FINANCIAL SERVICES AND GENERAL GOVERNMENT APPROPRIATIONS FOR FISCAL YEAR 2013

WEDNESDAY, MARCH 28, 2012

U.S. SENATE,
SUBCOMMITTEE OF THE COMMITTEE ON APPROPRIATIONS,
Washington, DC.

The subcommittee met at 2:30 p.m., in room SD–138, Dirksen Senate Office Building, Hon. Richard J. Durbin (chairman) presiding.

Present: Senators Durbin, Lautenberg, and Moran.

DEPARTMENT OF THE TREASURY

OFFICE OF THE SECRETARY

STATEMENT OF HON. TIMOTHY F. GEITHNER, SECRETARY

OPENING STATEMENT OF SENATOR RICHARD J. DURBIN

Senator DURBIN. Good afternoon. I am pleased to convene this hearing of the Appropriations Subcommittee on Financial Services and General Government. Senator Moran is at the Supreme Court—I do not know why—but will be back momentarily, and I will give him a chance if he would like an opening statement at that time.

Welcome to Treasury Secretary Timothy F. Geithner. Glad to have you here. We are going to discuss your Department's critical work in support of economic recovery—particularly programs and policies dealing with the foreclosure crisis. And I am going to raise issues about what I consider to be a looming debt crisis involving student loans and where that will take us.

The Department of the Treasury, as you know, plays a key role in promoting economic stability and prosperity, developing policies and strategies to promote not just recovery, but sustainable growth. Now, one of the largest barriers to economic recovery, we have discussed many times, is our struggling housing market. Under the Home Affordable Modification Program, the Treasury Department provides financial incentives for lenders to prevent foreclosures through principle reduction.

Our economy, I am afraid, will not make a full recovery until we address the $700 billion worth of underwater mortgages held by more than 11 million homeowners. I believe that around 20 percent of homeowners are affected. There are 3.3 million homeowners currently facing foreclosure.

There are a number of approaches that can help families save homes, but many economists, banks, administration officials, and attorneys general from both political parties believe that principle reduction has to be one of the tools we use. Reducing principle often makes sense for both the homeowner and the lender, not to mention the communities which are being littered with foreclosed and abandoned property. That is why the recent bipartisan settlement between the five major lenders and a coalition of attorneys general of both parties includes $10 billion in principle reduction for underwater homeowners. I think we have to do everything we can to stop this foreclosure problem from getting worse as a means of simple justice, as well as making certain that economy recovery continues.

Here is the issue I am going to raise with you. Of the 11 million underwater mortgages, 3 million are being held by Fannie Mae and Freddie Mac. To date, the Department of the Treasury has provided $170 billion in taxpayers' dollars to keep Fannie Mae and Freddie Mac afloat. I want to explore today what more your Department can do to help these homeowners, especially through carefully tailored principle reduction.

The second issue is the student loan crisis. And I had a hearing last week that really focused on what is happening. As you are undoubtedly aware, total outstanding student loan debt exceeded $1 trillion last year. There is now more student loan debt than credit card debt in America. The credit rating agency, Standard & Poor's, warned us that "Student loan debt has ballooned and may turn into a bubble."

The hearing I held last week brought several things to light, including the impact of high-interest loans on young people, and many times on their parents. I want to discuss the impact of this growing student loan debt, the numbers that are associated with it, and what it means for our future.

It was interesting to me that the 32-year-old woman who testified before us has started off with $79,000 in student loan debt 5 years ago. It is now up to $98,000. The private loan that she has incurred, which is in the range of $40,000, will ultimately cost her more than $111,000, if paid off over the term. And it has completely changed her life. She cannot borrow another penny to go to a real school. She wasted her money on a for-profit school. And she is about to lose her home.

I think these things are connected unfortunately, and the student loan debt, if it does not cost young couples their homes, may impede them from ever having one. That will have a long-term impact on economic growth.

Now, the money for your Department, which I am sure is first and foremost on your mind: the request from the administration is $14.072 billion for fiscal year 2013. It is a $909 billion or 6.9-percent increase more than current levels. And the majority is needed for the Internal Revenue Service, which constitutes more than one-half of the discretionary funding in our jurisdiction.

I am pleased to see your budget request continue to prioritize the Community Development Financial Institution Fund (CDFI). And if you would like to say a word about that, we will give you a chance. Last year this subcommittee held an in-depth hearing on how

CDFIs have leveraged small amounts of Federal funds to develop affordable housing, retail, small business lending, and the like. I have seen the impact on some neighborhoods in Illinois, and I would like to know if you share my positive impression. I hope you do.

