. DIAMOND, OF MASSACHUSETTS,  
TO BE A MEMBER OF THE BOARD OF GOVERNORS,  
FEDERAL RESERVE SYSTEM;**

**SARAH BLOOM RASKIN, OF MARYLAND,  
TO BE A MEMBER,  
FEDERAL RESERVE SYSTEM;**

**OSVALDO LUIS GRATACOS MUNET, OF PUERTO RICO,  
TO BE INSPECTOR GENERAL,  
EXPORT-IMPORT BANK, FEDERAL HOUSING  
FINANCE AGENCY;**

**STEVE A. LINICK, OF VIRGINIA,  
TO BE INSPECTOR GENERAL,  
FEDERAL HOUSING FINANCE AGENCY**

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**THURSDAY, JULY 15, 2010**

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

The Committee convened, at 9:06 a.m. in room 538, Dirksen Senate Office Building, Christopher J. Dodd, Chairman of the Committee, presiding.

**OPENING STATEMENT OF CHAIRMAN CHRISTOPHER J. DODD**

Chairman DODD. The Committee will come to order this morning. Let me welcome all who are here this morning, and particularly, and I would be remiss if I didn't begin my remarks by welcoming the former Chairman of this Committee. At any point you want to come up here and sit in this chair, Paul, you are welcome to it.

[Laughter.]

Chairman DODD. I will tell you, Paul and I love to tell this—  
Mr. SARBANES. Thank you very much, but no thanks.

Chairman DODD. Paul and I love to tell the story. Several years ago now, I was sitting in the chair that Tim Johnson sits in and

Chairman Sarbanes was sitting in this chair with a gavel in his hand and there was a rather chaotic hearing one day. I can't remember the subject matter, but the room was exploding with chaos of one kind or another and Paul had already made the decision to retire from a very distinguished career in the U.S. Congress.

In the midst of the chaos—I will never forget this moment—he took his right arm and put it around my shoulder and with his left hand swept across the room and he said, “Just think, in 6 months, all of this is yours.”

[Laughter.]

Chairman DODD. And little did I know how prophetic that would be in terms of what has happened over the years.

I am going to break tradition a little bit here because these are busy days, obviously, and here we have very distinguished friends and colleagues here. So normally, we would begin with an opening statement and Senator Shelby would make one, but in consultation with my friend from Alabama, what I would like to do is invite our colleagues who are here to introduce the witnesses and then we will make some opening statements ourselves here and then we will get to our witnesses. So if you will bear with us, the three very distinguished nominees this morning, we will proceed in that manner, if that is possible.

Dianne, why don't we begin with you, and then, Ben, I will go to you. And Paul, with respect to you, you have got a little more. We are not in session. You don't have to worry about votes this morning or other committee hearings. So I will go to you as the third introducer.

Senator CARDIN. Mr. Chairman, I would really yield to the former Chairman before me.

Chairman DODD. All right. You have got a vote here yet, Ben. Paul doesn't. So I want to make sure we take care of you.

Dianne, go ahead.

**STATEMENT OF DIANNE FEINSTEIN, SENATOR FROM THE  
STATE OF CALIFORNIA**

Senator FEINSTEIN. Thank you very much, Mr. Chairman, Senator Shelby, Senator Reed. It is a great pleasure for me to be here this morning to express my strong support for Dr. Janet Yellen, President Obama's nominee for Vice Chairman of the Federal Reserve.

I know Dr. Yellen. She has dedicated her life to understanding the complex field of economics. Her background makes her a strong candidate for Vice Chairman at a time when the country is recovering from the economic crisis.

Dr. Yellen graduated Summa Cum Laude from Brown in 1967. She earned a Doctorate in Economics from Yale in 1971. She began her teaching career as an Assistant Professor at Harvard, where she taught from 1971 to 1976. From 1977 to 1978, she served as Economist at the Federal Reserve Board of Governors. In 1979, she moved on to another teaching position, this time at the London School of Economics.

In 1980, Dr. Yellen began as Assistant Professor at the University of California-Berkeley, and she has been there ever since. Today, she is Professor Emeritus of Business and Economics.

Twice, she has been awarded Teacher of the Year at UC-Berkeley's Haas School of Business.

During her time at Berkeley and elsewhere, Dr. Yellen has published numerous research works. They included the noted, *Waiting for Work: A Study of Unemployment*, completed with her husband, George Akerlof, a Nobel Prize winning economist who is here with Janet today. Her work has been published in the *Journal of Economics*, *Business Economics*, and the *Brookings Papers on Economic Policy*, among other publications.

Dr. Yellen has also held a number of other academic and advisory positions. These include serving as a Research Associate in Monetary Economics at the National Bureau of Economic Research, a member of the Advisory Board on Economic Activity at Brookings, and an advisor to the Congressional Budget Office.

Her research has focused on unemployment, monetary policy, and international trade. This combination of expertise will be beneficial as she weighs issues with our rising debt and high unemployment levels. We were just talking about that on the side waiting for my colleagues.

From 1994 to 1997, Dr. Yellen sat on the Board of Governors of the Federal Reserve. There, she focused on consumer credit and small business lending, two areas vital to our current recovery. In 1997, she left the Federal Reserve to Chair the Council of Economic Advisors during the Clinton administration.

And since 2004, she has led the Federal Reserve Regional Districts from San Francisco. In this post, she has closely monitored the regional economy and provided valuable input on the direction of Federal Reserve monetary policy.

Along the way, she has received numerous awards and commendations. These include the Wilbur Cross Medal from Yale in 1997, fellowships at the Yale Corporation and the National Academy of Arts and Sciences, the Maria and Sidney Rolfe Award for National Economic Service by the Women's Economic Roundtable, an honorary Doctor of Laws from Brown. Dr. Yellen's substantial resume speaks for itself.

Her confirmation would add another professionally trained economist to the Federal Reserve Board. This is important, because with Vice Chairman Kohn's departure, Chairman Bernanke would be the Board's only trained economist.

Bottom line: Janet Yellen has the depth of knowledge and experience required to make the important decisions that could possibly have a strong positive and profound impact on our economy. I heartily recommend her to this Committee.

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

Senator FEINSTEIN. Thank you. Happy to do it.

Chairman DODD. That was a fine introduction. We are more than happy to have you stay with us, if you care to, but we also know what schedules are like, so—

Senator FEINSTEIN. If I could be excused, I would appreciate it.

Chairman DODD. You are excused.

Senator FEINSTEIN. Thank you.

Chairman DODD. We thank you for coming.

Dr. Diamond, let me just tell you, Senator Kerry has an opening statement for you which I will include in the record, and a very

gracious statement about your remarkable qualifications, as well, to assume this position. So I will put that in the record, but we want to thank you very much for being here, as well.

Chairman DODD. Let me turn to my two colleagues.

**STATEMENT OF BENJAMIN L. CARDIN, SENATOR FROM THE  
STATE OF MARYLAND**

Senator CARDIN. Thank you very much, Chairman Dodd and Ranking Member Shelby and the Members of the Committee.

First, let me thank and welcome all three of the nominees for the Federal Reserve Board of Governors. We very much appreciate your willingness to serve our nation during this very difficult time. And we also welcome your families, because we know this is a joint effort that will require the sacrifices of the family and we thank you very much for your willingness to step forward on these very important responsibilities.

I am particularly pleased, along with my colleague, Senator Sarbanes, to introduce to the Committee Sarah Bloom Raskin. We are very proud of her service and we are very proud that she is willing to put her name forward for the Federal Reserve Board of Governors. She is joined by her husband, Jamie, who is a State Senator in Maryland with a very distinguished career, and their three children.

Sarah is a 1986 graduate of Harvard Law School. Sarah also graduated from Amherst College in 1983, where she graduated Magna Cum Laude in Economics and a Phi Beta Kappa.

In 2007, Sarah was appointed Commissioner of Financial Regulation for the State of Maryland. In that role, she has done an outstanding job of improving consumer protection and supporting banks through the challenges of the financial crisis. She has been praised by the Maryland Bankers Association and the Maryland Consumer Rights Coalition for her fair, balanced approach to regulation in our State. Mr. Chairman, that is no easy task, to get both the bankers and the consumers to believe that you are doing the right thing and I applaud her for her balanced leadership in our State of Maryland.

Her leadership has been significant for Marylanders working on foreclosure prevention during the financial crisis, improving legislation related to payday lending abuses, and stopping unscrupulous debt collection agencies. These skills, I think, will serve her well in regards to the Federal Reserve Board of Governors.

She has spent much of her career in public service, including serving as Banking Counsel to the Senate Banking Committee under Senator Sarbanes, worked at the Federal Reserve Bank of New York, and helped with the Joint Economic Committee in Congress.

As a member of the Federal Reserve, I am certain she will continue her commitment of keeping our banks safe and sound. Her dedication and work ethic are tremendous assets to our nation during these critical times and I wholeheartedly recommend her confirmation to the Committee.

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

As you know, Senator Mikulski, by the way, was unable to be here this morning but sent a very strong letter or statement in



support, Ms. Raskin, of your nomination, as well, and so we thank her for that, and I will include that in the record, as well.

Chairman DODD. Paul, welcome back to the familiar haunts.

**STATEMENT OF PAUL SARBANES, FORMER SENATOR FROM  
THE STATE OF MARYLAND**

Mr. SARBANES. Thank you very much, Mr. Chairman. I am pleased to be back with you, my good friend, Senator Shelby, Senator Corker, Senator Gregg, and Jack Reed. We used to sit up there and conspire together, I have to admit here.

I am pleased to join with Senator Cardin and Senator Mikulski sending in a letter in very strong support of Sarah Bloom Raskin to go on the Federal Reserve Board. This is a terrific appointment and it really comes at the right time, given the responsibilities that the Fed is assuming in the legislation as well as the many other responsibilities it already has.

I am not going to repeat the biographical statement that Senator Cardin made, but I just want to make just a few quick observations.

Sarah has been an outstanding Commissioner of Financial Regulation for the State of Maryland over the last 3 years. In the 1990s, she served for 5 years, roughly 5 years, on the staff of the Banking Committee, where she was an outstanding member of the staff, very measured in her judgment, extremely hard working, very smart, and very able to deal with people across the board. She was part of a terrific staff, including, incidentally, Kathy Casey, who went from the Committee staff to the SEC and is serving there now with distinction.

I want to take just a moment of the Committee's time to quote from some letters that have come in in support of Sarah because I think it gives you some sense of the breadth of support for her.

The Commissioners of the Conference of State Bank Supervisors has written to Chairman Dodd and Ranking Member Shelby, and I will just quote one paragraph from this:

As Maryland Banking Commissioner, Commissioner Raskin has played a hands-on role as a banking and financial service regulator during a challenging period, bringing leadership to her agency and to Maryland's banking and financial industry. The Conference of State Bank Supervisors and its membership have benefited from her leadership role as a member of our Board of Directors and as Chair of our Legislative Committee. Additionally, she chaired our regulatory restructuring task force. Commissioner Raskin also was appointed to the Federal Financial Institutions Examination Council's State Liaison Committee, where she has effectively represented State banking regulators in joint efforts with the Federal banking agencies on a broad range of regulatory and supervisory issues.

So she has assumed in just a 3-year period of time an important leadership role within the Conference of State Bank Supervisors and I think that speaks well to her talents and her abilities.

The President and CEO of the Conference of State Bank Supervisors closes his letter saying:

Commissioner Raskin enjoys the full personal and professional support of her fellow Commissioners across the country. We hope that the Committee and the full Senate will act quickly in confirming her.

The Independent Community Bankers, whom we, of course, all know and with whom we have interacted on a range of issues over the years, Camden Fine has written to the Committee:

Ms. Raskin's service as Maryland Commissioner of Financial Regulation has given her a practical understanding of the operational concerns of community bankers as they serve their communities and comply with regulatory demands. She appreciates the vital role that community banking plays in the economic life of small and mid-sized communities. Ms. Raskin serves on the Board of the Conference of State Bank Supervisors, chairs the Federal Legislative Committee, the Regulatory Restructuring Task Force.

And then he goes on to close by saying:

I hope that Ms. Raskin can be confirmed quickly so that the Board may have the benefit of her experience as they navigate the remainder of the economic recovery.

And finally, a statement by Kathleen Murphy, who is the President of the Maryland Bankers Association, says, in part:

Commissioner Raskin has been accessible to the Association and member banks on a variety of important issues. She has worked with the Association and the industry to achieve numerous changes in Maryland law that have made the State Banking Charter stronger and more competitive. Commissioner Raskin's belief in a vibrant State banking system, as well as her experience with the Federal Reserve Bank of New York, the U.S. Senate Banking Committee, have led her to assuming the chairmanship of the Legislative Committee of the Conference of State Banks.

In addition to all of this, as my colleague pointed out, Senator Cardin, Sarah got the award, Consumer Advocate of the Year Award, from the Maryland Consumer Rights Coalition. So she has obviously shown an ability to come up with some very practical solutions to some very difficult problems.

Mr. Chairman and Senator Shelby and other Members of the Committee, I simply close with this observation. We depended on Sarah very much when she was on the staff of the Committee. She was really one of our very top people. She brought terrific analytical abilities to her work. She had measured and good judgment. She had the capacity to work very well with others. I think she is going to be a very important addition to the Federal Reserve Board and I really commend her to you in a very strong and unqualified manner.

Chairman DODD. Senator, we thank you very, very much for that recommendation.

Of course, all of us here who have been here for a little while remember Sarah very much as a part of the Committee staff, and I am sure, I don't know if you ever thought one day sitting here that you might be sitting there, so welcome back to the other side of the table. We are delighted to have you with us this morning.

I am going to take a few minutes for some opening comments. Then I will turn to Senator Shelby for any opening comments he may have. And then I will ask any of my colleagues, those who are here, obviously, now, if they want to make any opening statements. And then we will swear in our witnesses and proceed with some questioning for them.

But I thank Senator Sarbanes. We thank you, and Senator Cardin, thank you very much for coming by this morning.

None of us could ever plan these things this way, but obviously the coincidence of having the three nominees here this morning

and at some point later today we will be voting on the financial regulatory reform bill, in a sense, so it is all coming together, ironically in some ways, in having the three of you here as such a critical part ultimately of whether or not we are able to get back on our feet again and how well the Federal Reserve is able to act and deal with these issues.

So today, as has been pointed out, we are considering five very highly qualified nominees. There are two others we will be considering later this morning on the panel. On the first panel are three candidates, as we have all noted here, to serve as the Federal Reserve Board of Governors, one of whom has been nominated to a 4-year term as Vice Chairman of the Board. The Committee will also consider a second panel of two candidates to serve as Inspectors General. The first will serve for the Export-Import Bank of the United States and the other for the Federal Housing Finance Agency.

The Committee considers today the nominations of three Federal Reserve Board Governors. These positions are extraordinarily important because of the critical role the Federal Reserve plays in our economy, be it through the exercise of monetary policy, the supervision of financial institutions, oversight of the payment system, or as lender of the last resort. As arbiter of our nation's monetary policy, the Federal Reserve is charged with promoting full employment and maintaining price stability. The decisions it makes about the money supply and interest rates have profound effects on the performance of the real economy.

Under the financial reform legislation that Congress is poised to consider, the Federal Reserve's supervisory functions will be significantly enhanced. It will be incumbent, obviously, then, on the Federal Reserve to establish a set of robust prudential standards, including capital and liquidity, to govern the activities of the nation's large interconnected banking organizations. The Federal Reserve will be charged with overseeing the functioning of these complex organizations and identifying and addressing the type of excessive risk taking that led this country to the verge of economic collapse.

And as we have seen during the financial crisis, the Federal Reserve's role as lender of the last resort is pivotal to limiting the threats to our financial system. And while the financial reform legislation imposes new conditions on the Federal Reserve's emergency lending authority, conditions that Senator Shelby and I worked on together, the Fed will still retain the awesome power to put billions of dollars of taxpayer money on the line. Given its position in our economic system, much depends, obviously, then, on how well the Fed carries out its varied responsibilities.

In terms of performance, the Fed's track record, I will say politely, has been mixed. While in my opinion the Fed managed the crisis superbly, it clearly, in my view, fell down on the job during the period before the financial crisis. The Fed had authority under HOEPA that, if used, could have prevented, in my view, the serious deterioration in mortgage underwriting standards and the abusive and fraudulent lending practices. In my view, the Fed declined to exercise its authority until well after hundreds of billions of dollars

of overvalued, unsuitable mortgages had been originated, securitized, and distributed to important financial institutions.

The Fed also had supervisory authority over bank holding companies, but events have revealed that its supervision was inadequate, again, to put it mildly. Large bank holding companies were allowed to accumulate significant leveraged exposures to mortgage-related assets. The losses they suffered when the housing price bubble burst helped create the financial crisis from yet we have yet to recover.

Because of these failures, the first draft of our Committee's financial reform bill created both a new Consumer Financial Protection Agency and a Consolidated Banking Supervisor. To be very blunt, that draft bill contemplated removing all of the Fed's authority in areas where it had performed poorly, leaving it with the responsibility primarily over monetary policy.

However, as we worked our way through over the last year or so with the legislation, it became clear that the political will of the Congress was to retain and strengthen the Fed's supervisory role. The Federal Reserve will be part of the Financial Stability Oversight Council, which will function as an early warning system, responsible for spotting and mitigating threats to overall financial stability.

As I stated at the outset of these remarks, the Fed will have responsibility for devising and imposing heightened capital, liquidity, and other standards for large bank holding companies and designated non-bank financial companies. It will help enforce the so-called Volcker Rule, which prohibits proprietary trading and limits investment in hedge funds and private equity funds at banks and bank holding companies. And it will have a role in supervising systemically important financial utilities, such as clearinghouses, that are important to the stability of the payment system.

Moreover, the Fed will continue to play a very key role in helping the economy recover from the effects of the financial crisis. And while the economy is growing, it is not growing fast enough, I believe all would acknowledge, to help millions of Americans who lost their jobs as a result of this crisis. The seasonally adjusted Civilian Unemployment Rate declined from 9.7 percent in May to 9.5 percent in June, but remains far too high. Business investment demand, as measured by data on fixed non-residential investment, remains subdued because of excess capacity. And while headline price indices continue to increase at about 2 percent, year on year, other measures of price change suggest that we are moving toward price deflation. In May, the core CPI increased by just 0.9 percent.

It is evident, then, that the economy is going to need all the help the Fed can provide over the coming years. Put simply, the Federal Reserve is at the forefront of maintaining financial stability. Congress is entrusting the Federal Reserve with tremendous responsibilities, all of which the Fed, I might point out, has sought in this process. Now the Fed must step up and use these new powers to serve obviously the greater good of our nation.

We have before us today a slate of very, very accomplished candidates, and I mean that very sincerely. I have sat in this Committee for 30 years and I can't think of another panel I have seen that has come before us as qualified as this panel is to take on

these responsibilities, and I can't thank you enough for your willingness to do so and to step up and go through the arduous task in front of us. Our job, obviously, is to assess whether they are up to the task of serving on the Federal Reserve Board at this critical time, and I look forward this morning to discussing their views with us on these issues.

I am going to apologize in advance. I am going to be in and out in this process this morning because we are going to be considering on the floor the financial regulatory reform bill this morning, as well, so I need to be there, as well. So I will be coming back and forth, and Tim Johnson and Jack Reed and Sherrod, and I am confident maybe others on our minority side will step in, as well, and be here for this process.

But again, I thank all three of you. I notice that two of you, of course, had the benefit of a Connecticut education and a third has a daughter named Grace, so you are in pretty good stead with me to begin the process, having a daughter named Grace, as well.

[Laughter.]

Chairman DODD. With that, let me turn to Senator Shelby.

#### **STATEMENT OF SENATOR RICHARD C. SHELBY**

Senator SHELBY. Thank you, Mr. Chairman.

The Federal Reserve faces, as all of you know, some of the greatest challenges it has ever confronted. The economy is highly vulnerable and there is little clarity with respect to the best way forward. The banking system struggles to emerge from the financial crisis and hundreds of institutions will likely fail before we recover fully.

During the crisis, the Fed created massive new liabilities and ballooned its balance sheet from \$850 billion to more than \$2.3 trillion. Earlier this year, the Fed talked mostly about its strategy for removing its extraordinary support measures. Lately, as the economy seems to have hit another soft patch, discussion at the Fed has been a mixed bag. Some fear inflation, while others fear deflation. Some talk of unwinding the Fed's massive asset holdings while others talk about even more asset purchases, further ballooning the Fed's balance sheet.

The nominees for positions on the Federal Reserve Board, if approved, will face difficult and important decisions for the American economy. And while there are before us three talented and experienced candidates, I believe that some inquiry is in order, Mr. Chairman, to determine whether their qualifications are aligned with the positions for which they have been nominated. The work of the Federal Reserve is highly specialized and demands the best qualified and most capable people in the country that we can produce.

I will be interested to learn today if the nominees before us meet that standard. I will also want to be assured that these nominees will work to increase the Board's transparency, both to the public and to Congress.

Many of my colleagues believe that the Fed's relationship with Congress needs some mending. The Fed in the recent crisis was overly opaque and not receptive to providing information to Congress or the public. The Fed often seems more interested in seeking

additional power and authority, even though it failed to use its current authorities in the run-up to the crisis, a lot of us believe.

Ironically, despite its recent failures, the Fed could soon be rewarded, as Senator Dodd said, with expanded authorities and powers under the Dodd-Frank bill. With that in mind, I would want to hear what lessons have been learned and how the nominees intend to use those lessons as members of the Board.

The nominees, I believe, should identify what they learned about monetary policy, transparency, accountability, and financial regulation during the recent crisis. I will also be interested to learn where each of the nominees would draw the line between monetary and fiscal policy, a distinction that was blurred by the Fed during the recent crisis. Finally, each nominee should share their views, I believe, on credit channeling by the Federal Reserve to preferred and specific segments of financial markets, which amounts, I believe, to the Fed picking winners and losers.

Our second panel, and Mr. Chairman, if you will indulge me, I want to mention this, includes the President's nominee to be the Inspector General of the Federal Housing Finance Administration. And while we welcome this nomination, I would like to point out, Mr. Chairman, that nearly 2 years after passage of GSE legislation, we still have not received a nominee to head the Federal Housing Finance Administration. Both GSEs, as we all know, are in conservatorship, being run by the Federal Housing Finance Administration. Taxpayers have already lost \$150 billion and counting on the bailouts of these organizations. Two years would be much too long under normal circumstances, but under the current circumstances, I think it is inexcusable.

By law, the Federal Housing Finance Administration is supposed to put the failed mortgage lenders into a safe and sound condition and to preserve their value. But to accomplish this goal, the Federal Housing Finance Administration acts with all the powers of the shareholders, directors, and officers of the entities. Consequently, only the Inspector General is examining the practices of the conservator.

I look forward to hearing later on from Mr. Linick, if we are here, on his plans for providing the Committee and the American people with long-overdue oversight of FHFA, especially as it relates to the conservatorship of Fannie Mae and Freddie Mac.