And I am going to give Senator Moran a chance to speak when he arrives, but at this time I would like to turn the floor over to a busy man, our Treasury Secretary Tim Geithner. Welcome.

SUMMARY STATEMENT OF TIMOTHY F. GEITHNER

Secretary GEITHNER. Mr. Chairman, nice to see you. Thanks for having me here, and thanks for all your support and your colleagues' support for Treasury over these years.

PREPARED STATEMENT

You know, if you would like, since we are here alone, I would be happy to just leave my opening statement for the record and get to the conversation, whatever is best for you.

Senator DURBIN. Okay.

[The statement follows:]

PREPARED STATEMENT OF TIMOTHY F. GEITHNER

INTRODUCTION

Let me start with the broader challenges facing the national economy.

Our economy is gradually getting stronger. Over the last 2½ years, the economy has grown at an average annual rate of 2.5 percent. Businesses have added nearly 4 million jobs over the last 2 years, including 429,000 manufacturing jobs.

While the economy is regaining strength, we still face significant economic challenges. Unemployment is still far too high, the housing market remains weak, and the overall effects of the financial crisis remain an obstacle to growth. The strength of our recovery will depend in part on events beyond our shores, as we saw last year when United States growth was buffeted by headwinds from Europe.

The harm caused by the crisis came on top of a set of deep, pre-existing economic challenges, including a long period of stagnation in the median wage, diminished confidence in the ability of children to exceed the economic achievements of their parents, a substantial ongoing shift in the risk and cost of healthcare and retirement security away from employers and onto workers, poverty rates much higher than in any economy with comparable wealth, and the dramatic erosion in our fiscal position between 2001 and 2008.

The President has laid out a strategy to address these challenges. His strategy entails a carefully designed set of investments and reforms to improve opportunity for middle-class Americans and strengthen our capacity to grow by improving access to education and job training, promoting innovation in our manufacturing sector, and investing in infrastructure.

These critical investments are combined with a balanced plan for restoring fiscal sustainability. The President's budget reduces projected deficits by a total of more than $4 trillion over the next 10 years by adding more than $3 trillion in deficit reduction to the approximately $1 trillion in savings already enacted through the discretionary caps included in the Budget Control Act. These savings are sufficient to stabilize our debt as a share of the economy by 2015 and begin placing our debt on a downward path as a share of Gross Domestic Product.

Treasury plays a vital role in helping to shape and implement the President's economic policies, driving reform of the financial system, encouraging lending to small businesses, working to reform the tax system, promoting economic prosperity, and monitoring risk in the financial system.

Treasury is working hard with the Department of Housing and Urban Development and with the Federal Housing Finance Agency to repair the housing market. We have active programs to modify mortgages for distressed homeowners so that people can stay in their homes, help States in the hardest hit areas provide both loan principal reduction and payment forbearance for the unemployed, transition vacant homes to the rental market and make it easier for homeowners who are underwater to refinance their loans.

As the President has made clear, more can be done to help, and we urge the Congress to consider the President's plan to help homeowners refinance their mortgages to take advantage of lower rates.

Treasury is also working with other agencies, in particular the Department of Education, on a range of ways to help make college more affordable, such as the President's proposal to make permanent the American Opportunity Tax Credit. The administration is also moving forward with its "Pay As You Earn" proposal to help reduce debt burdens, and the President has called on the Congress to stop the interest rate on Stafford loans from doubling in July.

In addition to our core policy functions, the Congress has given Treasury a very broad mission, with responsibilities that touch many aspects of the lives of Americans.

Treasury is responsible for raising the resources necessary to fund critical government functions, from national defense to protecting national parks. The Department disbursed more than $2.4 trillion in Social Security benefits, veteran's pensions, and other benefit payments to more than 100 million Americans last year. Treasury delivered tax credits to drive investment in clean-energy production and to help families finance college education. We design and enforce the financial sanctions necessary to prevent the spread of nuclear weapons and the financing of terrorism. Our Internal Revenue Service (IRS) collected the $2.4 trillion in taxes necessary to fund core Government operations. We run the factories that produce every American dollar and coin.

Treasury's fiscal year 2013 budget proposal supports the President's strategy through key priorities that will strengthen economic growth and make the Government more efficient while delivering essential services at lower costs to the taxpayer. The proposal also reflects Treasury's contributions to protect our national security interests and prevent illicit use of the financial system.

Unlike most Federal agencies, Treasury's annually appropriated budget is about people more than programs. Salaries and operating costs make up 96 percent of our budget, and most of the rest of our budget is for investments in technology they require to function.

IMPROVING EFFICIENCY, REDUCING TAXPAYER COSTS, AND REFORMING GOVERNMENT

The Treasury budget request reflects our commitment to deliver core services more efficiently and at the lowest cost to the taxpayer. Our request includes efficiencies, program reductions, and other measures that will produce savings of $286 million in fiscal year 2013 and additional cost reductions in the years ahead.

Key proposals include the consolidation of the Bureau of the Public Debt and the Financial Management Service. This consolidation will save $36 million over 5 years, starting with fiscal year 2014, through management, administrative, and support service efficiencies.

As you know, these bureaus provide the financial infrastructure for the Federal Government. Both bureaus have successful track records working together on joint initiatives, including a recent information technology consolidation, which is projected to save $129 million over 5 years. I am confident that they will build on this success by consolidating and improving the delivery of their core services.

The budget also proposes legislation to provide Treasury with the ability to change the composition of coins to utilize more cost-effective materials. Currently, the costs of making the penny and the nickel are more than twice the face value of each of those coins. In addition to this proposal, Treasury is implementing measures to improve the efficiency of coin and currency production, including improved manufacturing practices and administrative cost reductions, which will save more than $75 million in fiscal year 2013.

These savings build on a number of steps that the Department has taken during the last 3 years to improve efficiency and reduce taxpayer costs.

Last December, we announced that we were suspending the production of Presidential dollar coins for circulation. At that time, there were 1.4 billion surplus $1 coins sitting unused in Federal Reserve vaults. These surplus coins will now be drawn down over time. Taking this simple step will save taxpayers $50 million per year in production and storage costs.

We are also continuing to achieve results in our ongoing paperless initiative, which will yield more than $500 million in savings over 5 years. These efforts not only improve our internal management but provide modernized services to meet the public demand for more electronic services. In response, we have changed the way we provide services and are achieving savings while providing taxpayers the services they deserve.

To give you an example of this, 6 years ago, just more than one-half of individual taxpayers filed their returns online. We have worked proactively to increase electronic filing, and today, 77 percent of taxpayers choose to file online. In 2013, it is our goal to get 80 percent of taxpayers to file online, achieving an additional $8.1 million in savings on top of the $63.9 million we have saved since 2009.

The fiscal year 2013 budget for Treasury's operating bureaus is 2.7 percent below fiscal year 2012 and 6.8 percent below our fiscal year 2010 enacted budget, excluding the IRS. The request for the IRS includes investments in enforcement activities that will contribute significantly to improving voluntary compliance with the tax code and closing the tax gap. For each additional $1 we propose to spend on compliance activities we bring in more than $4 in additional revenue. The enforcement investments in our request will bring in an additional $1.5 billion in annual revenue once fully implemented.

ECONOMIC GROWTH AND JOB CREATION

We are also supporting small business growth through our Small Business Lending Fund (SBLF) and State Small Business Credit Initiative (SSBCI). Last year, we provided more than $4 billion to 332 community banks through the SBLF. Participating institutions estimate that they will increase their small business lending by $9 billion within 2 years of receiving the investments. By the end of this fiscal year, we will have provided approximately $1.5 billion to State programs that support small business lending and investment through SSBCI. States expect these investments to spur at least $15 billion in new small business financing.

Our $221 million request for the Community Development Financial Institutions Fund (CDFI Fund) is focused on key community development priorities designed to improve services in underserved communities, including access to healthy food and financial services. Of the total request, up to $25 million is for the administration's Healthy Food Financing initiative, which will support increased availability of affordable, healthy food alternatives in these communities.

The CDFI Fund's core program for financial and technical assistance provides monetary awards to CDFIs, which in turn provide loans, investments, financial services, and technical assistance to underserved populations and low-income communities. In 2010, CDFIs were awarded $105 million in grants under the CDFI program, which should contribute to $589 million in community development activity and the creation or preservation of approximately 10,000 jobs.

PROTECT OUR NATIONAL SECURITY INTERESTS AND PREVENT ILLICIT USE OF THE FINANCIAL SYSTEM

Finally, Treasury's financial intelligence and enforcement activities play a significant role in protecting our financial system from threats to our national security. Our funding request for the Office of Terrorism and Financial Intelligence is maintained at $100 million and reflects our continued efforts to combat rogue nations, terrorist facilitators, money laundering, and other threats to our financial systems and our Nation's security.

The work that this office conducts is far reaching and of critical importance to national security. The sanctions the administration imposed on Libya were a critical factor in removing the Gaddafi regime, and they continue to add pressure to the regimes in Iran, Syria, and North Korea.

CONCLUSION

Treasury benefits from a talented and dedicated group of public servants. Their work affects the lives of all Americans. They have played a critical role in pulling our economy out of crisis and setting the Nation on a path to recovery.