Thank you, Mr. Chairman.

Chairman DODD. Thank you very much, Senator Shelby.

Senator Reed?

#### **STATEMENT OF SENATOR JACK REED**

Senator REED. Well, thank you very much, Mr. Chairman.

I want to welcome the nominees that the President has chosen very well and very wisely. You have got extraordinarily talented individuals with long years of experience. Dr. Yellen, of course, is a Brown graduate. We have to say no more.

[Laughter.]

Senator REED. Mr. Diamond is an expert in economics from Yale University as an undergraduate, couldn't get into Brown.

[Laughter.]

Senator REED. And then Ms. Bloom Raskin is a graduate of Harvard Law School, so nice to see, like me, you found a job.

But we are here at a critical moment, and there are those that suggest that things are coming along and we have to start focusing on sort of the great pivot away from support of the economy. But for the thousands and thousands of unemployed Rhode Islanders, nothing has changed much and we have to keep our eyes focused on unemployment, and the Fed, for many reasons, is the most significant actor in this situation, continuing to support policies that will put people back to work.

There is some encouraging news today. Claims seem to have fallen much more than expected, so that is a good sign. We have been increasing jobs over the last several months. But until we have a solid growth in employment that is sustainable and recognized by people, not here and on Wall Street but on Main Street, then we haven't done the job. So I would urge you in all your deliberations to keep that thought foremost in mind.

There are also some areas of innovation that might be embraced. I have been suggesting a work-share plan in which the unemployment funds are sort of used not to totally subsidize someone, but to help a business maintain partial employment if they maintain benefits. Chairman Bernanke has embraced that principle. Several States recently, including Oklahoma, have adopted it. So there are innovative ways we can make our funds go further and help more people. I hope we do that.

As we have all discussed, the Chairman and the Ranking Member, with the new Dodd-Frank bill that is just about to be passed, significant responsibilities will be given to the Federal Reserve. One of them will be, for the first time, there will be a Vice Chairman of Supervision on the Federal Reserve Board whose charge will be to look carefully at the regulatory arrangements that are in place. And now, as one of the chief voices on the proposed Financial Oversight Council, this person and the Board in toto will be extraordinarily important.

So you are coming onto the Federal Reserve Board at a critical moment, and I am very confident because of your skill and your dedication that you will do a superb job.

One final point. I think these confirmation proceedings are interesting. I am sure you find them interesting. But it does send a very strong message that through the Senate, you ultimately are accountable to the people of the United States, and I would like to send that same message to the individuals who operate as the President of the Federal Reserve Bank in New York, because that position is one of the most significant regulatory positions in the country. To have any confusion about who he or she may work for, I think, is a mistake, so I will continue to pursue that effort.

Thank you all.

Chairman DODD. Thank you very much.

Before I turn to Senator Gregg, let me just mention, I inquired of staff as to why we haven't had someone come over from FHFA and let me use the opportunity here. I presume there is someone from the Administration in the audience. It is long overdue. The idea originally was to have the head of FHEO to run that, and they

did for a while, but it is a vacant seat and they ought to get it filled. So I appreciate Senator Shelby raising that point.

Judd, good to have you here this morning.

#### STATEMENT OF SENATOR JUDD GREGG

Senator GREGG. Thank you, Mr. Chairman, and it is good to be here to participate in this hearing with three people who I think are exceptional. I appreciate the President's choices here and I appreciate your willingness to serve. It is nice to have folks of your talent and ability coming into the responsibility of the job of the Federal Reserve.

As we move forward over the next 3, 5, 10 years, the Federal Reserve's role is going to become even more and more critical. Regrettably, this country is on a track to fiscal insolvency under the present spending activities of the Congress and the debt which we are adding, and really, the only stabilizing force right now is the Federal Reserve because the Congress is totally irresponsible. And so your role is going to become more and more important in the role of—you can't correct our failures, but at least you can point them out and hopefully maintain the stability of the currency while we try to sort out the problems of domestic fiscal policy.

So this is going to be one of the most critical periods in the history of the Federal Reserve, over the next five to 10 years and I appreciate the fact that talented people like yourself are going to be there. Thank you.

Chairman DODD. Well, very good. I am going to ask all three of our witnesses to rise—

Senator BROWN. Mr. Chairman?

Chairman DODD. Oh, I am sorry. Senator Brown, I apologize.

Senator BROWN. I am not that new still, Mr. Chairman.

Chairman DODD. No, you are new enough, so go ahead. You went to Yale anyway.

[Laughter.]

#### STATEMENT OF SENATOR SHERROD BROWN

Senator BROWN. And I don't have that much to say, either, Mr. Chairman, but thank you. I appreciate the three nominees and I echo Senator Gregg's comments about how happy we are with the President's appointments and the quality of appointments and your willingness to do public service.

I want to briefly—obviously, I got the hint, Mr. Chairman—very briefly mention two things that are not necessarily historically in the sort of well-defined—not historically a part of the Fed's, the well-defined part of the Fed's job description. One is, as I mentioned in my office to the three of you, is manufacturing.

You know, this country 30 years ago, about a third of our GDP was manufacturing. About 11 percent was financial services. Today, those numbers are almost flipped, and we know what happened in a lot of ways. We obviously know what happened in the financial crisis. We also know what happened to particularly small town and medium-sized industrial town America and those cities of 20,000 to 50,000 that dot our landscapes, particularly in the Midwest, but really all over, where a plant closes or two plants close and the devastation to the town is long lasting. The young people



that get educations leave those communities because we don't offer them the kind of job opportunities in so many ways.

So I would hope—and I think if you look in an historical context, what happens when a country turns to financial services and away from making things, and whether making things is agriculture or transportation or especially manufacturing, look what happens to the middle class. Look what happens to the long-term prosperity of the nation. So I hope you will consider that in your deliberations.

The other thing that I wanted to mention is, and I have noticed this during the debate on the unemployment insurance bill. I go to the Senate floor almost every day and read letters from constituents, many of whom have been employed for 25 years, often with the same employer, paid into unemployment for years, been laid off for a year and a half, are losing their job skills in many ways. We have been reading more and more about that.

And I mention that because I think that many people in your position and my position talk a lot about numbers. Ninety-thousand Ohioans will lose their unemployment if we don't act next week, as I think we will. We cite all the numbers we do, but we don't often enough put a human face on what we do. And I hope that you find a way in the generally insulated jobs that you all have and the insulated jobs that we have, and we are guilty of this too often, of putting a face on the kinds of human suffering that you see come across your desk in the form of statistics.

I know that is a challenge sometimes, but whether—I know the President gets ten letters every day that he reads from people around the country. You aren't the focus of letter writers from people that have stories to tell, obviously, as much as the White House or as much as your offices, but I encourage you to find ways to do that so that as you formulate public policy, it really is more than just numbers and statistics and theories and practice and all of that, because I think it will serve our country well. I know from my conversations with you, you have that inclination, that proclivity anyway, and I hope you will find a way to drive it home even more in the months ahead.

I wish you well in this hearing and wish you well as you assume your jobs, which I assume that you will. Thanks.

Chairman DODD. Senator, thank you very much. My apologies again.

Now, we will ask you to stand, if I can, all three, and raise your right hands, if you will. I will ask you, do you swear or affirm that the testimony you are about to give is the truth, the whole truth, and nothing but the truth, so help you, God?

Ms. YELLEN. I do.

Mr. DIAMOND. I do.

Ms. RASKIN. I do.

Chairman DODD. And do you agree to appear and testify before any duly constituted Committee of the U.S. Senate?

Ms. YELLEN. I do.

Mr. DIAMOND. I do.

Ms. RASKIN. I do.

Chairman DODD. I thank all three of you.

Before turning to you for your statements, let me ask you, and I will begin with you, Dr. Yellen, any family members here at all you would like to recognize?

Ms. YELLEN. Thank you. My husband, George Akerlof, and my son, Robert Akerlof.

Chairman DODD. Very good. Glad to have you with us.

Dr. Diamond?

Mr. DIAMOND. My wife, Kate, and my son, Andy, are here.

Chairman DODD. Very good, as well.

Ms. Raskin?

Ms. RASKIN. I will introduce my husband, Jamie, and my three teenagers, Hannah, Tommy, and Tabitha. My parents are here from Connecticut—

Chairman DODD. Good.

Ms. RASKIN.—my mother, Arlene, my brother, Kenneth—

Chairman DODD. Very smart to bring those from Connecticut here.

[Laughter.]

Ms. RASKIN. My sister-in-law Erica—

Chairman DODD. Is anyone from the Raskin family not here in this room today?

[Laughter.]

Ms. RASKIN.—my father-in-law, his wife, and my niece and nephew and another sister-in-law.

[Laughter.]

Chairman DODD. You have done very well. I hope you didn't miss anyone. That is all I can tell you. The ones you have mentioned won't care. The ones you have forgotten will never forget that you have avoided them.

[Laughter.]

Senator SHELBY. Five years on the Committee helps.

Chairman DODD. Yes, her 5 years on the Committee, being here. Well, very, very good, and what we are going to do is begin with you, Dr. Yellen, your opening statement.

Now, normally, having read over your statements last evening, normally, I ask that the people try to restrain their remarks to 5 minutes apiece, but having read your statements, I want to urge you to speak for 5 minutes apiece. Rather brief statements, well advised, I think, by some. Don't make too long an opening statement.

So we will begin with you, Dr. Yellen, and let me just say to my colleagues, as well, for the purpose of the record here, any statements that Members of this Committee have, we will include in the record, and any additional questions they don't get to ask here this morning will also be included. We would ask the nominees, as quickly as you possibly could, to respond to those questions.

I believe it will be the appetite of this Committee to want to move along as quickly as we can, recognizing we have a relatively short amount of time left in this session of Congress, and I believe it will be the desire to want to move these nominees along, barring something that we are unfamiliar with. So on the assumption of that being the case, we would ask you to be as responsive as you can as quickly as you can.

And with that, Dr. Yellen, thank you once again. We are delighted to have you back here with us, and again, I can't begin to

thank you. I loved last night reading over your publications and that you worked on with your husband on some very interesting subject matters and topics. In fact, I made check marks on a few of them that don't really relate to this Committee's jurisdiction, but I would be very interested in going over and reading, so I thank you very much.

**STATEMENT OF JANET L. YELLEN, OF CALIFORNIA, TO BE A MEMBER AND VICE CHAIR OF THE BOARD OF GOVERNORS, FEDERAL RESERVE SYSTEM**

Ms. YELLEN. Thank you. Chairman Dodd, Senator Shelby, and Members of the Committee, I am honored to appear before you as President Obama's nominee to serve as a member and Vice Chair of the Board of Governors of the Federal Reserve System. If I am confirmed to these positions, I look forward to working with this Committee in the coming years.

I am wholeheartedly committed to pursuing the Federal Reserve's Congressionally mandated goals of maximum employment and price stability and to strengthening our program of supervision and regulation, building on the lessons learned during the financial crisis. We must work together and in cooperation with central banks and governments around the world to mitigate systemic risk in the financial and payment systems so that our country never again suffers such a devastating episode of financial instability.

We have learned a harsh lesson about the dire consequences a financial crisis has for ordinary Americans in the form of lost jobs, lost homes, lost wealth, and lost businesses. And those of us charged with overseeing the financial system should always keep this human cost in mind.

I have served since 2004 as President and Chief Executive Officer of the Federal Reserve Bank of San Francisco, and before that, from 1994 through 1997, as a member of the Federal Reserve Board. Through this service, I have gained experience in every one of the Federal Reserve's areas of responsibility, including monetary policy, banking supervision and regulation, consumer and community affairs, and the operation of payment system. I believe this extensive background equips me to work under Chairman Bernanke as a leader of the Federal Reserve System as we strive to carry out the missions Congress has assigned to us.

Over the next few years, the Fed must craft policies that ensure that our economy accelerates its progress along the recovery path it has begun to trace. With unemployment still painfully high, job creation must be a high priority of monetary policy. But we must also avoid any threats to price stability. That means that when the appropriate time comes, we must withdraw the extraordinary monetary accommodation now in place in a careful and deliberate fashion.

My approach going forward, as in the past, will be to bring a thoughtful and independent voice to the Federal Open Market Committee deliberations on monetary policy, drawing on the insights of business and community leaders throughout the country and thoroughly analyzing macroeconomic trends that affect the economic outlook and the risks to our forecasts.

In my view, Congress has wisely granted the Federal Reserve the freedom to make independent monetary policy decisions in pursuit of Congressionally mandated goals based on a forward-looking perspective and the best judgments of the Federal Open Market Committee participants. I believe that experience in the United States and around the globe demonstrates that central bank independence in monetary policy produces clear societal benefits. When central banks are independent, economies perform better, inflation is lower and more stable, and long-term interest rates are lower and less volatile. In other words, an independent central bank is best equipped to promote both price stability and high levels of growth in employment.

I should stress, though, that independence brings with it both responsibility and accountability. The Federal Reserve is fully accountable to Congress, and that is how it should be. That means the Fed must explain its actions, outlook, and strategy and provide the information necessary for Congress and the public to understand and evaluate its policy decisions.

I strongly support Fed independence in monetary policy and I am committed to enhancing the transparency that is essential to accountability and democratic legitimacy.

Senator JOHNSON. [Presiding.] Mr. Diamond?

**STATEMENT OF PETER A. DIAMOND, OF MASSACHUSETTS, TO BE A MEMBER OF THE BOARD OF GOVERNORS, FEDERAL RESERVE SYSTEM**

Mr. DIAMOND. Senator Johnson, Ranking Member Shelby, Members of the Committee, I am honored to have been nominated by President Obama to be a member of the Board of Governors of the Federal Reserve System. I am grateful to this Committee for scheduling this hearing.

If I am confirmed by the Senate, I will work to the best of my abilities to fulfill the responsibilities of this office. Those responsibilities have always been significant. The experience of the recent financial crisis and the financial reform legislation have underlined the multiple jobs the Fed has in working to fulfill the dual mandate of high employment and price stability. The Fed will have major work to do to implement the tasks that the legislation will be placing at the Fed. I would be honored and pleased to be able to be part of the process of responding to this challenge.

I studied both mathematics and economics as an undergraduate at Yale University. I received my Ph.D. in Economics from the Massachusetts Institute of Technology in June 1963. Since then, I have been a faculty member, first at the University of California at Berkeley, and since 1966 at MIT. Throughout this period, I have taught and done research in economics.

My primary focus in both teaching and research has been economic theory, particularly general equilibrium theory, macroeconomics, search theory, and public finance. Within public finance, my primary focus has been on taxes, pensions, and social insurance, particularly Social Security. I have done both theoretical analyses and policy analyses. I have also done research in other areas, including behavioral economics and law and economics. I took classes at Harvard Law School as part of my preparation for

doing research in law and economics. I believe in being well grounded in a subject when doing research or policy analysis.

In addition to microeconomics, macroeconomics, and public finance, I have also taught money and banking and law and economics. Being a member of two economics departments with great collegial interactions, I have gained a wide knowledge of a variety of economic topics as well as detailed knowledge in my areas of expertise. As a consequence, I have considerable awareness of the development of economic analyses of monetary policy and its impacts on both inflation and employment, as well as studies of the determinants of financial crises.

A central theme in my research career has been how the economy deals with risks, both risks at the individual level and risks that affect the entire economy. In all of my central research areas, I have thought about and written about the risks in the economy and how markets and Government can combine to make the economy function better for the people there. If confirmed, this background should be very helpful at the Federal Reserve as part of the process of addressing our heightened awareness of the dangers of systemic risks. My background in behavioral economics and law and economics give me high awareness of the issues involved in consumer protection and in increasing financial literacy.

If confirmed, I would welcome the opportunity to help address the important issues that have been raised by the financial crisis as well as the longstanding issues and concerns that the Federal Reserve faces, bringing my research experience and expertise to bear on these difficult and important issues. Thank you.

Senator JOHNSON. Ms. Bloom Raskin?

**STATEMENT OF SARAH BLOOM RASKIN, OF MARYLAND, TO BE  
A MEMBER, FEDERAL RESERVE SYSTEM**

Ms. RASKIN. Senator Johnson, Senator Shelby, Senator Brown, and to all the able staff who are sitting in the seats I remember so well, as a former Banking Counsel to your Committee, I cannot quite express what an honor it is to appear before you today. I never dreamed one day I would be here as a nominee to the Federal Reserve Board, or maybe I did dream it at some point, but I certainly never believed it.

I must thank, first of all, Senator Sarbanes, who has been an extraordinary mentor to me over the course of my career and has shown me how one can be passionately committed both to the public interest and to one's family at the same time.

It is a great and humbling honor to be nominated by President Obama to the Federal Reserve Board and I am very grateful. If confirmed, I will participate in the essential and difficult work of restraining inflation and maintaining price stability, maximizing sustainable employment and economic growth, and trying to continually reconcile and harmonize these goals.

This is a challenging moment for the Federal Reserve. Every Member of this Committee knows that even though the worst of the crisis is over, it remains a precarious time for far too many of our families and businesses. The Fed must do its part to restore the underlying strength and vibrancy of the American economy.

As Maryland's Commissioner of Financial Regulation over the last 4 years, I have worked day and night to counter the devastating effects on our communities of the national banking and liquidity crisis, the terrible spikes of home foreclosures, and high unemployment and underemployment. At the same time, as a front-line banking regulator, I have worked to revise and replace ineffectual and counterproductive State regulations that do not put the Government properly on the side of economic progress for our people. If I am confirmed, my experience working through this crisis at the State level will deeply inform my actions as a member of the Federal Reserve Board.

The proper conduct of monetary policy by our central bank is essential to calming the waves of financial instability that have engulfed so many of our communities, businesses, and households. Over the course of the last generation, the Federal Reserve has achieved price stability and successfully anchored long-term inflationary expectations. This achievement is critical to our economic strength and it remains a central institutional objective that I subscribe to wholeheartedly.

But it is only a partial victory when many American households continue to face the perils of unemployment and many small businesses struggle with weakened consumer demand and reduced access to credit. We need to strengthen this recovery by expanding its foundations. This means that in addition to maintaining stable inflationary expectations and keeping a vigilant eye on the emergence of new bubbles, the Fed must seek to fulfill the other part of its statutory mandate by addressing unemployment, which has pervasive social costs.

In my State, I have seen these costs in the loss of productive capacity, a weakened housing market, increased strain on State and local resources and services, and a nervous reluctance on the part of many businesses and banks to invest and make loans. The Fed must work for a broad and sustained recovery that not only controls inflation, but facilitates growth and more robust business lending by banks.

In sum, I know that there is a lot of hard work to do at the Fed. If you choose to confirm me, I will bring all of the experience, knowledge, and commitment I have gained over the course of my career to the task of fulfilling Congress's statutory expectations, and I will maintain the standards of professionalism, independence, and probity that I have always tried to uphold in my career and that, to my mind, are exemplified by the work of this Committee.

Thank you for the honor of hearing me today. I will be happy to respond to any and all questions you may have, verbally or promptly in writing, throughout this process and, indeed, throughout my tenure at the Fed, if I am fortunate enough to be confirmed.

Senator JOHNSON. Thank you.

In light of the fact that Senator Shelby has to go other places, I defer to Senator Shelby.

Senator SHELBY. Thank you, Mr. Chairman. Those other places just follow Senator Dodd to the floor and see what he is saying about this package.

[Laughter.]

Senator SHELBY. But we must go in a few minutes.

I have a number of questions for the record, but I have a question for each one of you. I will start with you, President Yellen. President Yellen, the Fed's 12th District, which is your responsibility, has experienced a large number of bank failures, some 65 institutions, at an estimated loss of around \$28 billion, I have been told, since 2004. Your district experienced failures of important firms with national implications. Further, the housing sector in your district displayed speculative excesses in the run-up to the crisis.

Regarding your tenure as President of the 12th District, I have two questions. First, what role do you believe a breakdown in regulatory oversight played in the failure of the institutions in your district? And second, were you raising any warning flags with respect to speculative excesses or lax monetary policy during that period?

Ms. YELLEN. So the first question was did a breakdown in—

Senator SHELBY. Do you believe a breakdown in regulatory oversight—what role do you believe that a breakdown in regulatory oversight played in the failure of the institutions in your district?

Ms. YELLEN. Working with other regulators, I think that our regulatory oversight was careful and appropriate, but I believe that—

Senator SHELBY. Excuse me. You say it is careful and appropriate? Most people believe—

Ms. YELLEN. Given the—

Senator SHELBY.—it was lax and inappropriate.

Ms. YELLEN. Well, I—in the institutions that have failed in my district are mainly community banks—

Senator SHELBY. OK.

Ms. YELLEN.—with high exposure to commercial real estate.

Senator SHELBY. OK.

Ms. YELLEN. And when I say careful and appropriate, I mean that as early as 2001, people in the Federal Reserve System and particularly in my bank were at the forefront of focusing on high concentrations that existed in the banks we supervised in commercial real estate. We saw that these exposures and concentrations could be a source of vulnerability and we monitored this carefully throughout.

I would say, the first briefing I ever received from my banking supervision staff when I joined the Federal Reserve Bank of San Francisco was on commercial real estate. They pinpointed it as a vulnerability, and for the 65-odd banks in my nine-State region, really, this is what is driving problems.

I would say that the regulatory response was insufficient over a period of years. I believe guidance came out in 2006, I believe it was, to the supervisors and to banks stating essentially that banks with high exposures needed to carefully manage risks around these exposures. I think what we have learned in hindsight is it was very hard for all of the regulators involved to take away the punch bowl in a timely way, and as the supervisors in the field, we didn't really have the ability to either limit concentrations or, for example, to demand that banks hold higher capital against these concentrations.

I would describe the guidance that came out as weak and the material loss reviews that have been done of the institutions that we supervise essentially say that this was the pitfall, and I would hope that going forward, one thing we have learned from this crisis is there is a need for all of us in regulation to act in a timely way to take away the punch bowl and to require more stringent capital requirements.

Senator SHELBY. Thank you.

Commissioner Raskin, in testimony before the Congressional Oversight Panel for the TARP, you said, "In the run-up to this financial crisis, both Wall Street and monetary policy were spiking the punch bowl." Those are your words. I presume from your comment that you believe that monetary policy was too loose for too long prior to the crisis. At what point would you have changed course? And what do you base your judgment on? And as Dr. Yellen has said, what have you learned, you know, what have we all learned but especially assuming you are confirmed as Member of the Board of Governors of the Fed, what has the Fed learned?

Ms. RASKIN. Thank you, Senator Shelby. I think that there have been a number of lessons learned, and there is clearly a lot of blame to go around.

In terms of the Federal Reserve, I think that the Federal Reserve has been subject to substantial and I believe justified criticism regarding the run-up to the failure. There, I believe, were failures both on the regulatory side and on the monetary policy side.

From the regulatory perspective, I think that there was not a sufficient focus given to the importance of capital and the importance of building up capital and robust capital during good times. We now know how difficult it is to find capital when times are not so good.