Our Treasury team helps to protect America's economic interests and national security—so seniors can get their Social Security benefits, families can borrow money to buy a home or send a child to college, and businesses can grow and create jobs. They have worked hard to continue to make Treasury a leaner, more efficient organization that effectively delivers essential services to the American people.

I appreciate the support of this subcommittee over the past several years in helping to make sure we have the resources to carry out these important responsibilities.

FEDERAL HOUSING FINANCE AGENCY'S LACK OF PRINCIPLE REDUCTION POLICY

Senator DURBIN. So, let us start talking about this situation involving Mr. DeMarco's Federal Housing Finance Agency (FHFA). Here is how I understand it, and I would like to hear your take on it. I have heard him defend his position against principle reduction saying, that is not my job. My job is to oversee Fannie Mae and Freddie Mac as to their solvency. And I am not promoting any type of housing project or any type of recovery project when it comes to mortgage foreclosure. I just look at the bottom line. How is it going to affect Fannie Mae and Freddie Mac? That is perhaps as brutally honest. I do not know if it is true, but that is how he sees it.

You are in a position where you are providing $170 billion in assistance to the government-sponsored enterprises (GSEs) through preferred stock purchase agreements. The administration has made it clear that principle reduction is an important component in stopping foreclosures and economic recovery. Now, reconcile these things.

Secretary GEITHNER. Excellent question, and I am glad you are drawing attention to it.

The law the Congress passed that put the GSEs into conservatorship and gave the FHFA more authority, gave them in some ways two mandates. One was to promote policies that help the overall housing market, but as important as that, and this is the critical constraint, they need to make sure they are operating in the interest of the taxpayer, looking to working to minimize losses, maximize returns to the taxpayer as a whole. They are doing a lot of different things to help people to modify mortgages with payment reductions and to help homeowners refinance, even homeowners that are deeply under water.

But in the area of principle reduction, as you have heard Mr. DeMarco testify, they adopt a program they call principle forbearance, and they have been very reluctant to reduce principle. There is a very strong economic case for investors, any investor, whether it is the Government, or a bank, or a private investor, to reduce principle in some circumstances because that might increase overall recovery to the investor and the taxpayers. And where that is true in the private market, it is equally true for Fannie Mae and Freddie Mac.

And so, we have been encouraging Fannie Mae and Freddie Mac to take another look at the math, at the economics of it, the finance, because we think there is a strong case in some circumstances to add principle reduction as part of their strategies to help maximize return to the taxpayer.

Now, what Mr. DeMarco has said is that they are taking another look at their numbers, looking at our economic case. We are in the process of working through that with him, and I hope he is going to be in a position to indicate what he plans to do in the next several weeks.

But you are right to emphasize this as an important part of a credible national strategy, that they have been reluctant to move, even though they have done a lot of things that have been very,

very helpful. The art in this to try to make the financial case that for homeowners that are deeply under water, and you and your spouse loses a job, there are some cases in which principle reduction is not just good for the homeowner and the community, but it is good for the taxpayer too.

Senator DURBIN. So, am I right to say that 30 percent of these mortgages, roughly, through Fannie Mae and Freddie Mac would be at least subject to this principle reduction?

Secretary GEITHNER. I do not think it is that high, but I have to look at the numbers and see. You know, Fannie Mae and Freddie Mac, contrary to what is popular perception in some quarters in Washington, were actually more conservative than the private markets and their underwriting standards, and required larger down payments in areas. So, in fact, the overall quality of the loans they made and the record of delinquencies performance is better than the overall market. I do not know what the exact numbers are in terms of how many people are under water, worst case. But, again, the economic case is there. There is a set of homeowners who are deeply under water and experience a hardship where it is better for the taxpayers to reduce principle. And our job is to try to encourage them to recognize that.

Senator DURBIN. So, let me just pursue this along a similar question, a little different line. It is the stated policy of the administration that principle reduction is one of the key elements in reducing foreclosures, stabilizing the real estate market, and perhaps reaching a point where we know what the value of real estate is, which I think is one of the still largely unanswered and central questions to our economic situation. And now you have the power through the Treasury Department to fund the group that oversees Fannie Mae and Freddie Mac, which is basically saying we do not buy that. We do not buy principle reduction. Do you need to be told by me or the Congress to close the carrot drawer and open the stick drawer? How do we get Fannie Mae and Freddie Mac to run the same play as the rest of the economy?

Secretary GEITHNER. I have asked that question of my staff many times and of my predecessor because the law that gave them this authority was passed in the fall 2008, before I took office as the Secretary. And the Congress, in considering how much authority to give the administrator at that point, decided to keep it completely independent of the Secretary of the Treasury and the administration. I have no power to compel, even though you are right to remind people that in a sense those institutions exist only because we are providing the kind of support in terms of capital they need to be able to borrow at affordable rates and to continue to play the role they are playing in the housing market.

I wish it were different, but the Congress considered this and decided at that point to—and they did it—I understand why they did it, to leave that entity, which had been subject to a lot of political pressure and political influence in the past, to leave it completely independent of any influence by the administration.

Senator DURBIN. Do you have anything to say about what they do with the senior preferred stock purchase money that you send their way?

Secretary GEITHNER. Well, let me say they were limited to the power of our persuasive abilities.

Senator DURBIN. Carrots.

Secretary GEITHNER. Of course, if the Congress were to change it, change that balance of authority, I would welcome that. But I think that, again, we are working very closely together, and we think there is a very strong economic case in this context, and we think that should govern.

Senator DURBIN. You know more about this business than I will ever know. Give me the Fannie Mae and Freddie Mac argument from their point of view against principle reduction.

Secretary GEITHNER. Well, I think Fannie Mae and Freddie Mac themselves are actually pretty supportive of this. FHFA has been a little more conservative over time because their argument would be this: they would say that, look, we have to make sure we are maximizing returns to the taxpayer. If there is a chance that over time if we forbear on principle but do not forgive it, we could get a higher return to the taxpayer, we are obligated to pursue that path. That is the argument they would make.

But ours is a simple choice. We think there is a set of cases where it is clearly in the interest of the taxpayer for them to do principle reduction up front. It is not an overwhelming number, but where it makes sense to do it, we should do it. That is what we are trying to convince them.

Senator DURBIN. I am going to turn to my colleagues with one last question. Can you think of an example where foreclosure would be in the best interest of Fannie Mae and Freddie Mac?

Secretary GEITHNER. Well, I hate to say it this way, because as you pointed out, and you have said this many times, across the country there are thousands and thousands and thousands of people who are completely innocent victims of the fact that they either lost their job or they saw their house price decline precipitously, or they face another hardship and could not afford to stay in their home. And in that context, the first best solution is for the bank or Fannie Mae and Freddie Mac to work with the homeowner to restructure their payment obligations so it is within the ability of the homeowner to pay so they are given a little more time to find another job to get back on their feet.

But not everyone will be able to do that. So, there are some cases where the best case for the homeowner is for them to be able to leave their house and go and find some affordable option, even if they have to rent.

But, again, the obligation of all of us should be to do everything we can to make sure where people have the chance to stay in their home, and when that is clearly better for the Government in some context, not just for the community, we want to give them that chance.

But there is one dimension of this that I would like to come back to, if we can, after your colleagues have a chance to do a——

Senator DURBIN. Sure. Okay. I will let Senator Moran.

Senator MORAN. I would yield to Mr. Lautenberg.

Senator DURBIN. Senator Lautenberg, would you like to proceed?

STATEMENT OF SENATOR FRANK R. LAUTENBERG

Senator LAUTENBERG. I apologize for being late. And perhaps, Mr. Secretary, welcome you. And I do not want to be repetitive, but I may run into that as a consequence of not having heard your full presentation.

PREPARED STATEMENT

One of the things that we see here, and especially in the private sector—I ask unanimous consent that my full statement be included in the record.

Senator DURBIN. Without objection.

[The information follows:]

PREPARED STATEMENT OF SENATOR FRANK R. LAUTENBERG

Mr. Chairman, we have stepped safely back from the edge of financial crisis, and our economy is steadily recovering. But some effects of the crisis remain. More than 11 million homeowners owe more than their homes are worth. A path forward for these homeowners is essential for the health of our housing market and our economy. Unless there is some relief, 9 million homeowners could face foreclosure and eventual liquidation. While the impact on our economy would be severe, the human cost would be unthinkable. None of us can afford foreclosures at this scale—not homeowners, not investors, not taxpayers. The path forward is clear. Writing down some of the principal owed by underwater homeowners will help stem the tide of foreclosures and revive the housing sector, which has long been a drag on our national recovery. Principal forgiveness for responsible homeowners will give hope to those families, and reason for optimism for our economy as a whole.

We must also be attentive to emerging risks to our financial system, and growing levels of student loan debt are raising alarms. I am concerned about reports that students are being swindled into borrowing more than they can afford. This sounds similar to the predatory mortgage lending practices that preceded the financial crisis. Like mortgages in the years before the crisis, student loans are difficult to understand and difficult to value. And Americans are taking out student loans—including private student loans—at a rapid pace. Many borrowers don't realize that private student loans lack the borrower protections of Federal student loans. Christopher Bryski—a constituent of mine who studied at Rutgers University—passed away in 2006. His Federal student loans were discharged by law when he passed, but his private loans were not. Six years later, Christopher's dad is still sending monthly payments to his deceased son's bank. Student loans should be designed to protect borrowers, not just enrich banks. If we learned anything from the recent crisis, it's that financial products designed to generate profits for banks at the expense of consumers pose serious risk to the economy as a whole.