I also think that there was an inappropriate treatment, regulatory treatment given to off-balance-sheet assets. And as we now know, those assets should have been more adequately capitalized, and they were not.

So I think there was quite a bit of misjudgment regarding asset quality, including the quality of mortgage-backed securities, up to the run-up through the crisis on the regulatory side. So I think there are a lot of lessons there that are worth repeating and correcting.

From the monetary policy side, which you also mentioned in that quote, I think the extent of the bubble, the housing bubble that was developing, was not appropriately monitored or taken seriously. And for those of us on the ground level, we saw quite a number of disturbing trends in housing markets, including sometimes weak regulation of the mortgage side of origination.

So clearly there were signs, also signs of predatory behaviors that were fueling this bubble, and it would have been good if the Federal Reserve Board had been able to see some of the determinants of that bubble.

Senator SHELBY. Thank you.

Professor Diamond, in an interview with *Macroeconomic Dynamics*, a publication, in 2007 you stated the following, and I quote: "I am a card-carrying behavioral economist, and I think that matters in both micro and macro."



Do you believe, Dr. Diamond, that behavioral economics can be applied to the regulatory functions of the Federal Reserve? And if so, in what ways? And should you? Or should we?

Mr. DIAMOND. Yes, I think it is very important, and the clearest example, and something I learned in the background information that the Fed has given me in preparation for the hearings and, if confirmed, carrying on, there was discussion of the treatment of disclosure with financial contracts. And they told me that their attitude toward disclosure had been to basically make sure everything was disclosed in the sense that a lawyer could see it was accurate. And they had learned the lesson, and now they were focusing on disclosure in a way that the person engaging in a financial contract, the man in the street, could understand what the financial contract was going to do.

Behavioral economics draws heavily on cognitive psychology, and cognitive psychology is very aware of the difficulty for inexperienced people in interpreting complicated elements. And this, I can add, is one of the things I also studied when I was taking classes at Harvard Law School, the issue of contracts that are hard to understand, contracts that are not available for negotiation. I think the behavioral economics aspect on the regulatory side is very important.

Senator SHELBY. Mr. Chairman, I have a number of questions that I would like to submit for the record. I appreciate you deferring to me a minute ago. I have got to go to the floor. Thank you.

Senator JOHNSON. Dr. Yellen, Dr. Diamond, and Ms. Bloom Raskin, what do each of you believe will be the greatest challenge for the Fed while implementing the Wall Street reform legislation? Dr. Yellen?

Ms. YELLEN. Thank you, Senator Johnson. We have enormous responsibilities that will be given to us under this legislation. The first key challenge will be to improve our supervision particularly of the largest and most complex bank holding companies based on what happened in this crisis and the lessons that we have learned. And that is something that is already taking place, partly building on what we learned from, I think, the very successful stress tests that were conducted of the 19 largest banking organizations last spring. I think what we learned is that taking an approach to bank supervision that involves horizontal simultaneous reviews of large organizations using multidisciplinary teams, including economists, we learn a great deal about the true situation and comparative situation in large banking organizations. And this is a strategy and tool where we are employing on a systemwide basis to ramp up our supervision of these institutions.

Going forward, we are being asked in this bill, appropriately so, to raise capital standards and liquidity standards for these institutions to take account of their impact on financial stability as well as to improve our understanding of the risks in the financial system and how they can impact these institutions. And we are working very hard to make that improvement.

More broadly, the bill creates an oversight council in which the Federal Reserve is expected to work collaboratively with other regulators to assess and monitor potential threats to financial stability

that may occur anywhere in the financial system, and I think it will be a challenge for us to enhance our work in that area.

So these are among the challenges I see for us and tasks coming from this legislative agenda.

Senator JOHNSON. Dr. Diamond, do you have any additional insights?

Mr. DIAMOND. Yes, I do. If you look back over the last few decades, we have seen an astonishing change in the financial environment. Financial engineering has produced a vast array of new instruments, and we have also seen an enormous growth in hedge funds, new institutions engaging in using the new instruments. And the financial engineering we have seen has done a great deal of good, but in the crisis has done a great deal of harm. And a big part of that problem was not just the regulators, but also the financial institutions themselves did not understand the risks they were taking on and the risks associated with the interconnections of the different financial institutions.

Going forward, I think we are going to see more change. That is the way the world goes, particularly the American way, and it is important that we not ask the simple question how could we have prevented the last crisis and put in place a Maginot Line for dealing with the last crisis but, rather, we monitor how things are evolving and how regulation and consultation and discussion with financial players can adapt to the changing circumstance so we do not get another crisis which is not the same old crisis but a brand-new and equally horrible crisis.

Senator JOHNSON. Ms. Bloom Raskin, do you have anything to add?

Ms. RASKIN. Yes, I would add a bit. I think that as you rightfully point out and observe, implementing the legislation is going to be a huge challenge. What in essence the Federal Reserve is going to have to step up to the plate to do is to really put in place an enhanced, consolidated supervisory plan for our largest institutions and those institutions that are deemed to be systemically significant. And when we talk about enhanced, consolidated supervision, it is really something quite robust. It is a set of regulatory measures that include capital and leverage, corporate governance, internal controls, proper risk management systems, and these are all items that are extremely complicated for the most complicated institutions.

So I think the work really cannot be underestimated here. I think that there is going to be quite a bit of organizational work, too, that will need to be done internally at the Federal Reserve to make this done correctly.

Senator JOHNSON. Senator Merkley.

Senator MERKLEY. Thank you very much, Mr. Chair, and thank you to the panel.

I want to start with just a general issue and see if any of you have thoughts you would like to share. There is an ongoing debate here in Washington about deficit reduction versus monetary and fiscal stimulus. And, in essence, it could be reduced a little bit to how do you steer on the one side to make sure that you do not have a Greek-like debt crisis, and on the other side how you do not end up with a decade-long, Japan-style recession? And so any insights

on the relevance of the experience of those two nations or insights for how we should manage our way through to a healthier economy.

Ms. YELLEN. I will begin. I think we have an outlook at this point where we seem to be in recovery but the recovery is not proceeding at a pace that is sufficient to bring down unemployment very rapidly. And so it is clear that it is appropriate—long-term unemployment is very high, it is clear that it is appropriate for us to be asking what to do.

I would say as Congress considers the option for further fiscal stimulus now, which is natural given the outlook, I would emphasize that it is very important and Congress will have more flexibility to move in the short run to support the economy if simultaneously it can put in place and show credibility on taking the measures that are necessary to attack the long-term deficit, which I think is widely understood to be an unsustainable situation that requires painful policy action.

So if simultaneously Congress were able to put in place meaningful measures that would phase in over time to address medium- and longer-term deficit issues, I believe that would create greater scope in the shorter term for Congress to also contemplate, if you consider it appropriate, actions to address short-term weakness in the economy.

Senator MERKLEY. Thank you.

Ms. RASKIN. Senator Merkley, I think your reference to Japan actually is noteworthy because I think there are a couple lessons there that we need to keep in mind, one having to do with the fact that, you know, Japan's recovery was probably slower than they would have liked, certainly, and it had something to do with not having a strong, robust resurgence of bank lending. The banking sector stayed weak there for quite a number of years. So I think that is something that we want to keep in mind here, especially as we have not yet seen an uptick in bank lending, the kind of uptick that we would like to see to actually spur growth. So I think that is one possible lesson of Japan, and then the other being just the general stop-go nature of that recovery, the importance to sort of think through a more sustained way of moving forward.

Senator MERKLEY. Well, you mentioned lending so let me use that as a segue, because I think many of my colleagues have the same experience that I have had of going home and hearing from every business group, every set of small business owners how difficult it is to obtain lending. Just this morning I have a group coffee, an Oregon coffee, and indeed the first small business owner talked about the difficulty of accessing credit, a long-time successful business. And we have in the small business jobs bill recapitalization of community banks to help assist them in lending more, but it feels like we need to find some more aggressive way to make funds available for businesses to seize opportunities and lead us forward and create jobs.

What should we be doing?

Ms. RASKIN. Clearly, that is definitely a challenge. There are a number of obstacles right now to bank lending, and I think we have to work carefully to try to figure out what they are. And what you are hearing, by the way, is not at all dissimilar to what I hear

in Maryland and what I know regulators and commissioners are hearing across the country. Bank lending is not where it should be.

Now, part of it has to do with the lack of robust demand. You will hear a lot of anecdotes about the fact that there are not enough borrowers actually seeking loans. But that is not the whole story because we also hear stories of creditworthy borrowers, borrowers who have an ability to repay and have credible cash-flows. The bankers do not have to be dependent on weak collateral coming from real estate. There is cash-flow here. These are borrowers who can sustain new loans. So why those borrowers are not able to get loans is a challenge, and I think we need to do some work on that.

Also, significantly, bank lending to small businesses is a critical factor in spurring employment, so I think the notion of getting this right will also have good consequences for employment.

Senator MERKLEY. Does anybody else want to jump in on that conversation?

Ms. YELLEN. Well, I would just say that the Federal Reserve has just concluded actually on Tuesday 40-odd sessions we have had around the country in which we have tried to bring together lenders, small business owners, and others to understand exactly what the problems are and all of the various items that Sarah mentioned in her answer. This is a complex situation.

One of the things certainly we are aware of is that as supervisors we need to be very careful not to be discouraging lending that is sound, carefully underwritten, and will be profitable. And we certainly hear frequently the complaint that banks are afraid that they will be criticized for loans that they make. So the regulators have jointly issued guidance to supervisors emphasizing that small business lending that is safe and sound is not only important to our communities and growing out of this recession, but is also important for profitability and the health of the institution. And we have emphasized training. We have tried to train our examiners. These are tough situations where they have to make judgment calls when they are in banks. We do not want to inadvertently stifle small business lending that would be very important to an economic recovery.

Senator MERKLEY. Thank you all very much. My time has expired. I appreciate your engagement.

Senator JOHNSON. Senator Corker.

Senator CORKER. Thank you, Mr. Chairman, and I thank each of you for your leadership and for coming by our office in the last few days to talk with us personally. I wish you well at the Fed. I am one of those folks that thinks the Fed needs to function at a very high level for our country, and I hope you will add to that.

Ms. Raskin, I know you have spent a lot of time in bank regulation and bring a lot of that to the Fed. The Fed has a number of people who already do that, and I think that, you know, here in the Senate each of us has to sort of figure out how we are going to make our mark and what we are going to bring to a body like the Senate to hopefully make it a stronger institution. There is obviously a number of people that do what you do already, and I just was curious, as you move to the Fed Board, joining people who have similar backgrounds in many ways, what is it that you plan

to do at the Fed, if you will, to make the “Raskin mark” on the Fed governance?

Ms. RASKIN. Well, I do not know if I will make a “Raskin mark” on the Fed governance, but it is a very thoughtful question, and I do agree that the staff at the Fed is really exemplary as far as I have been able to interact with them and a very impressive group of professionals, both economists and examiners.

What I would like to add to the mix I think is a perspective that really comes out of the work I have been doing at a very local level. As the State banking commissioner, I really have been able to see a lot of the spillover effects having to do with the crisis and also problems related to the run-up to the crisis. And I am not sure that all those perspectives have been sufficiently incorporated into both the monetary policy side of the Fed and the regulatory side.

One thing, for example, that we needed to do in Maryland was to act very quickly to reform our laws. Some of those laws were not at all fit for what the situation was developing, and other laws needed to be put in place.

So I think that the ability to react nimbly is important, and then the ability to move those observations into the more macro picture I think would be critical to the Fed.

Senator CORKER. We are getting ready to pass some legislation in the next 35 minutes. Regardless of what your testimony is, that is going to happen. Certainly in any 2,300-page bill there are good provisions in it. And I am not going to say this is the worst bill that has ever been created, but I do look at it as a tremendous missed opportunity in many ways.

I wonder, based on the comments you just made, if there are things that you would have liked to have seen in the legislation—that is going to be passed, regardless of what you say—that you would have liked to have seen in this legislation that you think might have caused our country to maybe deal with some of those things you saw in the run-up to the crisis we just went through. This is your last chance.

[Laughter.]

Ms. RASKIN. Well, I will point out that the legislation is obviously the product of a lot of hard work. I know that there has been a lot of very good minds put to the task of trying to put in place a system of reforms that can almost assure that we do not have a situation like this crisis happen again.

But to be completely candid, I think that one piece that we still need to tackle—and when I say “we,” I should really say the Congress needs to tackle—is GSE reform. That is a piece of the legislation that—a piece that was not addressed in the legislation, and it is something that I think still needs to be on the forefront of the Congress.

Senator CORKER. That is very astute.

[Laughter.]

Senator CORKER. I will come back to you in just a minute. Thank you very much for your testimony. I look forward to serving with you.

Mr. Diamond, when we met, I looked over your resume, and you have written more books than I have probably read in my lifetime.

[Laughter.]

Senator CORKER. Obviously, you are very well educated, and I would not want to enter into a debate with you on any of the topics that you have mastered.

I look at your background and think, God, this guy would be awesome to run the Social Security Administration, or he would be a great official at Treasury. It is not to be critical. I actually, you know, wish I knew as much as you knew about those topics. But as I see you being appointed to the Fed, I am sort of wondering what the hook was, you know, a great head of Social Security Administration, great at Treasury, but he is going to the Fed. And I am just wondering, you obviously think you are going to be a great Governor at the Board. What is it that those of us who look at you and look at your resume should think is the contribution you are going to make on the Board of Governors?

Mr. DIAMOND. In my opening remarks, I talked about working at how the economy and the economy with the regulatory guidance of Government handles risks throughout the economy. And obviously I have written heavily on how pension systems adapt to risk. But the questions that were raised by this crisis, the questions that the existing knowledge of the regulators and, indeed, the academic community had done some on, but not a great deal, we are now painfully aware of issues on how risks get generated and how risks in one place affect all sorts of other places, systemic risk. And my background is to think about those things. What I have started doing is reading the parts of the academic literature—some of it goes back decades—on how interactions can happen, and what I hope to be able to do is exploring how the regulatory structure will pay more attention to the interactions which go from an individual bank's risk to systemic risk. And I think that requires the kind of background and the nature of economic equilibrium that I bring to it, because the structure of the kinds of questions and regulations and much of the economic analysis simply does not engage with this, and we now know how important it is. And the opportunity to work on something that important in an environment as good for learning about the economy as the Fed would just be a wonderful opportunity for me, and I would hope to be very helpful at it.

Senator CORKER. Thank you.

Ms. Yellen, I was out of the room for a moment. I know Senator Shelby asked you a little bit about supervision. I know that Ms. Raskin seemed to indicate in her testimony earlier that she saw a lot of problems and felt the Fed should have responded or could have responded a little more nimbly, and I think talked a little bit about that a minute ago. You were head of the Fed in San Francisco and obviously had pretty large calamities out there. I know you addressed commercial real estate earlier. But it seems to me a huge level out there in residential real estate, and I am just curious. As you look back, do you wish there were actions that you had taken or the Fed had taken as it relates to the residential side? I know you are still focused on commercial. I think that is—I agree with you— still a problem here in our system. But do you wish there were actions that the Fed had taken as it relates to housing, especially in your part of the country?

Ms. YELLEN. I think we were monitoring housing prices very carefully and became concerned certainly by 2005 that there might

well be a bubble in the housing market. I think personally I gave speeches in 2005 warning of that possibility. So this is something that we were attentive to and I think tried to evaluate what the risks would be coming out of that. I think we failed completely to understand the complexity of what the impact of a decline, a national decline in housing prices would be in the financial system. We saw a number of different things, and we failed to connect the dots.

So while we thought about the risk coming from a housing price decline, I think we failed to understand just how seriously mortgage standards, underwriting standards had declined, what had happened with the complexity of securitization and the risks that we are building in the financial system around that. So what was triggered by that housing would be triggered by a housing price decline, I think we missed critical elements of it that caused the crisis to be as severe as it was.

Looking back on it, certainly I wish that regulators, including the Fed, had taken more significant steps earlier to appreciate what the risks were in underwriting, to understand as I saw in the supervision that we were doing in San Francisco mortgages that were being originated and packaged and sold into the market where there was a clear deterioration in underwriting standards. I think we should have focused, I wish we had focused more on the systemic risk that that was causing rather than being as focused as we were on safety and soundness of banks. Particularly, we failed to focus enough on systemic risk. I am pleased that this bill directs us to consider in our supervision of consolidated supervision of bank holding companies systemic risk, the risk that activities can pose to the broader financial system. But on the underwriting side, I believe we should have taken more significant steps to curtail that sooner.

Senator CORKER. Mr. Chairman, I know my time is up. Can I keep going for a little while since nobody is here?

Senator JOHNSON. The second panel is coming up, and I know that we must get out of here by 11 o'clock to vote.

Senator CORKER. Can I ask two more questions?

Senator JOHNSON. One short one.

Senator CORKER. That is a shame. I know we have a vote at 11, and yet I think there is a lot that could be gained.

I would just say to—I know that—

Senator JOHNSON. You may submit your questions.

Senator CORKER. OK. Let me just ask, I guess, one simple question then. Ms. Yellen, I tried to during our—first of all, I would love to hear from Ms. Raskin about GSEs, and I will talk to her a little bit later about that, and I understand what she thinks we are actually pressing for, now trying to understand and hopefully there will be a climate to deal with GSEs down the road. I think we missed a great opportunity to do that now.

But on underwriting, I tried to pass an amendment that would have required every person who purchased a home and borrowed money to have a minimum 5-percent downpayment. I know that many countries that have not had the problems we have had had 15-, 20-percent downpayments on average and still have the same homeownership rates.

Ms. Yellen, I wonder just from your perspective if that one requirement, that one simple requirement would have kept us from having the type of bubble that you had out in California and what we had here in the country and might have kept us from having many of the problems we have now.

Ms. YELLEN. Senator, I have not had a chance to think through the details carefully of that proposal. I know—

Senator CORKER. It is not very detailed. A 5-percent downpayment. It is a very simple—

Ms. YELLEN. Well, you know, I would say that there were certainly mortgages that created problems that did have downpayments at that level. We had Alt-A mortgages and Option ARMs—

Senator CORKER. Could not have happened with 5—yes, yes.

Ms. YELLEN.—that became problematic, so I would not—you know, I think that is an interesting proposal, and I do think underwriting standards should have been tougher, but there were a range of practices there that I think—no-doc lending and so forth—really created problems.

Senator CORKER. Thank you. I thank each of you for your testimony. I wish we had more time. I am disappointed in that. But I look forward to working with you, and, Mr. Chairman, I understand the time constraints you are working under, and thank you for the leeway.

Senator JOHNSON. I want to thank our first panel again and congratulate you all on your nominations. You may be dismissed.

I will now call up our second panel. Our second panel consists of two nominees to serve as Inspector General of two different independent agencies.

Our first nominee is Osvaldo Luis Gratacos. Mr. Gratacos has extensive experience working on issues related to the Office of Inspector General. He is currently serving as an Acting Inspector General for the Export-Import Bank, and he has served as Deputy Inspector General and legal counsel in that office as well. Mr. Gratacos has served as attorney adviser and legal counsel to the Inspector General for the United States Agency for International Development. Mr. Gratacos has experience in the private sector, and he has worked as a commercial counsel for Motorola, Incorporated. Mr. Gratacos holds a B.A. summa cum laude from the American University of Puerto Rico and an M.B.A. from the University of Massachusetts and a J.D. from the University of Florida. The Committee created the position of Inspector General of the Federal Housing Finance Agency as part of the Housing and Economic Reform Act of 2008 legislation.

Our second nominee, Steve A. Linick, has been nominated to serve in this inaugural role. Mr. Linick is a career Federal prosecutor who currently serves in two roles as Executive Director of the National Procurement Fraud Task Force and the Deputy Chief of the Fraud Section, Criminal Division of the Department of Justice. As Deputy Chief, Mr. Linick manages and supervises the investigation and prosecution of white-collar criminal cases involving procurement fraud, public corruption, corporate fraud, mortgage fraud, and money laundering, among others. In October 2008, Mr. Linick received the Attorney General's Distinguished Service



Award for his efforts in leading the Department's procurement fraud initiative. Previously, Mr. Linick was an Assistant U.S. Attorney, first in the Central District of California and then subsequently in the Eastern District of Virginia. Before joining the Federal Government, Mr. Linick was an Assistant District Attorney in Philadelphia and an associate at Newman & Holtzinger in Washington, D.C., from 1990 to 1992. Mr. Linick holds a J.D., M.A. in Philosophy, and a B.A. in Philosophy, all from Georgetown University.

Will the witnesses on the second panel please stand and raise your right hand while I administer the oath? Do you swear or affirm that the testimony you are about to give will be the truth, the whole truth, and nothing but the truth, so help you God?

Mr. GRATACOS. I do.

Mr. LINICK. Yes.

Senator JOHNSON. Do you agree to appear and testify before any duly constituted Committee of the Senate?

Mr. GRATACOS. I do.

Mr. LINICK. I do.

Senator JOHNSON. Thank you, and please take your seats.

Before you begin, please be assured that your written statements will be part of the record. Please also note that members of this Committee may submit written questions to you for the record, and you need to respond to these questions promptly in order that the Committee may proceed on your nomination.

Thank you for joining us today. I would invite you to introduce your family and loved ones in attendance before proceedings with your statements.

Mr. GRATACOS. Thank you, Senator Johnson and Senator Merkley. I want to introduce my wife who is here, Debbie Garcia; and my Dad, who came from Puerto Rico last night, Alejandro; and some former colleagues from USAID, and bosses in the past: Bill Perkins, Paula Hayes, and my former boss Mike Tankersley, who is also coming from Texas.

Senator JOHNSON. Welcome to you all.

Mr. LINICK. Senator Johnson, Senator Merkley, thank you. I would like to introduce my wife, Mary Britton, and my two teen-aged children, Zackary and Sarah, who are sitting in the front row over here.

Senator JOHNSON. Welcome.

Mr. Gratacos, you may proceed.

**STATEMENT OF OSVALDO LUIS GRATACOS MUNET, OF PUERTO RICO, TO BE INSPECTOR GENERAL, EXPORT-IMPORT BANK, FEDERAL HOUSING FINANCE AGENCY**

Mr. GRATACOS. Thank you, Mr. Johnson. Thank you, Mr. Merkley. Good morning. It is with great honor, humility, and enthusiasm that I stand before you today as President Obama's nominee to become the second Inspector General of the Export-Import Bank of the United States. Before I continue, I would like to thank the Almighty for this opportunity, my family, and the members of the Ex-Im Bank Office of Inspector General staff, a group of career public servants who make the work possible and are committed to

the OIG mission of preventing and detecting fraud, waste, and abuse.