I look forward to hearing from Secretary Geithner about what we can do to reduce risks and restore our economy back to full health.

MORTGAGE PRINCIPLE REDUCTION

Senator LAUTENBERG. But I am concerned about the students, and I know that you have been discussing the homeowner foreclosures, and I have a question there about—and I think I heard you say it. A few of us or none of us can afford foreclosures at this scale, not homeowners, not investors, not taxpayers. And I will have an opportunity to ask you questions about that.

But writing down some of the principle owed by underwater homeowners will help stem the tide of foreclosures, and revive the housing sector, which has long been drag on our national recovery. Principle forgiveness for responsible homeowners will give hope to these families and reason for optimism for our economy as a whole. And we have also got to be attentive to emerging risk to the financial system, growing levels of student loans.

STUDENT LOANS

I want to look at that, please, for a moment. And I am concerned about reports that students are being swindled into borrowing more than they can afford. And it sounds similar to the predatory mortgage lending practices that preceded the financial crisis.

Like mortgages in the years before the crisis, students are difficult to understand and difficult to value, and Americans taking out student loan, including private student loans, are running into difficulties at a rapid pace.

Many borrowers do not realize that private student loans lack the borrower protections of Federal student loans. And a case of a young man named Christopher Bryski, a constituent of mine who was studying at Rutgers University, who passed away very young in 2006, his Federal student loans were discharged by law when he passed. But his private loans were not. Six years later, Christopher's dad is still sending monthly payments to his deceased son's bank. And student loans should not—should be designed to protect borrowers, not just in rich banks.

So, if we learned anything from the recent crisis, it is that financial products designed to generate profits or banks at the expense of consumers pose serious risks to the economy as a whole.

So, I want to talk about that, and if I can use the remainder of my moments, Mr. Chairman, I would appreciate it.

FEDERAL HOUSING FINANCE AGENCY'S LACK OF PRINCIPLE REDUCTION POLICY

Opponents of principle forgiveness for struggling homeowners have argued that lowering the amount owed on underwater mortgage costs would cost taxpayers too much. We already heard that. However, analysis by the FHFA suggests that forgiveness would save taxpayer money.

And forgive me if this is repetitious, but what has your analysis of the Treasury's principle forgiveness program revealed about the benefits of principle forgiveness for taxpayers and homeowners?

[The information follows:]

THE EFFECT OF THE PRINCIPAL REDUCTION ALTERNATIVE ON REDEFAULT RATES IN THE HOME AFFORDABLE MODIFICATION PROGRAM: EARLY RESULTS [1]

EXECUTIVE SUMMARY

Since the inception of the Making Home Affordable Program, more than 1 million homeowners have had their mortgages permanently modified through the Home Affordable Modification Program (HAMP). As of May 2012, more than 63,000 homeowners have received permanent modifications with loan principal reduction under HAMP Principal Reduction Alternative (PRA).[2] This document presents an analysis of the performance of HAMP modifications with and without PRA. To date, this analysis has shown the following results:

—Payment reduction is an important driver of HAMP modification performance.
—HAMP modification redefault rates also fall as the loan's after modification mark-to-market loan-to-value, or MTMLTV, ratio decreases (i.e., as the size of the loan's current principal balance relative to the home's value decreases).
—HAMP PRA participating servicers tend to use the principal reduction feature on loans that have relatively riskier credit characteristics than the overall

[1] The logistic regression described in this paper was performed by Fannie Mae in its role as program administrator under Treasury's Making Home Affordable Program. The data points, figures and tables reflected herein were sourced from Fannie Mae as program administrator.
[2] Fannie Mae and Freddie Mac do not participate in the PRA program.

HAMP population—borrowers with much lower credit scores and that are more seriously delinquent at time of modification.

—A logistic regression controls for these riskier characteristics. The regression shows that for a given payment reduction, homeowners who received a HAMP modification with principal reduction perform better than homeowners who receive a HAMP modification without principal reduction.

EARLY EFFECTS OF HOME AFFORDABLE MODIFICATION PROGRAM PRINCIPAL REDUCTION ALTERNATIVE ON REDEFAULT RATES

In June 2010, the Department of the Treasury announced the HAMP Principal Reduction Alternative program. HAMP PRA provides financial incentives to investors for reducing principal owed by homeowners whose homes are worth significantly less than the remaining balance owed on the mortgage. As of May 2012, homeowners have been granted more than 63,000 HAMP PRA permanent modifications.

HAMP data show that the amount of the monthly payment reduction affects the performance of HAMP modifications. Twenty-four months after converting to a permanent modification, there is a 28-percentage-point difference in the redefault rate between loans that received a 20 percent or less monthly payment reduction and loans that received more than a 50-percent monthly payment reduction. Figure 1 shows the redefault curves by the percent of monthly payment reduction.

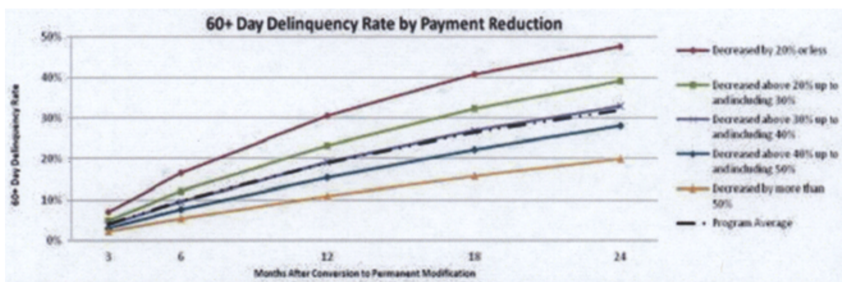

FIGURE 1. 60 + Day Delinquency Rate by Payment Reduction

The redefault rate of HAMP modifications also decreases as the after-modification MTMLTV ratio decreases. At 24 months, loans with less than or equal to 80-percent MTMLTV redefault at a rate that is 12-percentage points lower than loans with more than 170-percent MTMLTV. Figure 2 shows the redefault curves by MTMLTV. The gap in the redefault rate between loans with higher and lower postmodification MTMLTVs increases as the loans age. This gap is smaller for the redefault rate after 6 months than for the redefault rate after 24 months.

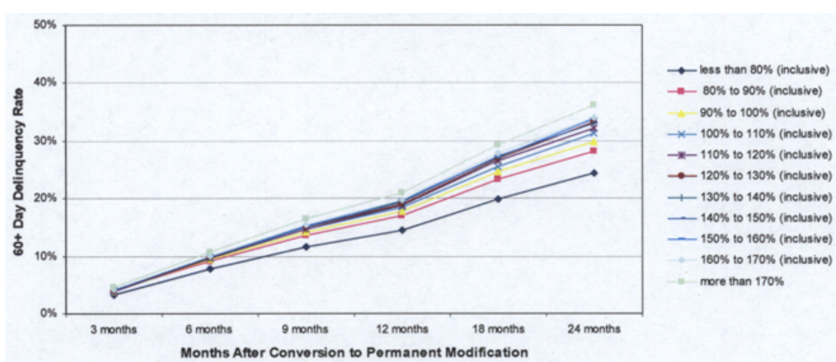

FIGURE 2. 60 + Day Delinquency Rate by After Mod MTMLTV

To date, participating servicers have selected loans with riskier credit characteristics to receive the principal reduction feature under HAMP PRA—loans that are more seriously delinquent at the time of modification and borrowers with lower overall credit scores than all HAMP modifications.

If one were to look only at the early redefault performance of HAMP PRA versus all HAMP modifications without controlling for these riskier characteristics, it would appear that loans modified with the principal reduction feature under HAMP PRA are performing slightly worse than overall HAMP modifications, as shown in Table 2.

TABLE 2.—HAMP MODIFICATION PERFORMANCE AFTER 6 MONTHS WITHOUT CONTROLLING FOR RISK CHARACTERISTICS [1]

All modifications		Modifications with PRA forgiveness	
Number of permanent modifications	Percentage of 90+ days delinquent at 6 months	Number of permanent modifications	Percentage of 90+ days delinquent at 6 months
800,613	5.80	30,345	6.30

[1] Sample shown includes all HAMP loans that were modified at least 6 months before March 2012.
SOURCE.—Making Home Affordable Program System of Record—data through March 2012

The standard approach in statistical analysis for disentangling the impacts of different factors influencing an outcome is called regression analysis. In this case, a logistic regression controls for risk characteristics, which allows a better comparison of the performance of HAMP modifications with and without the principal reduction feature. These loan characteristics include MTMLTV, origination loan-to-value ratio, percentage monthly payment change, credit score at modification, age of the loan, delinquency of the loan at time of modification, investor type, vintage of the modification, unpaid principal balance of the loan at time of modification (including all past due amounts), delinquency number of months in trial, whether the loan received principal reduction, whether the modification was done under the HAMP PRA program or received principal reduction under traditional HAMP, whether the loan received principal forbearance, geography, servicer, and home price forecast following the modification.