I had the privilege of joining the Ex-Im Bank OIG in 2008 as the first person hired by then-Inspector General Mike Tankersley, after spending almost 8 years of my career at USAID OIG and Motorola, Inc. The Ex-Im Bank OIG was established in 2007, and while I was hired as the legal counsel, I worked closely with the IG in establishing the organization. Since October 2009, I have had the honor of serving the American people as the Ex-Im Bank's Acting Inspector General. During this period, the OIG has had remarkable success and has met a number of milestones as shown by the latest Semiannual Report to Congress. Specifically, the OIG has issued 14 audit reports containing over 40 recommendations and suggestions for improving Ex-Im Bank programs and operations, and our investigative efforts have resulted in a number of law enforcement actions, including 24 arrests and indictments related to over \$45 million in claims paid by Ex-Im Bank; 17 pending indictments; one conviction, over 80 management referrals for actions; and over \$8.5 million in program savings due to policy cancellations arising out of our investigative efforts. Moreover, the OIG is currently investigating 35 open matters representing approximately \$327 million in claims paid by Ex-Im Bank, or 13.6 percent of all Ex-Im Bank claims paid as of the end of FY 2009. All of this has been accomplished with a very modest annual budget of \$2.5 million and a staff of ten professionals. As a recently created office, our work is only commencing, and if confirmed, I would work to continue to build on these successes.

Through our work, the OIG is committed to helping Ex-Im Bank meet its statutory mission of assisting in the financing of exports of U.S. goods and services to international markets, vital in protecting and creating American jobs. America produces the world's best manufactured goods, and it is the number one services provider in many global industries. Today the opportunity for increasing American exports is an important element to our Nation's economic recovery. Since 1934, Ex-Im Bank has played a key role in financing the export of these goods and services. That role has increased in recent years. In FY 2009, Ex-Im Bank announced record authorization levels reaching \$21 billion and has reported authorization levels of \$14.7 billion for the first 8 months of FY 2010. Ex-Im Bank's role coupled with these growth levels present a valuable opportunity for the OIG to partner with Ex-Im Bank in support of its mission while exercising OIG's statutory independence.

In only 3 years since its inception, and just over 1 year since reaching current staff levels, our efforts are having a noticeable impact on Ex-Im Bank's operations. While Ex-Im Bank continues to provide export credit and financing as part of its export credit agency functions, the OIG will enhance its independent oversight role by focusing on Ex-Im Bank operations in order to improve its operational efficiency as well as strengthen its efforts in preventing and detecting, fraud, waste, and abuse. I look forward to facing these challenges, and if confirmed, I will carry out the duties of this office with the highest standards of independence and integrity.

Mr. Chairman and members of this honorable Committee, thank you once again for considering my nomination at this hearing today. I would be pleased to respond to any questions from the Committee. Thank you.

Senator JOHNSON. Mr. Linick.

**STATEMENT OF STEVE A. LINICK, OF VIRGINIA, TO BE  
INSPECTOR GENERAL, FEDERAL HOUSING FINANCE AGENCY**

Mr. LINICK. Senator Johnson, Senator Merkley, thank you for this opportunity to appear before you today and provide testimony. I am honored to be the President's nominee for Inspector General of the Federal Housing Finance Agency.

By way of background, almost my entire professional career has been dedicated to public service. I have served in a number of leadership positions in the United States Department of Justice. Currently, I am the Executive Director of the Department of Justice's National Procurement Fraud Task Force, and I am also Deputy Chief of the Fraud Section at the Criminal Division.

In total, I have almost 16 years' experience as a Federal prosecutor with extensive trial and supervisory experience at the Department of Justice and in two United States Attorneys' Offices. I have managed and coordinated grand jury investigations and prosecutions involving health care fraud, procurement fraud, public corruption, mortgage fraud, and other financial frauds.

As a result of having investigated a wide variety of financial frauds, I have the experience and ability to develop effective strategies to prevent fraud, waste, and abuse associated with the regulation of the Government-sponsored enterprises.

I look forward to the prospect of serving as Inspector General at the Federal Housing Finance Agency during this critical time for both the FHFA and the Government-sponsored enterprises. The Federal Housing Finance Agency is a relatively new agency, which has never had an Inspector General. In 2008, the Federal Housing Finance Agency placed Fannie Mae and Freddie Mac in conservatorship out of concern that their deteriorating financial condition threatened the stability of the financial markets. Since then, the Department of Treasury has provided billions of dollars to the enterprises. Under these circumstances, the Federal Housing Finance Agency Inspector General will play a critical role in safeguarding taxpayer dollars and preventing fraud, waste, and abuse.

If I am fortunate enough to be confirmed as Inspector General, I intend to be proactive in overseeing the operations and programs of the Federal Housing Finance Agency, including its management of the conservatorship. While I intend to exercise complete independence that is required of an Inspector General, I will make it a priority to maintain a good working relationship with the Federal Housing Finance Agency Director and management, along with this Committee and Congress as a whole.

Thank you for your consideration. I look forward to answering your questions.

Senator JOHNSON. Thank you.

Mr. Linick, with Fannie Mae and Freddie Mac under conservatorship, did HERA provide enough resources to the Inspector

General's office at FHFA to provide strong, independent oversight? Are there other tools that would help you better do your job?

Mr. LINICK. Thank you, Senator, for that question. In terms of resources, because I am the nominee, I have not had a chance to probe into my budget or the number of individuals who would be on my staff.

That being said, I think that the resources will need to be significant. This is an agency that is facing some challenges and has significant responsibilities. The agency has never had any oversight before, and its regulatory role has not been tested. It is in conservatorship so, in effect, it is regulating itself, and it is overseeing billions of dollars that have been provided by Treasury, and I expect there is more to come.

As to your second question as to other tools, I intend to hit the ground running. I will be creative in trying to recruit detailees from other agencies and hire contract employees, but I will work with this Committee and I will also work with the agency to staff up immediately from day one.

Senator JOHNSON. Mr. Gratacos, the Ex-Im Bank has experienced great difficulty with fraud in its Medium Term Guarantee Program. You have been part of at least 12 arrests, numerous indictments, and other evidence of people trying to defraud the U.S. Government. What is your view on this program and its inherent difficulty serving U.S. exporters while not allowing for individuals to commit fraud? Has Ex-Im Bank done enough to deter fraud going forward? If not, what further steps need to be taken?

Mr. GRATACOS. Thank you, Senator Johnson. Ever since we started at Ex-Im Bank, the Medium Term Program has been one of the programs that has been exposed to fraud. A lot of cases come out of the Medium Term Program. Part of that reflects the fact there was no oversight and OIG presence at that time.

Since then, the Bank has taken a number of steps to improve—lower the likelihood of fraud in some of these transactions. Part of that has been enhancing our due diligence process. Part of it has been in response to some of the audits and recommendations we made on the medium term.

For example, we just issued a review of the initial recommendations on the Medium Term Program, and we are glad to report that the Bank has taken steps forward toward implementing a number of the recommendations that we have, including the creation of credit reviews and compliance division requiring sometimes payments in some of the transactions.

But we still think there are steps to be taken. There are still some open recommendations and some steps that the Bank could take. The Bank is in the process of a reorganization internally that would allow the programs to merge some of the different components into cell groups, allowing the intakers to be sitting with the credit underwriters at the same time.

But we also think that there should be more monitors in the performance of this program, and we still think that there is a way to go in terms of protecting the taxpayers' money.

Senator JOHNSON. Thank you.

Senator MERKLEY.

Senator MERKLEY. Thank you very much, Mr. Chair.

Mr. Linick, I am going to focus primarily on questions to you because of my interest in the challenges with housing, and particularly in the future of Fannie and Freddie.

One of the aspects of the bill that we just passed is it had three retail mortgage reforms. One was to end—well, I say “just passed.” We will hopefully just be passing it in a few minutes. But one was to end liar loans, require full underwriting. The second was to end steering payments in which the loan originator’s interests were put out of sync with the interests of the customer. And the third was to ban prepayment penalties on subprime loans which were used to lock people into exploding interest rates.

Now, one of those, in essence, is about direct misrepresentation or fraud, and that is certainly the issue of fully documenting loans or misdocumenting loans. But the other two play into the structure of the subprime market, which led to many other issues regarding how loans were packaged and how those packaged loans were represented, how they were rated, how they were sold.

Can you give us any insights on how those different retail issues might reverberate through the industry and affect the issues that you will face as Inspector General?

Mr. LINICK. Thank you, Senator. I do not have particular information about those—let me rephrase that. Those three issues are going to be key to several goals and objectives of FHFA. Absolutely, underwriting is obviously a control that FHFA obviously needs to make sure that it is part of their operations and programs. One of the goals of FHFA is to limit exposure, risk exposure in the future. And as Inspector General, I will make sure that I will take a look at internal controls to make sure that underwriting is adequately accomplished.

As far as the conflicts of interest issue, conflicts of interest obviously undermine the integrity of an institution organizationally and personal conflicts of interest, and one of my tasks as Inspector General will be to make sure that those types of issues are transparently—are transparent and that there are corrective actions taken to prevent them.

Senator MERKLEY. So in the news—I do not know, it must have been about 10 days ago—was a story about a firm that had allegedly misrepresented the packages of mortgages that it had sold, I believe to Fannie. But is that the type of abuse that you will be focusing on? If not, what do you see as kind of the top three issues that really need to be scrutinized to bring integrity to the process of writing mortgages and securitizing those mortgages?

Mr. LINICK. Senator, I think that the top three issues, number one, that Fannie and Freddie do not buy loans or mortgage-backed securities that are derived from fraud, and the underwriting standards are going to be very important in assuring that does not happen.

The second issue is the conservatorship. This is a situation where FHFA is essentially regulating an operating the company, so it is going to be critical to ensure that they are acting independently in their regulatory role and that there is a strong and credible regulator as well as a conservator.

And then the third issue is how is FHFA managing the billions of dollars that Treasury is providing to the GSEs. Conserving as-

sets is one of the goals of FHFA, conserving and mitigating risk. How are they conserving assets? In what manner they are conserving assets? Is there some sort of exit strategy for the conservatorship, which is not meant to be permanent? And also how are they addressing foreclosure prevention within the context of managing the conservatorship.

Senator MERKLEY. I have one second left, so my time is up. I will yield back to the Chair. Thank you.

Senator JOHNSON. Thank you, Senator Merkley.

Today we have a set of nominees before us that, while very different, will all play an important role as the Nation moves forward from our financial crisis and begins implementation of the Wall Street Reform and Consumer Protection Act as well as the formation of other equally important measures to create jobs, spur economic growth, and reduce our Nation's deficit.

Please also note that members of this Committee may submit written questions to you for the record, and you need to respond to these questions promptly in order that the Committee may proceed with your nominations.

I thank you all again for being here today, and this hearing is adjourned.

[Whereupon, at 11:03 a.m., the Committee was adjourned.]

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

**PREPARED STATEMENT OF SENATOR SHERROD BROWN**

JULY 15, 2010

Thank you, Mr. Chairman, and thank to the nominees for your testimony today. When Chairman Bernanke testified before us in February, we talked about the troubling decline in manufacturing and rise in financial services in the United States.

For most of our nation's history manufacturing, transportation, and agriculture were the engines driving our economy.

But as many Ohioans can tell you, manufacturing has steadily declined over the last three decades. At the same time the finance industry has rapidly expanded, to the point that the two have switched positions in our economy.

In the 1980s manufacturing made up 25 percent of GDP and financial services was 11 to 12 percent. Then manufacturing began to decline and finance began to expand and sometime in the 1990s the two industries crossed paths. By 2004-05 the two sectors had flipped: manufacturing was just 12 percent of GDP while the financial services industry was about 20 to 21 percent.

A number of emerging economies have thriving manufacturing and extraction industries.

First World export countries like Japan, Germany, and even Switzerland all have economies in which the manufacturing sector is larger than the financial sector. If we want to stay competitive with other nations, we need to refocus on productive industries.

I've heard from a lot of businesses in Ohio that they are being denied access to credit that they desperately need. Right now the financial industry's prosperity is not helping the other sectors of our economy.

I have repeatedly said that creating more jobs is essential. To do this we must re-invest in the manufacturing and service industries that have brought us prosperity since our nation's founding.

I'd like to hear what you think the Fed should be doing to promote productive industries like manufacturing.

I also want to emphasize the importance of considering real world perspectives when serving on the Board of Governors. In the luxuriant halls of the Federal Reserve Bank, it can be easy to focus on numbers like the inflation targets. But as you all know, the unemployment rate has been high for a substantial period of time, and it remains an unacceptable 9.3 percent. This is more than double the Fed's statutorily mandated target of 4 percent.

I urge you not to forget that your economic policy decisions affect the daily lives of Americans in your roles as Governors of the Federal Reserve.

**PREPARED STATEMENT OF SENATOR JOHN F. KERRY**

JULY 15, 2010

Chairman Dodd and Senator Shelby, I am pleased to support the nomination of Dr. Peter Diamond to become a member of the Board of Governors of the Federal Reserve System. The experience that Dr. Diamond has in economic and monetary policy will be a great asset to the Federal Reserve. I am very pleased that he is willing to serve our nation in this important role.

Our nation is facing its greatest economic crisis since the Great Depression. A series of financial institution failures and frozen credit markets imperiled our economy. I believe Dr. Diamond has the experience and judgment to become an effective Governor on the Federal Reserve Board. He will help the Federal Reserve take actions to provide liquidity for businesses, especially small businesses and create jobs that will help families who are currently bearing the weight of the crisis. He will also help the Federal Reserve provide appropriate oversight of financial institutions to insure that our recent financial crisis will never happen again.

His work has literally changed the way all economists think about national debt, taxes, risk and social security. Dr. Diamond is a pioneer in the field of "search theory" which seeks to explain how individual decisions in the labor market can build on each other to have a broader impact on the economy.

Dr. Diamond is a former chair of MIT's Department of Economics. He has made research advances in both macroeconomics and microeconomics during a wide-ranging career, studying subjects including growth, taxation and labor market searches. In recent decades he has analyzed social insurance programs closely and become a prominent authority on Social Security.

Dr. Peter Diamond first arrived at the Massachusetts Institute of Technology (MIT) 1960 as a graduate student. In 1966, he became a member of the MIT economics faculty. Today, he currently serves as an Institute Professor at MIT. He has previously served as President of the American Economic Association, President of the Econometric Society, and President of the National Academy of Social Insurance.

Dr. Diamond is the author or editor of 12 books and more than 130 articles, Dr. Diamond is a fellow of the American Academy of Arts and Sciences and a member of the National Academy of Sciences. He received his bachelor's degree from Yale University and his Ph.D. from the Massachusetts Institute of Technology.

Ricardo Caballero, chair of the MIT Department of Economics said that "Peter represents the very best that an academic economist has to offer to Washington: a superb and open mind, an insatiable appetite for understanding the institutional details of a problem and policy, and a spirit of service."

Chairman Dodd, you should be aware that Dr. Diamond is a fellow long-time Boston Red Sox fan who started attending games back in the 1960s.

I hope the Banking Committee will give Dr. Diamond's nomination full consideration.



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July 13, 2010

Senator Chris Dodd  
Chairman  
Committee on Banking, Housing and Urban Affairs  
United States Senate  
Washington, DC 20510

Dear Mr. Chairman,

I am sorry that because I am chairing an Appropriations Subcommittee hearing, I am unable to attend the nomination hearing for Sarah Bloom Raskin for membership on the Board of Governors of the Federal Reserve.

I want to express my full support for Ms. Raskin. As Maryland's chief financial regulator, Ms. Raskin demonstrated an unparalleled prowess in the supervision and regulation of financial institutions, and in grappling with the challenges of the current economic situation. Her academic and professional background is stellar. She is known for her intelligence, her commitment to public service and her work ethic. She has experience in regulatory policy, enforcement, and public policy. Ms. Raskin has worked in the public and private sector -- and even on the Senate Banking Committee -- giving her an extraordinary breadth of experience.

In an uncertain economy, the role of the Federal Reserve is more important than ever to conduct monetary policy, and to supervise and regulate banks to improve the flow of credit to small businesses.

Ms. Raskin has the skills, experience and integrity we need at the Federal Reserve. I strongly support her nomination and urge the Committee to vote for her confirmation.

Sincerely,



Barbara A. Mikulski  
United States Senator

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**PREPARED STATEMENT OF JANET L. YELLEN**  
 NOMINEE FOR MEMBER AND VICE CHAIR OF THE BOARD OF GOVERNORS,  
 FEDERAL RESERVE SYSTEM

JULY 15, 2010

Chairman Dodd, Senator Shelby, and members of the Committee, I am honored to appear before you as President Obama's nominee to serve as a Member and Vice Chair of the Board of Governors of the Federal Reserve System. If I am confirmed to these positions, I look forward to working with this Committee in the coming years. I am wholeheartedly committed to pursuing the Federal Reserve's congressionally mandated goals of maximum employment and price stability and to strengthening our program of supervision and regulation, building on the lessons learned during the financial crisis. We must work together, and in cooperation with central banks and governments around the world, to mitigate systemic risk in the financial and payments systems so that our country never again suffers such a devastating episode of financial instability. We have learned a harsh lesson about the dire consequences a financial crisis has for ordinary Americans in the form of lost jobs, lost homes, lost wealth, and lost businesses, and those of us charged with overseeing the financial system should always keep this human cost in mind.

I have served since 2004 as President and Chief Executive Officer of the Federal Reserve Bank of San Francisco and, before that, from 1994 through 1997, as a member of the Federal Reserve Board. Through this service, I have gained experience in every one of the Federal Reserve's areas of responsibility, including monetary policy, banking supervision and regulation, consumer and community affairs, and the operation of the payments system. I believe this extensive background equips me to work under Chairman Bernanke as a leader of the Federal Reserve System as we strive to carry out the missions Congress has assigned to us.

Over the next few years, the Fed must craft policies that ensure that our economy accelerates its progress along the recovery path it has begun to trace. With unemployment still painfully high, job creation must be a high priority of monetary policy. But we must also avoid any threats to price stability. That means that, when the appropriate time comes, we must withdraw the extraordinary monetary accommodation now in place in a careful and deliberate fashion. My approach going forward, as in the past, will be to bring a thoughtful and independent voice to Federal Open Market Committee deliberations on monetary policy, drawing on the insights of business and community leaders throughout the country, and thoroughly analyzing macroeconomic trends that affect the economic outlook and the risks to our forecasts.

In my view, Congress has wisely granted the Federal Reserve the freedom to make independent monetary policy decisions in pursuit of congressionally mandated goals, based on a forward-looking perspective and the best judgments of Federal Open Market Committee participants. I believe that experience in the United States and around the globe demonstrates that central bank independence in monetary policy produces clear societal benefits. When central banks are independent, economies perform better, inflation is lower and more stable, and long-term interest rates are lower and less volatile. In other words, an independent central bank is best equipped to promote both price stability and high levels of growth and employment. I should stress though that independence brings with it both responsibility and accountability. The Federal Reserve is fully accountable to Congress, and that's how it should be. That means the Fed must explain its actions, outlook and strategy, and provide the information necessary for Congress and the public to understand and evaluate its policy decisions. I strongly support Fed independence in monetary policy and I am committed to enhancing the transparency that is essential to accountability and democratic legitimacy.

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**PREPARED STATEMENT OF PETER A. DIAMOND**  
 NOMINEE FOR MEMBER OF THE BOARD OF GOVERNORS, FEDERAL RESERVE SYSTEM

JULY 15, 2010

Chairman Dodd, Senator Shelby, and Members of the Committee, I am honored to have been nominated by President Obama to be a member of the Board of Governors of the Federal Reserve System and grateful to this Committee for scheduling this hearing.

If I am confirmed by the Senate, I will work to the best of my abilities to fulfill the responsibilities of this office. Those responsibilities have always been significant. The experience of the recent financial crisis and the financial reform legislation

have underlined the multiple jobs the Fed has in working to fulfill the dual mandate of high employment and price stability. The Fed will have major work to do to implement the tasks that the legislation is placing at the Fed. I would be honored and pleased to be part of the process of responding to this challenge.

I studied both mathematics and economics as an undergraduate at Yale University. I received my Ph.D. in economics from the Massachusetts Institute of Technology (MIT) in June 1963. Since then I have been a faculty member, first at the University of California, Berkeley, and, since 1966, at MIT. Throughout this period I have taught and done research in economics. My primary focus in both teaching and research has been economic theory, particularly general equilibrium theory, macroeconomics, search theory, and public finance. Within public finance, my primary focus has been on taxes, pensions, and social insurance, particularly Social Security. I have done both theoretical analyses and policy analyses. I have also done research in other areas, including, behavioral economics, and law and economics. I took classes at Harvard Law School as part of my preparation for doing research in law and economics—I believe in being well-grounded in a subject when doing research or policy analysis. In addition to microeconomics, macroeconomics, and public finance, I have also taught money and banking, and law and economics.

Being a member of two economics departments with great collegial interactions, I have gained a wide knowledge of a variety of economics topics, as well as detailed knowledge in my areas of expertise. As a consequence, I have considerable awareness of the development of economic analyses of monetary policy and its impacts on both inflation and employment as well as studies of the determinants of financial crises.

A central theme in my research career has been how the economy deals with risks, both risks at the individual level and risks that affect the entire economy. In all of my central research areas, I have thought about and written about the risks in the economy and how markets and Government can combine to make the economy function better for individuals. If confirmed, this background should be very helpful at the Federal Reserve as part of the process of addressing our heightened awareness of the dangers of systemic risks. My background in behavioral economics and law and economics give me high awareness of the issues involved in consumer protection and increasing financial literacy.

If confirmed, I would welcome the opportunity to help address the important issues that have been raised by the financial crisis, as well as the longstanding issues and concerns that the Federal Reserve faces, bringing my research experience and expertise to bear on these difficult and important issues.

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**PREPARED STATEMENT OF SARAH BLOOM RASKIN**

NOMINEE FOR MEMBER OF THE BOARD OF GOVERNORS,  
FEDERAL RESERVE SYSTEM

JULY 15, 2010

Chairman Dodd, Senator Shelby, Distinguished Members of the Committee, and to all the able staff who are sitting in seats I remember so well:

As a former banking counsel to your Committee, I cannot quite express what an honor it is to appear before you today. I never dreamed I would one day be here as a nominee to the Federal Reserve Board. (Or maybe I did dream it at some point, but I certainly never believed it.)

I must thank Senator Sarbanes who has been an extraordinary mentor to me over the course of my career and has shown me how one can be passionately committed both to the public interest and to one's family at the same time.

It is a great and humbling honor to be nominated by President Obama, and I am very grateful.

If confirmed, I will participate in the essential and difficult work of restraining inflation and maintaining price stability, maximizing sustainable employment and economic growth, and trying to continually reconcile and harmonize these two goals.

This is a challenging moment for the Federal Reserve. Every member of this Committee knows that even though the worst of the crisis is over, it remains a precarious time for far too many of our families and businesses. The Fed must do its part to restore the underlying strength and vibrancy of the American economy.

As Maryland's Commissioner for Financial Regulation over the last 4 years, I have worked day and night to counter the devastating effects on our communities of the national banking and liquidity crisis, the terrible spikes in home foreclosures, and persisting high unemployment and underemployment.

At the same time, as a front line banking regulator, I have worked to revise and replace ineffectual and counterproductive State regulations that do not put the Government on the side of economic progress for our people.

If I am confirmed, my experience working through this crisis at the state level will deeply inform my actions as a member of the Federal Reserve Board.

The proper conduct of monetary policy by our central bank is essential to calming the waves of financial instability that have engulfed so many of our communities, businesses and households. Over the course of the last generation, the Federal Reserve has achieved price stability and successfully anchored long-term inflationary expectations. This achievement is critical to our economic strength, and it remains a central institutional objective that I subscribe to wholeheartedly.

But it is only a partial victory when many American households continue to face the perils of unemployment and many small businesses struggle with weakened consumer demand and reduced access to credit.

We need to strengthen this recovery by expanding its foundations. This means that, in addition to maintaining stable inflationary expectations and keeping a vigilant eye on the emergence of new bubbles, the Fed must seek to fulfill the other part of its statutory mandate by addressing unemployment, which has pervasive social costs. In my state, I have seen these costs in a loss of productive capacity, a weakened housing market, increased strain on state and local resources and services, and a nervous reluctance on the part of many businesses and banks to invest and make loans. The Fed must work for a broad and sustained recovery that not only controls inflation but facilitates growth and more robust business lending by banks.

In sum, I know that there is a lot of hard work to do at the Fed. If you choose to confirm me, I will bring all of the experience, knowledge and commitment I have gained over the course of my career to the task of fulfilling Congress's statutory expectations. And I will maintain the standards of professionalism, independence and probity that I have always tried to uphold in my career and that, to my mind, are exemplified by the work of this Committee.

Thank you for the honor of hearing me today. I will be happy to respond to any and all questions you may have—verbally or promptly in writing—throughout this process and indeed throughout my tenure at the Fed if I am fortunate enough to be confirmed.

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**PREPARED STATEMENT OF OSVALDO LUIS GRATACOS MUNET**

NOMINEE FOR INSPECTOR GENERAL, EXPORT-IMPORT BANK OF THE UNITED STATES

JULY 15, 2010

Good morning, Mr. Chairman, Christopher Dodd, Senator Shelby, and distinguished members of this honorable Committee.

It is with great honor, humility and enthusiasm that I stand before you today as President Obama's nominee to become the second Inspector General at the Export-Import Bank of the United States. Before I continue, I would like to thank the Almighty for this opportunity, my family, and the members of the Ex-Im Bank Office of Inspector General staff, a group of career public servants who make the work possible and are committed to the OIG mission of preventing and detecting fraud, waste and abuse.

I had the privilege of joining Ex-Im Bank OIG in 2008, as the first person hired by then Inspector General, Michael W. Tankersley, after spending almost eight (8) years of my career at the U.S. Agency for International Development OIG and Motorola, Inc. The Ex-Im Bank OIG was established in 2007 and while I was hired as the legal counsel, I worked closely with the IG in establishing the organization. Since October 2009, I have had the honor of serving the American people as the Ex-Im Bank Acting Inspector General. During this period, the OIG has had remarkable success and has met a number of milestones as shown by our latest Semi-annual Report to Congress. Specifically, the OIG has issued fourteen (14) audit reports containing over forty (40) recommendations and suggestions for improving Ex-Im Bank programs and operations, and our investigative efforts have resulted in a number of law enforcement actions) including: twenty-four (24) arrests and indictments relating to over \$45 million in claims paid by Ex-Im Bank; seventeen (17) pending indictments; one conviction; over eighty (80) management referrals for actions, and over \$8.5 million in program savings due to policy cancellations arising of our investigative efforts. Moreover, the OIG is currently investigating thirty-five (35) open matters representing approximately \$327 million in claims paid by Ex-Im Bank (or 13.6 percent of all Ex-Im Bank claims paid as of the end of FY 2009). All

of this has been accomplished with a very modest annual budget of \$2.5 million and a staff of ten professionals. As a recently created office, our work is only commencing, and if confirmed, I would work to continue to build on these successes.

Through our work, the OIG is committed to helping Ex-Im Bank meet its statutory mission of assisting in the financing of exports of U.S. goods and services to international markets, vital in protecting and creating American jobs. America produces the world's best manufactured goods and it is the number one services provider in many global industries. Today the opportunity for increasing American exports is an important element to our nation's economic recovery. Since 1934, Ex-Im Bank's has played a key role in financing the export of these goods and services. That role has increased in recent years. In FY 2009, Ex-Im Bank announced record authorization levels reaching \$21 billion and has reported authorization levels of \$14.7 billion for the first 8 months of FY 2010. Ex-Im Bank's role coupled with these growth levels present a valuable opportunity for the OIG to partner with Ex-Im Bank in support of its mission while exercising OIG's statutory independence.

In only 3 years since its inception (and just over 1 year since reaching current staff levels), our efforts are having a noticeable impact on Ex-Im Bank's operations. While Ex-Im Bank continues to provide export credit and financing as part of its export credit agency functions, the OIG will enhance its independent oversight role by focusing on Ex-Im Bank operations in order to improve its operational efficiency as well as strengthen its efforts in preventing and detecting fraud, waste and abuse. I look forward to facing these challenges and, if confirmed, I will carry out the duties of this office with the highest standards of independence and integrity.

Mr. Chairman and members of this honorable Committee, thank you once again for considering my nomination at this hearing today. I would be pleased to respond to any questions from the Committee. Thank you!

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**PREPARED STATEMENT OF STEVE A. LINICK**

NOMINEE FOR INSPECTOR GENERAL, FEDERAL HOUSING FINANCE AGENCY

JULY 15, 2010

Chairman Dodd, Ranking Member Shelby, and Members of the Committee, thank you for this opportunity to appear before you today and provide testimony. I am honored to be the President's nominee for Inspector General of the Federal Housing Finance Agency ("FHFA"). I also want to thank members of the Committee's staff who gave of their time generously in preparation for this hearing.

Before I proceed with a brief opening statement, I would like to introduce my wife, Mary Britton, and my son and daughter, Zackary and Sarah, who are here with me today.

By way of background, almost my entire professional life has been dedicated to public service. I have served in a number of leadership positions in the United States Department of Justice ("DOJ"). Since 2006, I have been Executive Director of DOJ's National Procurement Fraud Task Force (the "Task Force"), consisting of more than 30 Offices of Inspectors General and other law enforcement agencies. In this capacity, I have been involved in developing and overseeing a strategic plan and nationwide effort to strengthen the Government's efforts to fight procurement and grant fraud, including fraud associated with the American Recovery and Reinvestment Act. As part of this effort, I have been the primary point of contact at DOJ for contract fraud cases related to the wars and reconstruction efforts in Iraq and Afghanistan.

Since 2006, I also have served as Deputy Chief of the Fraud Section, Criminal Division, DOJ, where I currently supervise 18 attorneys and am responsible for supervising and managing the investigation and prosecution of a wide range of financial frauds. Between 2004 and 2006, I was Deputy Chief of the Fraud Unit in the U.S. Attorney's Office for the Eastern District of Virginia, where I was involved in both supervising attorneys and establishing office initiatives and priorities.

In total, I have almost 16 years experience as a Federal prosecutor with extensive trial, appellate, and supervisory experience at DOJ and in two U.S. Attorneys' Offices, including the Eastern District of Virginia and the Central District of California. I have managed and coordinated grand jury investigations and prosecutions involving health care fraud, procurement fraud, public corruption, securities fraud, and other financial frauds. I have investigated and prosecuted individuals who have committed various types of mortgage fraud, including fraud in the loan origination process and real estate flip schemes. Recently, I was involved in supervising a team of Fraud Section attorneys, who, in partnership with the U.S. Attorney's Office in

Las Vegas, charged 19 defendants as part of a nation-wide mortgage fraud sweep dubbed "Operation Stolen Dreams."

As a result of having investigated a wide variety of financial frauds, I have the experience and ability to develop effective strategies to prevent and detect fraud, waste, and abuse associated with the regulation of the Government-sponsored enterprises. Moreover, through my work on the Task Force, I have become very familiar with the Inspector General community and the challenges that Inspectors General face.

I look forward to the prospect of serving as Inspector General at FHFA during this critical time for both FHFA and the Government-sponsored enterprises. The FHFA is a relatively new agency, which has never had an Inspector General. In 2008, FHFA placed Fannie Mae and Freddie Mac in conservatorship out of concern that their deteriorating financial condition threatened the stability of the financial markets. Since then, the Department of Treasury has provided billions of dollars to the enterprises. Under these circumstances, the FHFA Inspector General will play a critical role in safeguarding taxpayer dollars and preventing fraud, waste, and abuse. In addition, the FHFA Inspector General will carry significant management responsibility in having to establish a new office and hire a staff of highly qualified individuals.

If confirmed as Inspector General, I intend to be proactive in overseeing the operations and programs of FHFA, including its management of the conservatorship. While I intend to exercise complete independence that is required of an Inspector General, I will make it a priority to maintain a good working relationship with the FHFA Director and management, along with this Committee and Congress as a whole.

Thank you for your consideration. I look forward to answering your questions.

**RESPONSE TO WRITTEN QUESTIONS OF SENATOR SHELBY  
FROM JANET L. YELLEN**

**Q.1.** President Yellen, Olivier Blanchard, chief economist of the International Monetary Fund, recently floated the idea of 4 percent inflation targets for central banks, double the roughly 2 percent rate presumed by many to have governed Fed policy in many recent years. Yet, Fed Chairman Bernanke, identifying the significant investment central banks have made in creating low and stable inflation expectations, has identified that he thinks such a move would be “a very risky transition.” Do you side with Mr. Blanchard or with Chairman Bernanke?

**A.1.** During the recent crisis and recession, the zero lower bound on interest rates limited the amount of monetary stimulus that the Federal Reserve and other central banks can provide. Admittedly, a higher long-run inflation objective would give the Fed more maneuvering room in the future. But, any such benefit would be counterbalanced by other factors, including the potential erosion of the Fed’s hard-earned inflation credibility and the economic costs of higher inflation and interest rates. This issue will be debated by economists in the years ahead, and I will follow such discussions with interest. At this time, however, I agree with Chairman Bernanke that an increase in the long-run inflation objective to 4 percent would be a risky policy strategy.

**Q.2.** President Yellen, you identify in material provided to the Banking Committee, that you acquired “. . . first-hand experience in the conduct of banking supervision through my oversight of the Federal Reserve Bank of San Francisco’s banking supervision and regulation division.” You began as President and CEO of the San Francisco bank in 2004. What actions or written work can you point to that indicates that your oversight of supervision and regulation was designed to help guard the Fed’s 12th District and, indeed, the financial system from growing speculative excesses in real estate?

**A.2.** In 2004, the Federal Reserve Bank of San Francisco became concerned with relaxed underwriting standards and growing commercial real estate concentrations at commercial banks in our District. We initiated a horizontal review that resulted in findings around deficiencies in risk management and governance and demands for remedial action. Recognizing that these issues were present not only in banks supervised by our Reserve Bank, but also by other banks in our District and throughout the country, we brought our findings and concerns to the Board of Governors and urged that guidance be issued on an interagency basis to address the risks to the banking sector that were building as a result of these concentrations. We contributed to the process led by Board of Governors staff that resulted in the issuance of interagency guidance on commercial real estate concentrations in December 2006. I personally emphasized my concern about the dangers of growing commercial real estate concentrations in speeches to community banking organizations beginning in 2005. I cited the weak practices we had detected in our supervision around risk management and capital planning, indicated that our banking supervision staff had “communicated our high expectations around high commercial real

estate concentrations to the banks we supervise”, and noted that “we’re now at the early stages of developing potential interagency guidance.” Other examples of our supervisory efforts are provided in the response to question 6.

In addition, I began to discuss risks relating to real estate in economic outlook speeches that I gave starting in 2005. I cited evidence suggesting that housing prices were overvalued and discussed the possibility that a significant correction could occur. My intention, in part, was to use the “bully pulpit” to damp speculative excesses. I argued that regulation, rather than monetary policy, was the most appropriate tool to use to address developing excesses. I noted the decline in mortgage underwriting standards and the proliferation of loans with riskier terms but thought, wrongly as it turned out, that much of the risk had been diversified out of the financial sector via securitization, thereby reducing the odds of widespread financial disruption were house prices to decline.

**Q.3.** President Yellen, writing in a November 2009 edition of your bank’s publication *Economic Letter*, you say that “. . . monetary policy may also play a role in managing systemic risk.” You further say that “. . . monetary policy could play a role in restraining undesirable swings in leverage and, by extension, reduce systemic risk.” Do you advocate that the Fed should use monetary policy to lean against swings in asset prices? If so, how do you know which swings are potential bubbles and which are temporarily outsized movement of asset prices well grounded in fundamentals?

**A.3.** In that speech I also noted that the use of monetary policy in managing systemic risk compromises the attainment of our inflation and employment goals. Therefore, I concluded that supervision and regulation of financial institutions should provide the first line of defense against systemic risk, rather than monetary policy. The events of the past few years teach us that we need to closely monitor and analyze movements in leverage and asset prices and be cognizant of their effects in the conduct of monetary policy.

**Q.4.** President Yellen, do you have any ideas about how the Federal Reserve Board could increase its transparency with Congress?

**A.4.** I am committed to working with the Committee and with Congress to consider ways in which transparency might be enhanced. I believe that the Federal Reserve should provide any and all information necessary for Congress and the public to fully understand and evaluate the Federal Reserve’s actions as long as such disclosures are consistent with independence in monetary policy formulation and the effective implementation of monetary policy, including the operation of the discount window. The Dodd-Frank Regulatory Reform bill includes provisions, which I support, to further enhance transparency, particularly a complete GAO audit of the Federal Reserve’s 13–3 facilities and emergency actions. The bill also requires that discount window loans be reported with an eight-quarter lag. Confidentiality relating to discount window borrowing is essential for this facility to retain its effectiveness. I believe, however, that the reporting lag included in the Dodd-Frank bill is sufficiently long to mitigate this concern.



**Q.5.** President Yellen, how many Federal Reserve-regulated banks and bank holding companies failed in the 12th Federal Reserve district, where you oversee regulation, and how do failures in your district compare to those in other districts?

**A.5.** Since 2008, six state member banks and forty bank holding companies supervised by the Federal Reserve have failed in the 12th Federal Reserve district. The number of bank failures in the 12th district exceeds those in all other districts except Chicago and Atlanta. The number of bank holding company failures in the 12th district ranks second among districts, just below Atlanta. Not surprisingly, those districts—San Francisco and Atlanta—with the most significant collapse in housing prices and the highest levels of concentrations in residential construction and land development loans have experienced the most significant failure rates in banks and bank holding companies. It is important to note that the vast majority of 12th district bank holding companies are considered “shell” holding companies with little activity outside of the subsidiary bank. Consequently, the failure of bank holding companies has been driven by the failure of the underlying banks, which are predominately banks for which the Federal Reserve is not the primary regulator. It is also noteworthy that bank holding companies in the 12th District tended to hold banks with significantly higher construction and land development concentrations compared to holding companies in other Districts, leading to a higher failure rate.

**Q.6.** President Yellen, did you warn about declines in underwriting standards and increases in subprime lending prior to 2007? What steps did you take, as a regulator, to address the growing risks?

**A.6.** Starting in 2004, the San Francisco Fed provided several warnings about subprime and residential lending through our publication on banking risks in the West. Over several years, we noted concerns regarding high loan-to-value ratios, cash-out refinancing, the sustainability of housing price appreciation and the vulnerability of subprime borrowers to these practices and conditions. As I noted in my answer to question 2, starting in 2005, I started to warn in my speeches that soaring housing prices raised concerns about national economic stability and suggested that tighter supervision and regulation might be one viable strategy for addressing the bubble. Indeed, our examiners intensified their focus on evaluating the adequacy of underwriting, risk controls and management across a range of mortgage-related activities, including subprime origination. Specific examples of our examination work include evaluating policies and practices to preclude predatory lending practices, ensuring that a documented “benefit to the borrower” existed in the transaction, and evaluating whether underwriting models complied with Equal Credit Opportunity (ECOA) and Fair Housing Act requirements. Data and insights gained from these efforts were provided to the Board of Governors. This information contributed to their efforts to restrain such practices through the supervisory guidance on nontraditional mortgages issued in 2006.

Starting in 2004, the San Francisco Fed’s community development group began to address concerns in low-income communities relating to both subprime and predatory lending. At the National

Community Reinvestment Conference in Los Angeles in March 2004, the San Francisco Fed sponsored a special session on predatory lending and community-based strategies for preventing predatory lending. In addition, starting in the spring of 2004, staff worked with Freddie Mac and other community partners to establish “Don’t Borrow Trouble” campaigns in both Arizona and California. In March 2005, the San Francisco Fed hosted a meeting in collaboration with the Greenlining Institute and Operation Hope to discuss the rising prevalence of adjustable rate mortgages in low-income communities with senior executives of banks within the 12th District. The purpose of the meeting was to identify problems that low-income families with ARMs would face if interest rates were to rise, and to identify ways that the banks could work to better protect both consumers and their business interests. In June 2005, the San Francisco Fed hosted a luncheon for local community leaders with Federal Reserve Governor Edward Gramlich to discuss his concerns about subprime lending and to identify strategies that could help promote sustainable homeownership, particularly within the high-cost regions of the 12th District. In June 2006, we hosted the Federal Reserve Board’s HOEPA hearings to gather community input into the HOEPA regulations. We became increasingly concerned by the growing number of reports from community groups about the problems with subprime and predatory lending. In January 2006, we initiated a research project to collect local data on foreclosure filings and published a study in July 2006 that linked rising foreclosures in California to higher-priced lending. This was followed by a dedicated issue of our Community Investments publication on foreclosure prevention in December 2006, which sounded concerns about rising foreclosures and presented models from across the country for mitigating the foreclosure crisis. These two research publications laid the groundwork for an extensive effort by our community development group to establish local foreclosure prevention task forces in Arizona, California, and Nevada in 2006 and 2007. In 2007, we sponsored 13 foreclosure prevention forums throughout the 12th District to help launch these task forces and to develop targeted prevention strategies, which included detailed data analysis of foreclosure “hotspots” to help guide local foreclosure prevention activities.

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**RESPONSE TO WRITTEN QUESTIONS OF SENATOR VITTER  
FROM JANET L. YELLEN**

**Q.1.** The Federal Reserve, as specified by the Federal Reserve Act of 1913 and later the Federal Reserve Act of 1977, is required to “promote effectively the goals of maximum employment, stable prices, and moderate long-term interest rates.” This is often referred to as the dual mandate because the Federal Reserve is required to pursue maximum employment and stable prices equally. Do you think it is efficient to pursue one at a time?

**A.1.** I strongly support the Fed’s dual mandate and pay close attention to both inflation and employment at all times. Typically these two objectives are not in conflict in terms of their implications for monetary policy. In the current situation, employment and inflation are below desired levels, and both of these conditions argue for

monetary stimulus. Similarly, in an unsustainable economic boom, employment and inflation will both tend to reach levels that call for restrictive monetary policy. A supply shock, such as an increase in oil prices, does create a short-run tradeoff between our goals, but one which the Fed has effectively navigated over the past quarter century.

**Q.2.** Currently, we are responding to the high unemployment in the country. Later, we will respond to inflation. In the 1970s that approach produced higher inflation and higher unemployment. Why should we believe that won't happen again?

**A.2.** I think it would be more accurate to say that the Fed is currently responding to both inflation, which is now below the level that most FOMC members consider to be most consistent with our dual mandate and is trending downward, and unemployment, which is very high. A key lesson of the 1970s is the critical importance of maintaining well-anchored inflation expectations so that a wage-price spiral like we saw back then does not break out again. The Federal Reserve earned a great deal of inflation credibility over the past thirty years and inflation expectations are now well anchored. Still, we monitor closely a variety of measures of inflation expectations, and inflation expectations are a key driver of policy decisions, as emphasized in recent FOMC statements. This approach should minimize the risks of seeing a recurrence of stagflation.

**Q.3.** Paul Volcker and Alan Greenspan have concluded that the Phillips curve is a misleading guide. Do you agree or disagree and why?

**A.3.** The modern version of the Phillips curve model—relating movements in inflation to the degree of slack in the economy—has solid theoretical and empirical support. Of course, in this model other factors besides slack affect inflation, such as commodity and other import prices and inflation expectations. Moreover, the U.S. economy is evolving and the Phillips curve changes as well. Despite these shortcomings, the Phillips curve model provides a coherent and useful framework for thinking about the influence of monetary policy on inflation. Of course, no single model captures the complexity of the U.S. economy. As a result, I find it necessary to consult a wide range of models, examine data from many sources, and listen carefully to the reports we receive from business contacts around the country.

**Q.4.** The financial reform bill, Dodd-Frank, creates a consumer regulator inside the Fed that is administered separately. How will the Federal Reserve prevent conflict?

**A.4.** The Dodd-Frank bill calls for the Bureau of Consumer Financial Protection to be completely autonomous within the Federal Reserve and contains provisions designed to minimize future conflict. The Bureau will have its own authority to hire and fire personnel, set salaries and benefits, and organize itself and its divisions. The legislation specifically prohibits the Board of Governors from intervening in Bureau proceedings and other matters. The Board of Governors is committed to respecting Congress' intentions and in-

structions. We will cooperate with the Treasury Department in planning a smooth transition of functions and personnel.

**Q.5.** In a speech this last February you said:

Some people worry that sustained Federal budget deficits and the huge increase in the Federal Reserve's lending and stimulus programs could eventually lead to high inflation. Others take the opposite view, arguing that economic slack and downward pressure on wages and prices are pushing inflation down. I would put myself squarely in the second camp. As far as inflation is concerned, there's no evidence that big Government deficits cause high inflation in advanced economies with independent central banks.

Is high inflation the only thing to fear of sustained Federal budget deficits and the huge increase in the Federal Reserve's lending and stimulus programs? What other concerns should we be monitoring?

**A.5.** Sustained structural deficits in the Federal budget will likely put upward pressure on real interest rates as private demand recovers and the economy moves back toward full employment. Under these conditions, Federal Government borrowing will crowd out private investment and other interest-sensitive spending, with negative consequences for productivity, economic growth, and living standards. In addition, large structural deficits may induce larger capital inflows from abroad, expanding the U.S. trade and current account deficits. Appropriate policies by the Federal Reserve—namely, the timely removal of the extraordinary monetary accommodation currently in place as the economy recovers—are necessary to guard against threats to price stability.

**Q.6.** Would you describe your view, that big Government deficits do not cause high inflation in advanced economies with independent central banks, as mainstream?

**A.6.** Yes, I consider it mainstream. It is commonly recognized that large and chronic Government budget deficits generate high inflation, or even hyperinflation, when a country turns to its central bank to print money on an ongoing basis to finance them. The temptation of a government to use seignorage as a source of finance arises when deficits and/or debt become so large that the Government faces exceptionally high borrowing costs in domestic or international markets. In extreme cases, the Government may find itself unable to float debt entirely. Examples include the hyperinflations experienced in Germany and Hungary in the aftermath of World War I, and prolonged episodes of high inflation in many Latin American countries in the aftermath of the debt crises of the 1980s. An independent central bank, especially one that has established a credible commitment to price stability, is best positioned to resist the political pressure to monetize budget deficits. This independence explains why there is no correlation between inflation and budget deficits in advanced countries and is a primary rationale for central bank independence.

**Q.7.** In a speech this March, Dr. Yellen, you said, “so I’m not alarmed by the current enormous deficits. I see them as transitory and recession-related.” Let us say in the future we reach a point that we are truly out of this recession in a meaningful way and the national deficits are where they are projected, 4 to 7 percent, versus 2½ percent. Would you then become concerned with the enormous deficits? How quickly would those deficits become a

major problem in terms of the economy? What would those problems be?

**A.7.** I am very concerned about the economic consequences of sustained structural budget deficits in the United States. While the U.S. debt/GDP ratio is currently not out of the range of experience of many industrial countries, it is at its highest level since the aftermath of World War II, and absent material changes in current policies, it is projected to rise considerably in the years ahead. Thus, it is important for the Congress and the Administration to have an intermediate-term strategy for fiscal consolidation and stabilization of the ratio of debt to GDP at a sustainable level in order to avoid the long-term costs and risks associated with a rapidly rising debt—primarily, an increase in long-term interest rates that crowds out private investment spending, weakening productivity growth and harming long-run living standards, as well as possible further increases in the U.S. trade deficit and our net international indebtedness.

**Q.8.** In your role as a voting member of the FOMC, how many times have you cast a dissenting vote from the Chairman? What were the circumstances?

**A.8.** Never. Although I have voted with the Chairman, I have consistently arrived at policy positions independently, based on my own analysis and best judgment.

**Q.9.** A lot of thought has been put into how and when to remove the excess liquidity that the Federal Reserve has pumped into the economy since 2008. Do you think we have reached a point where the Federal Reserve can begin withdrawing that liquidity? If not, what metrics will you look at to make that determination?

**A.9.** I do not think that we have reached the point where the Federal Reserve should begin to withdraw monetary accommodation. As the Federal Open Market Committee noted in its most recent statement, it anticipates that economic conditions, including low rates of resource utilization, subdued inflation trends, and stable inflation expectations, are likely to warrant exceptionally low levels of the Federal funds rate for an extended period. I agree with this assessment. At the same time, the Committee has prepared itself to remove monetary accommodation in a timely fashion as the economy recovers in order to avoid future threats to price stability. To determine when to begin the process of removing accommodation, I will be carefully monitoring economic and financial developments, including evidence bearing on the strength and durability of the recovery, the degree of slack in the economy, and the evolution of inflation and inflation expectations.

**Q.10.** The United States monetary policy is often described as mixed policy, which indicates that the Fed funds rate responds to shocks in inflation and output. However, many other well developed economies such as the United Kingdom, Switzerland, Canada, Australia, and countless others utilize an inflation targeting approach. What do you think are the benefits of mixed policy as opposed to inflation targeting.

**A.10.** In textbook descriptions of inflation targeting, the central bank's only goal is to bring inflation back to its target rate, regard-

less of the effects on employment. A key component of that strategy is the clear articulation of a long-run inflation goal. I think it is more accurate to describe the listed countries as practicing “flexible” inflation targeting, in which they aim for a balanced approach of limiting movements of both inflation and employment (or GDP) from their desired levels. The Fed’s approach, based on the dual mandate, does not differ fundamentally from that of flexible inflation targeting, except that the Fed does not have a specified numerical inflation objective. The Fed has taken steps over the past few years to improve transparency of monetary policy, including providing greater clarity on our longer-run inflation goals.

**Q.11.** Economist Lawrence Mishel of the Economic Policy Institute stated “I think these are all great choices, and ones that will move Fed policy in the needed direction—responsive to the needs of middle-class and working families.” Would you agree that this is the direction in which you plan to take the Federal Reserve?

**A.11.** The Federal Reserve’s dual mandate from Congress is to foster price stability and promote maximum employment. I think the Federal Reserve should remain focused on implementing policies to attain these objectives, which are essential to the well-being of middle-class and working families, and indeed all Americans. A well-functioning labor market is necessary for families to obtain the work they need for their support; and price stability promotes economic growth and facilitates sound economic decisions and financial and retirement planning. The Federal Reserve must also identify and act to mitigate systemic risks that threaten the financial system. As we have seen, financial crises exact a heavy toll on middle-class and working families in the form of lost jobs, homes, businesses and wealth.

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**RESPONSE TO WRITTEN QUESTIONS OF SENATOR SHELBY  
FROM PETER A. DIAMOND**

**Q.1.** Professor Diamond, in an interview with *Macroeconomic Dynamics* in 2007, you stated that “. . . it’s not the case that I stay abreast of macro developments.” Yet the position for which you have been nominated requires someone who stays abreast of those developments. In material you submitted, you identified that “. . . I have considerable awareness of the development of economic analyses of monetary policy and its impacts on both inflation and employment.” Has something changed for you with respect to the attention you give to macro events since 2007?

**A.1.** As an academic doing basic research and policy research on public finance questions, staying abreast of day-to-day developments in the economy and the latest macro research would not have been germane to my research, although I naturally did follow economic developments from a variety of sources and some analyses of causes and consequences of macro developments in seminars and discussions with colleagues. Since the start of the possibility of my being appointed to the Fed, I have begun focusing even more attention to such developments. If confirmed, I will need to pay attention to macro developments in great detail to perform my duties, and I will do so.

**Q.2.** Professor Diamond, in an interview with *Macroeconomic Dynamics* in 2007, you stated the following: “I think nominal stuff really matters.” Please clarify what you mean and how it applies to monetary policy. To the extent you believe that nominal stuff mattering means that the Fed can engineer real effects from nominal changes, what are the transmission mechanisms that are most important?

**A.2.** The quote in the question was the start of my answering the question: “Since we are interviewing for *Macroeconomic Dynamics*, maybe the readers would like to hear your comments on the state of macroeconomics, past, present, and future.” There has been a great deal of research using what are called “real business cycle” models. As the name suggests these models, in their pure form, do not have any role for “nominal stuff.” Yet the evidence is clear that prices and wages do not adjust to the money supply in a simple market-clearing way. In other words, prices and wages are “sticky.” As a result I believe there are real effects from nominal changes. For example, if the economy were to experience deflation, as Japan did, that would be harmful to the level of employment, and monetary policy to prevent deflation would have real effects. There are multiple transmission mechanisms beyond the stickiness of prices and wages through expectations about future opportunities and through the credit channel.

**Q.3.** Professor Diamond, you have a long and impressive list of published papers and books covering a variety of topics. However, a very small fraction of the work you have done directly involves monetary economics or monetary policy. Why are you interested in serving on the Federal Reserve Board?

**A.3.** I have done considerable research, both basic and policy-related, on the role of Government in helping markets to improve the bearing of risks in the economy. The current crisis has made us aware of systemic risks arising from behavior of financial institutions and their interactions with other financial institutions and markets more generally. Analysis of systemic risks will draw on the type of analyses I have done throughout my career.

**Q.4.** Professor Diamond, do you believe that there are tradeoffs between inflation and unemployment? Do you believe that the Fed should engage in active aggregate demand management to exploit the tradeoff?

**A.4.** When Samuelson and Solow wrote their famous paper on the Phillips curve, the paper included the warning that the presence of the historic pattern did not imply that the pattern would remain if there was a systematic attempt to exploit it; that is, they warned that there might not be an exploitable tradeoff. It is common in empirical work in macroeconomics to assume that there is no long-run tradeoff between inflation and unemployment as part of the assumptions underlying the empirical work. Most economists believe that an attempt to increase employment by steadily ratcheting up inflation is a bad policy that will harm the economy in the long run, and I agree. The widespread view, which I share, is that it is advantageous to have a relatively low and stable inflation rate, with policy responses to macroeconomic shocks built around returning to the target range of inflation rates over time. Thus I see the

two parts of the Federal Reserve's dual mandate of stable inflation and maximum employment as generally complementary, because price stability adds to the economy's employment prospects over the longer run. However, not all stable inflation rates have the same impact on employment. I believe an economy will function better with a stable 2 per cent inflation rate than with a stable 10 per cent inflation rate or a stable 2 per cent deflation rate. Moreover, the economy is subject to periodic shocks and the ability to respond to shocks is better with a 2 per cent inflation target than with zero percent inflation or a 2 per cent deflation. In these two senses, both long run efficiency and the ability to respond to shocks, there is a tradeoff between the level of a stable long run inflation target and the unemployment rate. This does not contradict the absence of an exploitable tradeoff that would make worthwhile a policy of steadily ratcheting up inflation.

**Q.5.** Professor Diamond, what is your impression of views by some within the Federal Reserve system that monetary policy is too loose, and that if we continue with the monetary ease, we risk the creation of new financial bubbles?

**A.5.** There is a long history of asset bubbles. It appears that some investors base their decisions unduly on extrapolations of recent asset price trends, which can encourage a bubble, in part as other investors, even some aware that it is a bubble, try to take advantage of what appears to be a favorable short-term investment opportunity, hoping to get out before the bubble bursts. Experimental economics has shown that bubbles can happen in controlled environments where they could not happen if all people were behaving in accord with the standard rational model of economic behavior. Bubbles, once started, can be fueled by borrowed funds, with lower borrowing rates making investing during a bubble seem more attractive, and so adding to the bubble. While there is this possible link between loose monetary policy and the risks of bubbles, monetary policy is not the best tool for addressing the risk of bubbles, as regulatory policies can be more targeted and even tax policies can influence the incentive to invest in such circumstances. In current circumstances of very high unemployment and sluggish growth, monetary ease is essential for economic growth, which appears to be a more important issue right now than the risk of a new widespread bubble. Nevertheless, our recent experience makes it incumbent on policymakers to be attentive to the risk of bubbles.

**Q.6.** Professor Diamond, it has been reported that you were a mentor to Fed Chairman Bernanke when he was in graduate school. What grade would you assign to Chairman Bernanke's Fed Chairmanship, and where do you see room for improvement?

**A.6.** In the run up to the financial crisis, the Federal Reserve did not address the mortgage origination issues and did not consider regulatory tools to limit the housing price bubble, although many of these developments were already in motion before Bernanke became chair of the Fed. These are issues the Fed should have pursued for consumer protection as well as for trying to head off what became a financial crisis. While it would have been good if the Fed had limited more tightly the leverage of the financial institutions it regulated and the degree of concentration of assets in particular



classes of assets (mortgage based and commercial real estate) the widespread (although not universal) failure to recognize the degree of risk and systemic implications imply less of a downgrade than if these issues were ignored in a context of widespread awareness of them. In part, failure of regulators to keep up with the complexity coming from financial engineering went along with failures of the financial institutions to realize the risk characteristics of their own actions.

Since the start of the crisis I think Chairman Bernanke has deserved high marks for recognizing the seriousness of the situation, being willing to use the full range of powers of the Fed (and to cooperate with the Treasury in use of its powers) to limit the impact of the crisis on the economy. I also applaud his willingness to try unusual approaches, since we were in an unprecedented situation for which one could not simply rely on the history of the use of past policies.

In his remarks at various times, Chairman Bernanke has acknowledged the earlier failures of the Fed relative to the housing market and indicated a heightened attention to interactions of financial institutions and systemic risk. The intended addressing of these issues, already begun, will mark an improvement at the Fed going forward.

**Q.7.** Professor Diamond, do you believe that inflation or deflation is the larger threat currently? Given your belief, what do you intend to advocate in terms of the evolution of monetary policy: further ease in policy; maintenance of the existing amount of ease; or movement to begin firming policy?

**A.7.** Currently, I think deflation is the greater risk. While I do not think that significant deflation is a likely outcome, the risk from inflation rising beyond the desired range in the near future appears even smaller. At present I favor maintenance of the current level of ease, with vigilance to circumstances that might call for a change in either direction.

**Q.8.** Professor Diamond, do you believe that the Federal Reserve effectively used its lending power to channel equity into subsidiaries of the American International Group by setting up Maiden Lane II?

**A.8.** I played no role in the Fed's decisions (either directly or as a commentator) that led to that transaction, and I have no knowledge of the structure or details of Maiden Lane II.

**Q.9.** Professor Diamond, you describe yourself as a "card carrying" behavioral economist. What discipline is there in behavioral models to restrict bureaucrats from, let us say, taking the results of a survey, extrapolating to national and global markets, and unleashing rules to guide the behavior of Americans to protect them from themselves?

**A.9.** In all of economics, and not just behavioral economics, to extrapolate a single survey to national and global markets and base policies on that alone would be unwise. The economy is a complex system with great heterogeneity in behavior. Policy needs to draw on a wide range of analyses to understand both the workings of the

economy and the possible effects (intended and undesired) that might follow from a policy. As Alfred Marshall put it:

it [is] necessary for man with his limited powers to go step by step; breaking up a complex question, studying one bit at a time, and at last combining his partial solutions into a more or less complete solution of the whole riddle . . . The more the issue is thus narrowed, the more exactly can it be handled: but also the less closely does it correspond to real life. Each exact and firm handling of a narrow issue, however, helps toward treating broader issues, in which that narrow issue is contained, more exactly than would otherwise have been possible. With each step . . . exact discussions can be made less abstract, realistic discussions can be made less inexact than was possible at an earlier stage. [Alfred Marshall, *Principles of Economics*, eighth edition. New York: The Macmillan Company. 1948, page 366.]

I consider reliance on a narrow viewing of the economy to be bad methodology for policy analyses. The discipline to base policy on good analyses with good methodology must come from the policy process, it does not come from basic research per se, whether behavioral or not.

**Q.10.** Professor Diamond, you describe yourself as a “card carrying” behavioral economist. An Assistant Secretary for Financial Institutions at Treasury has written a so-called “behavioral” paper to inform financial regulation. One of his proposals is to allow banks to charge late fees to discourage such bad behavior. He suggests the banks be allowed to keep some of those fees, but put the bulk of the fees into a national trust for use in funding things like financial literacy and other consumer initiatives. As a behavioral economist, what is your assessment of such a proposal?

**A.10.** The policy referred to is to levy an implicit tax on late fees, with the revenue dedicated to financial education and assistance to troubled borrowers. I expect the new Consumer Financial Protection Bureau to explore the appropriateness of the current setting of late fees. The inability of consumers to negotiate a credit card contract with a different fee structure and the complexity of exploring across credit cards to find a combination with different fees suggest the appropriateness of such an exploration. Such an exploration would need to develop far more information and modeling of the range of implications of having different fees than the paper presents. Without such study, it is difficult to see what pattern of fees across different cards would best serve the public in general. And it is difficult to see whether a tax would move the fee structure in a desired direction. Indeed, the paper itself recognizes that it is exploring ideas and approaches, not making concrete recommendations: “The purpose of this paper is not to champion policies, but to illustrate how a behaviorally informed regulatory analysis would lead to a deeper understanding of the costs and benefits of specific policies.” My preliminary view is that this approach to addressing questions about fees is too convoluted, that more straightforward approaches would do better if significant problems are found in a more detailed empirical study of equilibrium fee setting in the credit card market. I do think that a proper study of the effects of fees does need to consider actual behavior of cardholders, and not just an idealized picture of optimal use of credit cards.

**RESPONSE TO WRITTEN QUESTIONS OF SENATOR VITTER  
FROM PETER A. DIAMOND**

**Q.1.** Mr. Diamond, you are a well respected expert on social security and pensions and a professor of economics at MIT. How do you plan to influence monetary policy decisions in a way which would make you more than a rubber stamp for Chairman Bernanke?

**A.1.** If confirmed, as a member of the FOMC, I will scrutinize analyses of the state of the economy and the policy implications of the picture of the economy that emerges. I will express myself at meetings based on my evaluation of the evidence and its implications. As my colleagues and others can attest, I have a long history of thinking for myself and expressing my own views.

**Q.2.** Do you believe that a Federal Reserve Board of Governors that is comprised of only two experts in monetary policy will provide enough balance and expertise on the Board to make crucial monetary policy decisions like when and how to withdraw the excess liquidity the Federal Reserve has flooded into the economy?

**A.2.** The Federal Reserve has several important functions, including regulation of financial institutions as well as monetary policy. In addition, the Fed will play an important role in monitoring systemic risks and developing policies to address such risks. If my fellow nominees and I are confirmed by the Senate, the Board of Governors will have a set of individuals with a broad range of backgrounds and expertise that should do well in addressing the various responsibilities of the Board. Also, as you are aware, many significant monetary policy decisions are made by the Federal Open Market Committee (FOMC) rather than the Board. The FOMC also includes five of the Federal Reserve Bank presidents, with all of the Reserve Bank presidents participating in FOMC discussions. Some of the Federal Reserve Bank presidents have substantial backgrounds in macroeconomics or monetary economics.

**Q.3.** The Federal Reserve, as specified by the Federal Reserve Act of 1913 and later the Federal Reserve Act of 1977, is required to “promote effectively the goals of maximum employment, stable prices, and moderate long-term interest rates.” This is often referred to as the dual mandate because the Federal Reserve is required to pursue maximum employment and stable prices equally. Do you think it is efficient to pursue one at a time?

**A.3.** I believe that, in general, the objectives of maximum employment and stable prices are mutually reinforcing and that both are very important objectives. High unemployment reflects inadequate and inefficient output in the economy as a whole and has very painful consequences for individual workers and their families. Low and stable inflation contributes to the efficiency in the economy and supports the attainment of maximum employment. Pursuit of a single goal would not adequately address the economic concerns that monetary policy can address.

**Q.4.** Currently, we are responding to the high unemployment in the country. Later, we will respond to inflation. In the 1970s that approach produced higher inflation and higher unemployment. Why should we believe that won't happen again?

**A.4.** The 1970s were marked by oil price shocks that boosted inflation and also contributed to unemployment as the economy adapted to the shocks and the policies followed by the Government at the time. The current situation is very different, with painfully high unemployment and very low inflation, recently running below the 2 percent level widely accepted as a good objective for the medium-to-long run. I believe that at present monetary ease is appropriate for this combination of high unemployment and low inflation. Nonetheless, policymakers will need to be vigilant and respond promptly and appropriately to changes in economic conditions and expectations.

**Q.5.** Paul Volcker and Alan Greenspan have concluded that the Phillips curve was a misleading guide. Do you agree or disagree and why?

**A.5.** When Samuelson and Solow wrote their famous paper on the Phillips curve, the paper included the warning that the presence of the historic pattern did not imply that the pattern would remain if there was a systematic attempt to exploit it; that is, they warned that there might not be an exploitable tradeoff. Most economists believe that an attempt to increase employment by steadily ratcheting up inflation is a bad policy that will harm the economy in the long run, and I agree. The widespread view, which I share, is that it is advantageous to have a relatively stable inflation rate, with policy responses to macroeconomic shocks built around returning to the target range of inflation rates over time.

**Q.6.** The financial reform bill, Dodd-Frank, creates a consumer regulator inside the Fed that is administered separately. How will the Federal Reserve prevent conflict?

**A.6.** The Consumer Financial Protection Bureau created by the Dodd-Frank bill is to be an independent agency, within the Federal Reserve Board. The independence includes autonomy in hiring, operations, and policymaking activities. The Board continues to have a consumer protection role in the small bank sector of the economy. I anticipate that the Bureau and the Board will develop a good working relationship, on the order of the ones that currently exist between the Board and the other Federal banking regulatory agencies. The relationship is likely to include a mutually beneficial framework for sharing information on consumer protection and safety and soundness matters. As the Bureau will become a member of the FFIEC, that will provide another source of collaboration with the Board.

**Q.7.** Earlier this year the N.Y. Times reported that the Triple-A credit rating of the United States “may be at risk in the coming years as the Nation copes with its growing debts.” Since 2007 the national has increased from \$8.67 trillion to \$12.6 trillion—an increase of \$3.93 trillion or 45.3 percent, the debt limit has increased six times and the deficit has increased from \$161 billion in FY 2007 to \$1.42 trillion in FY 2009. The FY 2010 deficit is projected to come in at another \$1.5 trillion. Do these deficits pose any harm to the economy or economic growth?

**A.7.** Projections of the long-term fiscal position of the Federal Government, for example, by the CBO, show an unsustainable track.

At some point, if Government debt follows that projected path, the Triple-A credit rating would be at risk. However, I think that that point is not imminent. Recent large deficits have reflected both the effects of the deep recession, which automatically reduces tax revenues and increases outlays for income support programs, and discretionary fiscal policy actions taken to directly counter the recession and stabilize financial markets. I think the fiscal stimulus has been important in limiting the size of the current contraction as well as supporting some valuable public programs. And I think that near-term deficit reduction would not be helpful for supporting economic growth that can bring down the painfully high unemployment rate. It is important, however, to address the causes of the deficit's long-term unsustainable path.

**Q.8.** Let us say in the future we reach a point that we are truly out of this recession in a meaningful way and the national deficits are where they are projected, 4 to 7 percent, versus 2½ percent. How quickly would that become a major problem in terms of the economy? What would those problems be?

**A.8.** At some point, steady increases in the debt to GDP ratio, together with expectations of a path of continuing increases become a major problem for an economy. However, there is no clear guide from either the experience of different countries or from economic theory to clearly indicate at what point the size of the U.S. Federal debt relative to GDP poses significant risks of instability in financial markets and costs to the functioning of the economy. A central concern is that the expectation of future growth of the debt plays a key role in how capital markets respond to any given level of debt. Since the U.S. debt is denoted in our own currency, unlike many countries which have had financial crises from too much debt, and since U.S. Government debt has been viewed as the safest place to invest during the recent crisis, it is difficult to draw inferences from the experiences of other countries. Once we are truly out of this recession, persistent budget deficits that push up the debt to GDP ratio represent shifts of financial burdens onto future generations, which, at some point, do not represent good policy. Moreover, the reaction of the capital market to a belief that the trend in debt will not be reversed can be abrupt. For both reasons it would be good to legislate policies that support projections of a stable debt to GDP ratio and that do not hurt the process of getting truly out of this recession.

**Q.9.** A lot of thought has been put into how to remove the excess liquidity that the Federal Reserve has pumped into the economy since 2008. Do you think we have reached a point where the Federal Reserve can begin withdrawing that liquidity? If not, what metrics will you look at to make that determination?

**A.9.** Much of the liquidity provided by the Federal Reserve during the crisis has been withdrawn already, as nearly all of the special liquidity facilities that were established have expired. A key remaining legacy of addressing the financial crisis is the large volume of agency mortgage-backed securities and direct agency obligations held on the Fed's balance sheet, and large reserves in the banking system as a consequence of their purchases. At present the Fed is following a policy of gradual decline in these holdings as as-

sets mature or prepay. In addition, it appears that the intention is to have gradual and pre-announced sales of agency MBS at some point to speed the return to a Treasury-securities-only portfolio. I think it would be premature to begin such sales now given the high unemployment and the low inflation (with low inflation expectations) that we currently have and the ongoing potential risks to the economy. A decision to begin such asset sales needs to be made in the context of the overall policy addressing price stability and maximum employment. Since I have not participated in FOMC discussions of this topic, and since the future track of the economy is uncertain, I am reserving judgment at this point regarding when such asset sales should begin.

**Q.10.** The United States monetary policy is often described as mixed policy, which indicates that the Fed funds rate responds to shocks in inflation and output. However, many other well developed economies such as the United Kingdom, Switzerland, Canada, Australia, and countless others utilize an inflation targeting approach. What do you think are the benefits of mixed policy as opposed to inflation targeting.

**A.10.** The objectives of price stability and maximum sustainable employment are mutually supportive in that price stability helps maintain economic conditions that are conducive to maximum employment and employment at its maximum sustainable level supports price stability, as fluctuations, both up and down, of the rate of price increases can be harmful. I think it could be harmful for a central bank to focus exclusively on price stability. A financial crisis can be harmful to the economy even if the inflation rate does not change and can be usefully addressed by policies available to central banks. Moreover, I think that in practice, some central banks with a single objective of price stability will want to take economic activity into account as well, and the recent crisis has seen wide awareness of the need for addressing the crisis. Indeed, central banks of all stripes have pursued broadly similar policies in response to the global financial crisis and recession.

Moreover, the Federal Reserve's congressionally mandated dual objectives of price stability and maximum sustainable employment reaffirm that the ultimate measure of prosperity for Americans is ample employment and rising real incomes and that long-run stability of price increases is necessary to foster such outcomes.

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**RESPONSE TO WRITTEN QUESTIONS OF SENATOR SHELBY  
FROM SARAH BLOOM RASKIN**

**Q.1.** The Federal Reserve has ballooned its balance sheet from a pre-crisis level of around \$850 billion to over \$2.3 *trillion* in reserve liabilities. There are differing views within the Fed about how and when it should shrink the size of its balance sheet, including possible asset sales. Commissioner Raskin, how would you shrink the Fed's balance sheet, and when do you think that sales of mortgage-related holdings should begin?

**A.1.** I believe that it is important to normalize the size and composition of the Federal Reserve's balance sheet, but it should be done in a way that does not endanger the recovery. Given current

conditions in the housing market, I would wait for stabilization before selling mortgage-backed securities. I also do not believe that active sales are necessary until after the Federal funds rate is raised. After that, I believe it would be appropriate to reduce the size of and shorten the maturity of the Federal Reserve's holdings of Treasuries. When the time has come for both normalizing the holding of Treasuries and selling mortgage-backed securities, the process the Federal Reserve follows should be announced in advance and fully transparent.

**Q.2.** The European Central Bank, the Bank of England, and central banks in Australia, Canada, and New Zealand use versions of a “corridor” or “channel” method for setting policy rates. The Fed has contemplated using such a system. Commissioner Raskin, are you aware of any impediments to the Fed's use of a corridor to help control variation in the Federal funds rate by bracketing it between the discount rate and the rate paid on reserves?

**A.2.** The corridor method has been successful at other central banks and believe that it could work in the United States. However, there are some technical problems—both with the interest rate on reserves acting as a lower bound to the corridor and with the discount rate acting as an upper bound to the corridor. The technical problem at the lower bound has to do with the Government-sponsored enterprises. The GSE's are participants in the Federal funds market but are not eligible to earn interest on the balances they hold at the Federal Reserve. Consequently, they have an incentive to lend funds at interest rates below the rate paid on reserves. Because of this incentive, the Federal funds rate could be lower than the interest rate paid on reserves. The technical problem at the ceiling arises because the discount rate may not always cap the Federal fund rate. Banks sometimes view borrowing from the discount window as stigmatizing, and have at times been quite reluctant to borrow there. Given this reluctance, the Federal funds rate may need to rise somewhat above the discount rate for banks to have sufficient incentive to use the window. Despite these potential issues with the effectiveness of the upper and lower bounds of a corridor system in the United States, I believe that such a system could work here. However, I have not seen much evidence that the Federal Reserve is having difficulty being able to continue to keep the Federal fund rates close to the target rate established by the FOMC.

**Q.3.** Commissioner Raskin, do you believe that the Fed should follow some variant of the Taylor rule in setting monetary policy?

**A.3.** The Taylor rule and its variants can provide a useful diagnostic check to establish that monetary policy is consistent with its two goals—maximum employment and stable prices. As a matter of policymaking, however, the Federal Reserve should attempt to use all information that it has at its disposal to meet the dual mandate. Therefore, it is my view at this point that it would not be prudent to set the conduct of monetary policy on “automatic pilot” through rigid adherence to a single rule. The Taylor rule and its variants are best used as a check to the policy decisions that the Federal Reserve makes after it takes into account the wide range

of indicators that are relevant to maximum employment and stable prices.

**Q.4.** Commissioner Raskin, some forecasters in the Fed explain that they look at core measures of inflation that exclude volatile energy and food prices because they have better forecasting properties than headline inflation numbers. Alternative measures of core inflation consider growth in so-called trimmed mean price indexes. Do you favor any of these measures in formulating forecasts of future inflation?

**A.4.** I do not view either measure as superior in all circumstances and think that it is not appropriate to ignore any particular set of inflation measures in gauging current inflation trends for the purposes of setting policy. For example, while economists often focus on core inflation measures that exclude food and energy prices because these items sometimes exhibit sharp but temporary fluctuations, it is also important to recognize that food and energy are important components of a household's expenses. Thus, changes in these prices must also be taken into account when considering monetary policy actions.

**Q.5.** Commissioner Raskin, you have been a vocal advocate of a Federal financial consumer protection bureau that sets a "floor," not ceiling, for such protections. You have appeared before Congress to urge adoption of a recommendation made by Elizabeth Warren's Congressional Oversight Panel to, in your words, "eliminate Federal preemption of the application of State consumer protection laws to national banks." That is, you strongly favor a patchwork of State-by-State rules and limited Federal preemption. In making your argument, you seem to rely almost exclusively on the SAFE Act as a model for how the States and the Federal regulators could interact. Is there anything aside from your experience with the SAFE Act to support your views on preemption?

**A.5.** In addition to my experience with the State and Federal process around the SAFE Act, my work with the FFIEC, my work on mortgage servicing and loss mitigation and my day-to-day work with Federal regulators in the supervision of Maryland state-chartered banks, has consistently highlighted that if Congress establishes laws and regulatory structures that encourage State and Federal cooperation the outcome leads to greater consistency and uniformity without sacrificing the benefit of local decisionmaking where it makes the greatest difference. Those differences can mean survival for small to medium banks and businesses and responsiveness and accountability to the consumer. To be clear, I do not support difference for the sake of difference, but rather a State-Federal dialogue that balances the goals of uniformity with the need for flexibility and responsiveness.

And as the chairman of the Conference of State Bank Supervisors' Legislative Committee, I became sensitized to the experiences of my colleague State bank commissioners and realized that the issue of finding the appropriate State/Federal balance is of critical importance to all State regulators across the country. I witnessed the virtues of American federalism which gives to the States the front-line authority to respond to local conditions on behalf of the public interest of their own communities. The State regulators



that I work with have been continuously dealing with an extraordinary array of problems in their State and local economies. For example, certain States have been confronting the problem of capital flight; others have been dealing with elevated rates of mortgage fraud; others have been working with mortgage servicers that are unable to respond to requests for modifications; others have been responding to changes in the demand for agricultural loans or for energy loans.

I believe in the capacity of State governments to respond to local conditions, often in a way that is far more effective and nimble than what can be done from Washington. For this reason, while the Supremacy Clause provides that Federal law clearly trumps State law, I believe that, as a matter of public policy, Federal policy-makers should give the States their proper due and permit them to act with administrative dexterity, alacrity and precision to deal with problems that arise at the local level. This is why I generally—though not categorically and never blindly—favor Federal laws that create floors rather than ceilings and leave room for some play in the joints of our federalism.

There has always been a tension in American history between those who favor more centralized power and Government and those who want to make sure that the States and the people continue to enjoy a measure of sovereign democratic freedom to advance and protect local interests. I confess I find myself often in the latter camp. What others sometimes describe critically as a “patchwork” of laws, I actually see as the decentralized “laboratories of democracy” that are the essence of American constitutional federalism. In the case of the current crisis, I have seen how several effective and independent State efforts to deal with our problems have become the basis for successful national efforts.

Federal preemption is not, and should not be an “up or down” issue but an ongoing dialog to balance national interests with local interests in pursuit of the more perfect solutions.

**Q.6.** Commissioner Raskin, the New York Times labels you “an ally of consumer advocacy groups,” and I notice that you received the 2009 Maryland Consumer Rights Coalition Consumer Advocate of the Year Award. Nothing I can see provides comfort to me that you have the knowledge of monetary economics and monetary policy to sit at the Board making decisions that influence interest rates and economies globally. What can you tell me to provide comfort that you will not focus simply on consumer advocacy and activist issues, and will not serve simply as a rubber stamp on monetary policy, deferring to whatever are the whims of the Chairman?

**A.6.** Both my academic and professional background have provided me with the knowledge of monetary economics and monetary policy to “sit at the Board making decisions that influence interest rates and economies globally.” From my undergraduate studies, through my graduate years in law school, and in my 25 years of experience in the private and public sectors, I have experienced, written about, and taught both the theoretical and practical aspects of monetary economics and policy.

My interest and work in monetary macroeconomics and monetary policy began during my undergraduate years at Amherst College,

where I graduated Phi Beta Kappa and *magna cum laude* in economics and wrote my senior thesis on the Federal Reserve Board's experience with intermediate targeting of monetary policy. This senior thesis was anchored in econometric analysis but also discussed strategic issues related to central banking. It earned me the James R. Nelson Prize in Economics which is awarded to the top economics student in the graduating class. Much of the analysis for that thesis was inspired by work I had done during college at the Joint Economic Committee of Congress.

Although I chose to go to Harvard Law School rather than pursue a doctorate in economics, I was invited to teach Economics 10 as a teaching fellow with Professors Martin Feldstein and Lawrence Lindsey while I was a law student. This course covered macroeconomic subjects, including monetary policy and monetary macroeconomics. Then, the summer after my second year of law school, I worked at the Federal Reserve Bank of New York and continued to participate in projects related to the Federal Reserve's role in monetary policy, regulation and payments systems. I worked with a team of lawyers and economists that summer to restructure the Brazilian debt escrow accounts which are maintained by the Federal Reserve Bank of New York. I prepared an analysis of interest rate swaps that evolved into a paper when I returned to Harvard on the subject of their structural implications.

My career trajectory has given me ample opportunity to apply this academic immersion in monetary policy to concrete problems in both the private and public sectors. I spent more than a decade in the private sector as a banking attorney with Mayer Brown and with Arnold and Porter. Subsequent to my work at those law firms, I became a managing director of Promontory Financial Group. In all of these positions, I have worked with and represented a variety of banks and financial institutions facing regulatory and transactional issues. I also served as an adjunct professor at American University, where I have taught International Economic Law.

My years as counsel to the Senate Banking Committee gave me further opportunities to grapple with issues of monetary macroeconomic policy and Federal Reserve System oversight. And, as Maryland's Commissioner of Financial Regulation, I have been steeped in all facets of economic policy and have paid close and careful attention to actions and policies of the Federal Reserve Board.

Both my academic background and my professional background have thus provided me with the knowledge of monetary economics and monetary policy. The Board's responsibilities also include regulation and supervision and oversight of the payments system. I believe that my background and expertise as a regulator prepare me well to participate effectively in the full breadth of Board responsibilities.

I have throughout my career, including as Maryland's Commissioner for Financial Regulation, sought to independently and critically analyze each decision I confront. I will continue that practice, if confirmed by the Senate, as a Governor of the Federal Reserve Board and member of the FOMC.

**Q.7.** Commissioner Raskin, there is little for us to go on regarding your views on monetary policy, macroeconomics, or the recent fi-

nancial crisis. In testimony before the Congressional Oversight Panel for the TARP, you stated that “Housing policies may have enabled this crisis, but they did not cause it.” It is difficult to imagine witnessing the recent crisis and not finding that housing policies that promote over-consumption of housing and increasingly speculative financing mechanisms were, if at least not directly causal, quite important. Please elaborate on your statement, because I fail to grasp what distinguishes something that enables a crisis from something that causes a crisis.

**A.7.** I agree that housing-related risks were an important feature of the financial crisis. My statement that housing policies did not by themselves cause the crisis reflects my belief that the causes of the financial crisis were complex and multi-faceted. In my view, there was excessive risk-taking across a wide range of assets and financial institutions, both here and abroad. There was also a failure by regulators to understand the escalating dangers associated with weak mortgage broker regulation, weak or nonexistent underwriting standards, the absence of due diligence incentives in the securitization process, the creation and trading of complex derivatives based on mortgage backed assets, and absent or useless disclosures that collectively helped to inflate the housing bubble. In other words, the failure was not one merely of housing policy but also one of regulatory policy and excessive private risk-taking with the absence of sufficient internal controls.

**Q.8.** Commissioner Raskin, in testimony before the Congressional Oversight Panel for the TARP, you identify that “...the Federal Government has so far proved itself incapable of managing systemic risk.” If you are appointed to the Board of Governors and a new Financial System Oversight Council is constructed, you will have input into the manner in which the Federal Government manages systemic risk. How confident are you that you, the Fed, or a new Council will be able to spot growing systemic risks and deal with them before they turn into the next new bubble?

**A.8.** The identification of systemic risk will be a challenging endeavor. The financial crisis has highlighted shortcomings in policymakers’ abilities to identify and to respond to buildups of risk. Financial reform legislation gives regulators new tools and a more extensive framework of information with which to monitor risk. These additions are intended to lay a foundation for better performance by regulators going forward. Members of the Board of Governors and the Financial System Oversight Council will need to build on this foundation by not forgetting the economic cost of the crisis, by maintaining the needed focus on system-wide risk, and by exhibiting a willingness to use the tools at their disposal when they perceive that systemic risk is building.

**Q.9.** Commissioner Raskin, in testimony before the Congressional Oversight Panel for the TARP, you cite your disagreement with what you call an unstated assumption in a GAO report “. . . that Federal regulatory reforms can address the systemic risk posed by our largest and most complex institutions.” You further argue that “. . . there may be some institutions whose size or complexity make their risks too large to effectively manage or regulate. Regulators and Congress should contemplate whether breaking up these

institutions is in the best interest of the marketplace and the public.” Do you believe that the Fed could and should take actions to break up large institutions right now?

**A.9.** I believe that the systemic risk posed by our largest and most complex institutions is not easy to control. The Federal legislation attempts to address potential threats that these institutions pose to financial stability, including subjecting them to heightened capital and liquidity requirements and more intensive supervision. In addition, the Federal Reserve will have the authority to force a major financial firm to terminate activities or sell businesses if the firm’s operations pose a grave threat to financial stability. I believe the Federal Reserve should act upon these mandates if warranted by the riskiness in the growth presented by these institutions. In addition, I believe that it is important that the Federal Reserve attend to potential systemic risks generated by growing concentrations in the financial sector before they reach levels that are dangerous.

**Q.10.** Fed Chairman Bernanke has argued in the past that a global savings glut had, before the crisis, put downward pressure on real interest rates globally and in the United States despite large U.S. current account deficits. Do you agree or disagree with Chairman Bernanke’s global savings glut hypothesis? Please cite supporting evidence for your view.

**A.10.** Chairman Bernanke’s hypothesis makes sense. The large current account surpluses in emerging economies did put downward pressure on U.S. interest rates and required demand from the United States to maintain high employment globally. An excess of saving over investment in a number of foreign countries—particularly the emerging Asian economies and commodity exporters—appears to have put downward pressure on U.S. and global interest rates. During the years preceding the crisis, bond yields in the advanced economies, including the United States, appeared to decline by more than could be explained by movements in inflation, economic activity, Government budget positions, and other factors. The substantial inflows of funds coming into the United States at that time, especially from China and other emerging Asian economies, to purchase U.S. Treasury and Agency debt seem to have boosted the demand for these securities and thus lowered their yields.

**Q.11.** Commissioner Raskin, we saw that “repo” activity was important in the recent crisis. If you constructed a measure of money in the economy that included repos, you may have detected rapid growth, which would have signaled you, as a monetary policymaker, that there were growing risks. Yet, with abandonment of consideration of broad monetary aggregates like M3, the Fed has potentially blinded itself to developments in those aggregates. Do you believe that the Fed should begin, again, to publish and monitor broad monetary aggregates such as M3 or so-called “Divisia” indexes?

**A.11.** The buildup of risk in repo markets and other securities financing markets played an important role in turning the loss in confidence in the credit markets into a liquidity crisis. This buildup was an important aspect of the financial crisis. Fundamentally, in-

vestors were able to acquire a range of longer-term assets with substantial credit and interest-rate risk and fund those securities in short-term financing markets. Much of this activity occurred outside of the traditional banking sector in funding vehicles such as asset-backed commercial paper conduits, collateralized debt obligations, collateralized loan obligations, and structured investment vehicles. The ready availability of credit in short-term financing markets allowed investors to buildup very substantial leverage in these securities financing transactions. In addition, the types of securities financed in these transactions became increasingly risky over time.

However, it is unlikely that data on M3 would have been helpful in providing an advance warning of the nature and extent of risks developing in securities financing markets prior to the crisis. Measures of the money stock are based largely on the obligations of depository institutions and, as noted above, much of the expansion of risk and leverage in the financial system occurred outside of the banking sector.

**Q.12.** Commissioner Raskin, do you have any views on the Special Purpose Vehicle called Maiden Lane II that the Fed created to make loans to AIG and that looked dangerously close to equity injections into AIG by the Fed?

**A.12.** I was not involved in the Federal Reserve Board's consideration of that transaction. Going forward, Congress has determined that the Federal Reserve should not be permitted to make such loans pursuant to its emergency lending authority.

**Q.13.** Commissioner Raskin, some of your expertise is in financial supervision and regulation, and you seem to be labeled often as a consumer advocate. As you know, there is legislation afoot to set up a new consumer financial protection bureaucracy. It is supposed to have the Fed's name on it but, from what I can tell, only so that it can tap the Fed's printing presses for undisciplined funding. Proponents of the new bureaucracy speak of creating the right "culture." Could you explain what that means to you?

**A.13.** The basic framework that all of us, as public officials, operate in is the culture of the rule of law. Our foremost responsibility is to enforce the law and organize resources in such a way that assures that we are adhering tightly to Federal statutes and Congress's intent in passing laws. Accordingly, the new Consumer Financial Protection Bureau should strive at all times to operate squarely within the legal constraints and mandates established for it by Congress.

In an operational sense, we should seek as public officials to create a culture of professional ethics and excellence. In the regulatory agency I lead in Maryland, I have consciously attempted to raise the standards of professional performance in such a way that we may be able to better execute the laws that the State legislature enacted. Similarly, I would hope that the leaders of the Consumer Financial Protection Bureau, which is a creation of Congress, would establish expectations of professional excellence in training employees to engage in the appropriate rulemaking, examination and enforcement responsibilities set forth by Congress.

The culture of the rule of law and the culture of professional ethics and excellence imply also a culture of accountability and transparency, values I have always striven to uphold. Thus, I trust that the Consumer Financial Protection Bureau would report to Congress periodically and maintain a policy of accessibility, transparency and accountability.

**Q.14.** Commissioner Raskin, some of your expertise is in financial supervision and regulation, and you seem to be labeled often as a consumer advocate. Another consumer advocate and an activist lawyer from Harvard has spoken of a need for a consumer financial protection bureaucracy in an environment in which, in her mind, it is banks against families. Do you share the view that our financial markets can be characterized as banks against the people?

**A.14.** No. The reason that our financial markets have inspired confidence for most of our history and have been a catalyst for extraordinary growth is because we have acted to regulate their excesses and abuses when they become manifest and to conform market behavior to the rule of law under our system of constitutional Government.

Banks can be engines of local economic growth for our communities. Small businesses depend on community banks for credit, and their ability to access loans is necessary for employment and economic growth. I have encouraged banks to fulfill their lending role as Commissioner for Financial Regulation in Maryland and will continue that effort, if confirmed, at the Board of Governors.

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**RESPONSE TO WRITTEN QUESTIONS OF SENATOR VITTER  
FROM SARAH BLOOM RASKIN**

**Q.1.** Please describe your background in monetary policy and how you hope to impact the Board's discussions on the subject.

**A.1.** Both my academic and professional background have provided me with the knowledge of monetary economics and monetary policy. From my undergraduate studies, through my graduate years in law school, and in my 25 years of experience in the private and public sectors, I have experienced, written about, and taught both the theoretical and practical aspects of monetary economics and policy.

My interest and work in monetary macroeconomics and monetary policy began during my undergraduate years at Amherst College, where I graduated Phi Beta Kappa and *magna cum laude* in economics and wrote my senior thesis on the Federal Reserve Board's experience with intermediate targeting of monetary policy. This senior thesis was anchored in econometric analysis but also discussed strategic issues related to central banking. It earned me the James R. Nelson Prize in Economics which is awarded to the top economics student in the graduating class. Much of the analysis for that thesis was inspired by work I had done during college at the Joint Economic Committee of Congress.

Although I chose to go to Harvard Law School rather than pursue a doctorate in economics, I was invited to teach Economics 10 as a teaching fellow with Professors Martin Feldstein and Lawrence Lindsey while I was a law student. This course covered mac-

roeconomic subjects, including monetary policy and monetary macroeconomics. Then, the summer after my second year of law school, I worked at the Federal Reserve Bank of New York and continued to participate in projects related to the Federal Reserve's role in monetary policy, regulation and payment systems. I worked with a team of lawyers and economists that summer to restructure the Brazilian debt escrow accounts which are maintained by the Federal Reserve Bank of New York. I prepared an analysis of interest rate swaps that evolved into a paper when I returned to Harvard on the subject of their structural implications.

My career trajectory has given me ample opportunity to apply this academic immersion in monetary policy to concrete problems in both the private and public sectors. I spent more than a decade in the private sector as a banking attorney with Mayer Brown and with Arnold and Porter. Subsequent to my work at those law firms, I became a managing director of Promontory Financial Group. In all of these positions, I have worked with and represented a variety of banks and financial institutions facing regulatory and transactional issues. I also served as an adjunct professor at American University, where I have taught International Economic Law.

My years as counsel to the Senate Banking Committee gave me further opportunities to grapple with issues of monetary macroeconomic policy and Federal Reserve System oversight. And, as Maryland's Commissioner of Financial Regulation, I have been steeped in all facets of economic policy and have paid close and careful attention to actions and policies of the Federal Reserve Board.

Both my academic background and my professional background have thus provided me with the knowledge of monetary economics and monetary policy. The Board's responsibilities also include regulation and supervision and oversight to the payment system. I believe that my background and expertise as a regulator prepare me well to participate effectively in the full breadth of Board responsibilities.

**Q.2.** Commissioner Raskin you have a very well established reputation as a "consumer advocate," having worked at the Federal Reserve Bank of New York and the Senate Banking Committee before your current job as Maryland's Commissioner of Financial Regulation, how do you plan to influence monetary policy decisions in a way which would make you more than a rubber stamp for Chairman Bernanke?

**A.2.** I view all American households and businesses as consumers of financial products and services. As citizens, we become consumers whenever we enter the marketplace to purchase goods and services and businesses obviously do the same. Therefore, I have been proud of the recognition I have received on behalf of my work protecting consumers because this is work in service of the public interest and the soundness of the economy generally. I have been equally proud of the strong support my nomination has received from banks and banking leaders, including the Independent Community Bankers Association and the Maryland Bankers Association. I believe that my work in Maryland has produced marked improvements in the environment for banking and financial services

and that the banks in my State view me and my agency as an honest broker with the interest of economic progress and business investment constantly in mind. I have always rejected the implication that the interests of citizens as consumers must be adversarial to the interests of profitable, safe and sound banks. On the contrary, it has been a hallmark of my leadership in Maryland that my agency does not see the public interest as structurally adverse in any way to a sound and thriving banking sector; rather, they stand best when they stand together.

I have throughout my career, including as Maryland's Commissioner for Financial Regulation, sought to independently and critically analyze each decision I confront. I will continue that practice, if confirmed by the Senate, as a Governor of the Federal Reserve Board and member of the FOMC.

**Q.3.** Do you believe that a Federal Reserve Board of Governors that is comprised of only two experts in monetary policy will provide enough balance and expertise on the Board to make crucial monetary policy decisions like when and how to withdraw the excess liquidity the Federal Reserve has flooded into the economy?

**A.3.** The Board of Governors has had a long tradition of broad representation from the business and financial community. One prominent example is Marriner Eccles, the Chairman of the Federal Reserve Board from 1934 to 1948. While Eccles is viewed by many as one of the most successful chairmen, he was not a trained economist.

I believe that, if my fellow nominees and I are confirmed by the Senate, the Board of Governors will be comprised of individuals who possess the broad range of backgrounds and expertise necessary to carry out, in responsible and effective fashion, the various monetary policy, regulatory, supervisory and payments system responsibilities with which the Congress has charged the Board.

**Q.4.** The Federal Reserve, as specified by the Federal Reserve Act of 1913 and later the Federal Reserve Act of 1977, is required to "promote effectively the goals of maximum employment, stable prices, and moderate long-term interest rates." This is often referred to as the dual mandate because the Federal Reserve is required to pursue maximum employment and stable prices equally. Do you think it is efficient to pursue one at a time?

**A.4.** Both goals of the dual mandate must be pursued simultaneously. Currently, for example, we have both unacceptably high unemployment and a falling rate of inflation. The stimulative policies that the Federal Reserve and Congress have pursued should help to lower the unemployment rate as well as prevent further declines in inflation and the possibility of deflation.

There are times, and the 1970s are an example of such times, when the two goals for the dual mandate can conflict in the short run. In those situations, it is still the case that the Federal Reserve must focus on both goals simultaneously and make clear that short-term increases in inflation will not be tolerated in the longer term. In this way, the Federal Reserve can stabilize inflationary expectations and thereby minimize volatility in both inflation and unemployment.



**Q.5.** Currently, we are responding to the high unemployment in the country. Later, we will respond to inflation. In the 1970s that approach produced higher inflation and higher unemployment. Why should we believe that won't happen again?

**A.5.** Those results will not happen again because over the last 30 years the Federal Reserve has earned a strong reputation for its commitment to price stability. We can and must reinforce this reputation by removing the extraordinary monetary stimulus in a transparent and consistent manner when the time is appropriate.

**Q.6.** Paul Volcker and Alan Greenspan have concluded that the Phillips curve was a misleading guide. Do you agree or disagree and why?

**A.6.** I believe that current and expected resource slack, as measured by the unemployment rate or an output gap, is one factor that influences inflation, in part through its effects on the costs of production. However, it is not the only factor. Movements in the prices of oil and other commodities, exchange rates, and productivity all can influence inflation as well. In addition, stable inflationary expectations and confidence in the Federal Reserve's commitment to price stability play a key role in keeping actual inflation in check. As a result, I will be looking at many factors in assessing inflation and monetary policy.

**Q.7.** The financial reform bill, Dodd-Frank, creates a consumer regulator inside the Fed that is administered separately. How will the Federal Reserve prevent conflict?

**A.7.** The financial reform bill establishes a Consumer Financial Protection Bureau, as an independent agency, within the Federal Reserve Board. The bill provides the Bureau with independent operational and rulemaking authority. However, even with those guideposts, the Board anticipates a close working relationship with the Bureau, much as it has with other banking agencies. The Bureau's membership on the Federal Financial Institutions Examination Council will also give it contact with other regulators and State supervisors.

**Q.8.** Earlier this year the N.Y. Times reported that the Triple-A credit rating of the United States "may be at risk in the coming years as the Nation copes with its growing debts." Since 2007 the national has increased from \$8.67 trillion to \$12.6 trillion—an increase of \$3.93 trillion or 45.3 percent, the debt limit has increased six times and the deficit has increased from \$161 billion in FY 2007 to \$1.42 trillion in FY 2009. The FY 2010 deficit is projected to come in at another \$1.5 trillion. Do these deficits pose any harm to the economy or economic growth?

**A.8.** The increase in the budget deficit over the last 2 years in large part reflects both the effects of the deep recession (which automatically reduces tax revenues and increases outlays for support programs), and the effects of discretionary fiscal policy actions taken to counteract the recession and stabilize financial markets. In the near term, these stimulative fiscal policies have helped support the recovery in the economy. As the economy continues to recover and stimulus policies wind down, the budget deficit should narrow over the next few years.

Over the longer term, the retirement of the baby boom generation and fast-rising health care costs will put significant pressure on the Federal budget. Large and persistent increases in Federal debt would lead to higher interest rates that restrain capital formation and productivity growth, and, in turn, slow the rate of growth in real aggregate economic activity. The ideal way to deal with this longer term unsustainability is to adopt a credible long-term plan that reduces the deficit and stabilizes the ratio of Federal debt to gross domestic product.

**Q.9.** Let us say in the future we reach a point that we are truly out of this recession in a meaningful way and the national deficits are where they are projected, 4 to 7 percent, versus 2 ½ percent. How quickly would that become a major problem in terms of the economy? What would those problems be?

**A.9.** It is difficult to know how soon an unsustainable fiscal policy would adversely affect the economy. At the moment, credit markets are viewing U.S. debt as extremely safe. If, however, we do not get our house in order, this will not continue indefinitely. In addition, as is illustrated in Greece, when confidence disappears, it disappears quickly with obviously devastating consequences. As noted above, unsustainable budget deficits lead to higher interest rates that restrain capital formation and productivity growth, and, in turn, slow the rate of growth in the economy. Also, to the extent that higher debt increases the reliance of United States on foreign borrowing, an ever larger share of future income would be devoted to interest payments on Federal debt held outside of the United States, which would reduce the income available for domestic consumption and investment.

**Q.10.** A lot of thought has been put into how to remove the excess liquidity that the Federal Reserve has pumped into the economy since 2008. Do you think we have reached a point where the Federal Reserve can begin withdrawing that liquidity? If not, what metrics will you look at to make that determination?

**A.10.** A substantial portion of the liquidity provided by the Federal Reserve during the crisis has been withdrawn at this point. Nearly all of the special liquidity facilities that were established to address pressures in short-term funding markets have expired. Moreover, the terms for the Federal Reserve's regular lending program for depository institutions are now similar to those prevailing prior to the crisis, and the amount of credit outstanding to depository institutions is very low.

However, the Federal Reserve did purchase a large volume of agency mortgage-backed securities and direct agency obligations, and reserves in the banking system have increased considerably as a result of these purchases. Accordingly, gradual sales of these securities should be undertaken at some point to speed the return to a Treasury-securities-only portfolio. A decision to begin sales of assets or use other tools to further drain liquidity needs to be made in the context of the overarching goals of the Federal Reserve to foster price stability and maximum employment.

**Q.11.** When asked how you would have handled monetary policy differently in regards to the financial crisis by Senator Shelby, you

cited lapses in regulation and oversight. While this is an important aspect of the Federal Reserve's duties, you still did not inform us whether tighter or looser monetary policy may have been in order leading up to the crisis. Do you think loose monetary policy may have played a role in the crisis, what would you do to correct this issue to avoid a future crisis and in what timeframe should that be done?

**A.11.** It appears to me that in 2003–2004 there were prudent reasons for keeping interest rates low. There was weakness in the economy and a threat of excessive disinflation, and so the considerable monetary accommodation put in place at that time, and its subsequent gradual removal by the Federal Reserve, appeared to be appropriate to promote the dual mandate of maximum employment and stable prices.

I believe that the Federal Reserve should remain vigilant in watching for the development of asset price bubbles, and while monetary policy may not be the most effective method for pricking such bubbles, I do believe that the Federal Reserve should consider whether its regulatory and supervisory powers permit it to address such bubbles in a manner that does not have sudden and dramatic effects on the economy.

**Q.12.** The United States monetary policy is often described as mixed policy, which indicates that the Fed funds rate responds to shocks in inflation and output. However, many other well developed economies such as the United Kingdom, Switzerland, Canada, Australia, and countless others utilize an inflation targeting approach. What do you think are the benefits of mixed policy as opposed to inflation targeting.

**A.12.** I believe that the difference between the mixed policy and inflation targeting is small. Most of the countries that have adopted an inflation target follow what is called “flexible inflation targeting.” These countries pursue a target for inflation in a flexible manner so as to provide price stability and high employment. Inflation targeting countries have found that the numerical target for inflation helps in making monetary policy actions more transparent and increasing accountability. In addition, an inflation target has generally been useful in anchoring long-term inflationary expectations in the targeting countries.

Given the Federal Reserve's well-earned reputation for its commitment to price stability, a numerical target would provide little added benefit and it is possible that it could even create uncertainty about the Federal Reserve's commitment to aid the recovery. In addition, the Federal Reserve has adopted a number of measures to increase transparency that make an inflation target less important.

**RESPONSE TO WRITTEN QUESTIONS OF SENATOR VITTER  
FROM OSVALDO LUIS GRATACOS MUNET**

**Q.1.** Mr. Gratacos, over the past year a number of schemes to defraud the Ex-Im Bank have been discovered. These schemes would have cost Ex-Im Bank millions of dollars. According to your last semiannual report, your office presently has 35 ongoing investigations involving claims of more than \$300 million. What accounts for

the apparent increase in the number of frauds being committed in Ex-Im Bank's loan guarantee programs? Does the Ex-Im Bank have sufficient controls to detect and prevent the fraudulent use of its loan guarantees?

**A.1.** Historically, Ex-Im Bank's fraud exposure (based upon what has been uncovered by the AIG as of today) is concentrated in the medium-term program. During the mid 2000s, Ex-Im Bank reacted to market capacity related to medium-term financing and aggressively promoted its medium-term program to lenders, exporters and buyers. The medium-term program traditionally provides financing to small to medium-sized businesses in markets where accurate and reliable financial information is not readily available, requiring more emphasis on Ex-Im Bank's underwriting capacity. The increase in medium-term participation was met with inappropriate internal allocation of resources, lack of staff, and a culture of transaction promotion incentivized to produce deals. Also, a number of conditions affecting Ex-Im Bank and the medium-term program increased its inherent fraud risk. These include:

- (i) Ex-Im Bank's mission to extend credit in more than 160 countries and the resulting wide variations in business and credit practices and legal systems between those countries;
- (ii) Ex-Im Bank's mission to accept risks that the private sector cannot or will not accept;
- (iii) Ex-Im Bank's public disclosure of its underwriting standards, which can guide borrowers in misrepresenting their financial statements;
- (iv) the limited resources of many medium-term program lenders to verify the veracity of borrowers and conduct thorough due diligence;
- (v) the limited resources available to Ex-Im Bank to fully scrutinize every transaction within a reasonable time after an application is submitted;
- (vi) the "moral hazard" resulting from the 100 percent guarantee provided to medium-term program lenders creates a disincentive for private sector participants to conduct thorough due diligence inquiries that would be more likely to identify potentially fraudulent transactions; and
- (vii) the inexperience of many of the exporters, lenders and buyer/borrowers supported by the medium-term program.

Since 2008, Ex-Im Bank has taken a number of steps in order to improve its medium-term program. Some of the most visible steps are: Know Your Customer guidance (providing guidance to lenders in order to increase turn around time); enhancing due diligence efforts in certain transactions; creating a Credit Review and Compliance Division; utilizing different payment frequencies in certain transactions; enhancing quality assurance efforts; and implementing of a pilot program involving cross-functional groups in order to scrutinize transactions submitted to Ex-Im Bank.

Nonetheless, Ex-Im Bank still lacks adequate internal controls to prevent and detect fraud. Ex-Im Bank management has not implemented important OIG recommendations and suggestions relevant to its ability to combat waste and fraud. These recommendations

and suggestions can only mitigate, but not eliminate, the challenges present in the performance of the medium-term and other guarantee programs. Specifically, the following OIG recommendations and suggestions have not been implemented:

- a) Create a formal lender oversight function to actively manage and monitor performance of transactions on a lender-by-lender basis and to assess the quality of lender due diligence performed;
  - i.) This lender oversight function should report to a division, such as Credit Review and Compliance, independent of front-office originations.
- b) Restructure the exposure fee pricing structure for non-sovereign medium-term program transactions to more effectively account for transaction-level risk;
- c) Obtain, or require that parties to MT program transactions provide Ex-Im Bank, documentary evidence of the completed export transaction in the form of shipping documents and U.S. and foreign customs documents, promptly after the exported goods are received.
- d) Implement more rigorous due diligence and underwriting practices in transactions when complex or high-risk markets, risky industries and products are being considered.
- e) Require participating lenders to undergo more rigorous due diligence efforts and require such lenders to highlight the transactional or credit risks identified.
- f) Develop a more comprehensive strategic plan for Ex-Im Bank products, specifically the medium-term program.

**RESPONSE TO WRITTEN QUESTIONS OF SENATOR SHELBY  
FROM STEVE A. LINICK**

**Q.1.** Mr. Linick, to date, the GSE's have received one of the largest taxpayer-funded bailouts in our history. Unfortunately, the taxpayer remains exposed to considerable losses going forward. To properly review the FHFA's conservatorship of these entities, it seems that one would need direct access to examine Fannie and Freddie, especially since the Director of the FHFA acts with all the powers of the shareholders, directors, and officers of the regulated entity. Do you believe that the FHFA IG can credibly determine if FHFA is acting properly as conservator without having direct access to the institutions themselves?

**A.1.** In order for the FHFA IG to credibly determine if FHFA is acting properly as both conservator and regulator of Fannie and Freddie, I believe that the FHFA IG will require direct access to the institutions themselves.

**Q.2.** Mr. Linick, Federal law allows the FHFA to "take such action as may be: 1) necessary to put the regulated entity in a sound and solvent condition; and 2) appropriate to carry on the business of the regulated entity and preserve and conserve the assets and property of the regulated entity." The FHFA, acting as conservator of Fannie or Freddie, executes any directives given to those institutions, whether those directives originate within the FHFA or another en-

tity. Given these facts, would you agree that the FHFA IG has a duty to examine those directives and to report on any impact that these directives may have on the ability of the FHFA to properly execute its duties as conservator or receiver? If so, how would you plan to fulfill this duty?

**A.2.** The FHFA IG has responsibility for, among other things, overseeing the manner in which FHFA carries out its management of the conservatorship, including its actions to ensure that Fannie and Freddie operate in a safe and sound manner and preserve and conserve the assets of Fannie and Freddie. To the extent that FHFA executes any directives (regardless of their origination) that impact FHFA's ability to carry out its management of the conservatorship, I believe the IG has a duty to report on the impact of those directives. If confirmed as IG, I intend to fulfill this duty by providing reports to Congress as required by the Inspector General Act, and by working closely with Congressional members and staff through regular and open communication.

**Q.3.** Mr. Linick, in addition to the multiple challenges that any IG would face, there is not currently, nor has there ever been, an IG for the FHFA. As such, should you be confirmed, you will be starting from scratch. As an unconfirmed nominee, I certainly understand that you have not been able to undertake the analysis necessary to determine the resources required to properly perform your duties, and hence I won't ask you to speculate on specifics today. Due to the importance of this office having adequate resources to complete its mission, however, it is vital that both the FHFA and Congress quickly know what will be necessary. If you are confirmed, would you, within a realistic timeframe, provide the Committee with an estimate regarding the budgetary needs of your office?

**A.3.** The FHFA is a relatively new agency, whose regulatory role has never been tested. In 2008, FHFA placed Fannie Mae and Freddie Mac in conservatorship out of concern that their deteriorating financial condition threatened the stability of the financial markets. Since then, the Department of Treasury has provided billions of dollars to the enterprises. Under these circumstances, the FHFA IG will play a critical role in safeguarding taxpayer dollars, ensuring transparency, and preventing fraud, waste, and abuse. In addition, the FHFA IG will carry significant management responsibility in having to establish a new office and quickly hire a staff of highly qualified individuals. Given the scope of the IG's mission, substantial resources will be essential. If confirmed as IG, I will commit to working expeditiously to provide this Committee with an estimate regarding the budgetary needs of the office.

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**RESPONSE TO WRITTEN QUESTIONS OF SENATOR VITTER  
FROM STEVE A. LINICK**

**Q.1.** In your testimony you say that you intend to be proactive in overseeing the conservatorship of Fannie Mae and Freddie Mac. I believe it is important for you to aggressively and regularly, more often than annually, report to Congress on how the conservatorship is being managed and how the two institutions are being run in

order to understand the impacts of their business practices on the taxpayer. Did HERA, the law which created the FHFA and the position of the IG for which you are nominated, place any constraints on your ability to examine these institutions as aggressively as Congress intends?

**A.1.** If confirmed as IG, I will work closely with Congressional members and staff and regularly report on how FHFA is fulfilling its mission as conservator and regulator. At this time, I am not aware of anything in HERA that would constrain the IG's ability to aggressively and proactively perform oversight responsibilities.

**Q.2.** It is important that your office, as inspector general for the agency running the conservatorship of Fannie Mae and Freddie Mac and charged with overseeing the Federal Home Loan Bank System, has enough resources and staff to aggressively do your job. You may be aware that the Special Inspector General for TARP's budget was 23 million in 2010, and 50 million in 2011. The SEC Inspector General budget is closer to 15 million. Have you given any thought to the size of your budget given the magnitude of the undertaking Congress is asking the FHFA IG office to undertake?

**A.2.** The FHFA is a relatively new agency, whose regulatory role has never been tested. In 2008, FHFA placed Fannie Mae and Freddie Mac in conservatorship out of concern that their deteriorating financial condition threatened the stability of the financial markets. Since then, the Department of Treasury has provided billions of dollars to the enterprises. Under these circumstances, the FHFA IG will play a critical role in safeguarding taxpayer dollars, ensuring transparency, and preventing fraud, waste, and abuse. In addition, the FHFA IG will carry significant management responsibility in having to establish a new office and quickly hire a staff of highly qualified individuals. Given the scope of the IG's mission, substantial resources will be essential. If confirmed as IG, I will commit to working expeditiously to provide this Committee with an estimate regarding the budgetary needs of the office.

**Q.3.** Are you aware that the FHFA recently released a report to Congress that stated that the condition and performance of 6 of 12 FHLBanks are less than adequate, four FHLBanks have negative accumulated other comprehensive income and that Seattle FHLBank has been designated "undercapitalized"? Do you plan on looking into the activities that lead these banks into such a perilous position or are there legal impediments that would prevent you from doing so?

**A.3.** One of FHFA's primary goals as regulator is to ensure that the Government-sponsored enterprises, including the FHLBanks, operate in a safe and sound manner, are adequately capitalized, and comply with legal requirements. I am aware of FHFA's recent report to Congress describing the poor condition and performance of the FHLBanks referenced above. I believe it is well within the IG's authority to review FHFA's oversight in this area and the activities that led these banks into their current condition. If confirmed as IG, I will develop a proactive agenda to oversee the programs and operations of FHFA with this and other important issues in mind.

**Q.4.** Is it within your ability as inspector general of the FHFA to examine the impact of the affordable housing goals on Fannie Mae and Freddie Mac and do you intend to use that authority to help paint an accurate picture for Congress on the impacts of all of its housing policies on the GSEs?

**A.4.** In addition to ensuring that Fannie and Freddie operate in a safe and sound manner and conserving and preserving their assets, FHFA is charged with promoting homeownership and affordable housing and supporting an efficient secondary market. I believe it is well within the authority of the IG to evaluate the impact of the affordable housing goals on Fannie and Freddie and FHFA's ability to operate them in a safe and sound manner and conserve and preserve their assets. If confirmed as IG, I will develop a proactive agenda to oversee the programs and operations of FHFA with this and other important issues in mind.



## ADDITIONAL MATERIAL SUPPLIED FOR THE RECORD



*Commonwealth of Puerto Rico*  
House of Representatives

Hon. Héctor Ferrer-Ríos  
Minority Leader

June 8<sup>th</sup>, 2010

The Honorable Senator Chris Dodd  
Chairman  
Committee on Banking, Housing and Urban Affairs  
United States Senate  
534 Dirksen Senate Office Building  
Washington, D.C. 20510

Dear Chairman Dodd:

I would like to submit the following remarks as prepared to be included in the record of the hearing on the nomination by President Obama of Osvaldo Luis Gratacós Munet to be Inspector General of the Export- Import Bank (Ex-Im Bank).

*Chairman Dodd, Ranking Member Shelby, Members of the Committee, My name is Héctor Ferrer Ríos. I am the Minority Leader at the Puerto Rico House of Representatives. I am also the President of the Popular Democratic Party of Puerto Rico. It is a privilege for me to appear before you with respect to the nomination of Osvaldo Luis Gratacós Munet to be Inspector General of the Export- Import Bank. Born to a fellow Puerto Rican family, Gratacós grew up in Puerto Rico, graduating with honors from the Interamerican University of Puerto Rico. He holds a master's degree in business administration from the University of Massachusetts and a law degree from the University of Florida.*

*Mr. Gratacós has served as the acting Inspector General for Ex-Im Bank since October of 2009. He also served as Deputy Inspector General and legal counsel for the Ex-Im Bank Office of Inspector General and is an adjunct faculty member at the University of Virginia.*

*His impressive background in international business and his service in the public sector as well as his integrity and intellect make him an outstanding nominee. He is a fine jurist that has earned the admiration and respect of the Puerto Rican community for his hard work and accomplishments. This nomination is also a testimony of recognition to the*

*capacity and the contributions of the people of Puerto Rico. I unconditionally support his nomination and urge you to confirm him as Inspector General for Ex-Im Bank. Thank you.*

Thank you for the opportunity to appear before you and allowing me to submit this written testimony as part of the record of the hearing on the nomination of Osvaldo Luis Gratacós Munet to be Inspector General for Ex-Im Bank. Should you need more information, please do not hesitate to contact me.

Sincerely,



HÉCTOR J. FERRER RÍOS