This analysis indicates that for loans with similar characteristics, there is a measurable improvement in performance when the HAMP modification includes principal reduction.

This result is consistent with an assumption of the HAMP net present value (NPV) default model that a homeowner who receives a modification with principal reduction will perform similarly to a homeowner at the same post-modification MTMLTV who receives a modification without principal reduction.

Some have wondered if principal forbearance has a similar effect on modification performance as principal reduction. These results indicate that a homeowner receiving a HAMP modification with principal forbearance performs slightly better than a homeowner who receives a HAMP modification without forbearance as well as without principal reduction. This improvement, though, is smaller than the improvement seen for a HAMP modification with principal reduction.

The regression analysis allows us to separate the impact of the principal reduction from other characteristics that influence default. For illustrative purposes, we constructed a hypothetical homeowner with a premodification MTMLTV of 165 percent and a 10-percent chance of redefault (90+ days delinquent) within 6 months without a payment reduction. We then consider the redefault rate after 6 months implied by the same regression model for three different modifications, each of which provides a 30-percent payment reduction. The three different modifications provide the 30-percent payment reduction in the following ways, via:

—Rate reduction and term extension to achieve a 30-percent payment reduction, an example of a standard HAMP modification: The model shows that the homeowner would have a 4.6-percent chance of redefault.

—Forbearance (no rate or term adjustment) to achieve a 30-percent payment reduction: The model shows that the homeowner would have a 4.4-percent chance of redefault.

—Principal reduction (no rate, term, or forbearance adjustments), to achieve a 30-percent payment reduction and an after-modification MTMLTV of 115 percent: The model shows that the homeowner would have a 3.5-percent chance of redefault.

Table 3 illustrates these results for our hypothetical borrower with an MTMLTV of 165 percent.

TABLE 3.—ESTIMATED DEFAULT OUTCOMES BY MODIFICATION STRUCTURE FOR HYPOTHETICAL BORROWER WITH 10 PERCENT INITIAL DEFAULT PROBABILITY

Modification structure	Probability of advancing to 90-day delinquency within 6 months (percentage)
No modification	10
Rate reduction and term extension to achieve a 30-percent payment reduction (no change in MTMLTV)	4.6
Forbearance to achieve a 30-percent payment reduction (no change in MTMLTV)	4.4
Principal reduction to achieve a 30-percent payment reduction and MTMLTV of 115 percent	3.5

NOTE.—These early redefault rates are just a fraction of expected redefault probabilities over the loan's lifetime, and so the absolute differences in probabilities that we see here would be expected to increase over time.

CONCLUSION

While it is still early, data show that there is a measurable improvement in borrower performance when the HAMP modification includes principal reduction. The outcome of the regression test is consistent with the assumption in the HAMP NPV default model that a homeowner who receives a modification with principal reduction to a certain MTMLTV will perform similarly to a homeowner getting a modification at that MTMLTV without principal reduction. In summary, the table above demonstrates that principal reduction leads to a 20-percent reduction in redefault probabilities as compared to a modification utilizing forbearance, and principal reduction leads to a 24-percent reduction in redefault probabilities as compared to a modification that receives payment reduction, but neither forgiveness nor forbearance.

Secretary GEITHNER. Well, if you look at the economics of it and the finance, we believe that there is a very strong case for some homeowners who are deeply under water, experiencing hardship, there is a very strong case to provide principle reduction up front instead of other forms of payment reduction. And we are trying to make that case to FHFA.

Now, you know, what you do with these cases, you look at a range of options, and you try to figure out what is the best option for both the borrower and the family and the home at the least cost to the taxpayer. And in some cases, it may be a payment reduction that substantially reduces the level of your monthly obligations for a long period of time. In some cases it may be principle reduction.

What we are trying to do is to work through the case with FHFA and convince them that it is in the interest of the taxpayer and consistent with conservatorship for them to adopt the type of program we put in place for their book of mortgages. And they are working with us on this. They have been a little hesitant, a little more conservative so far. But they are reasonable people, and they are amenable to argument, and we think the facts are very compelling.

Senator LAUTENBERG. You will be able to have another——

Senator DURBIN. Yes. We will have a second round for sure.

Senator Moran.

STATEMENT OF SENATOR JERRY MORAN

Senator MORAN. Mr. Chairman, thank you. Mr. Secretary, thank you very much. Thank you for calling and giving me the opportunity to visit with you. I am sorry I was not able to do that.

I continue to hear concerns about a lack of coordination among the Stability Council members on various Dodd-Frank Act rulemakings, especially those related to the derivative titles.

DERIVATIVE MARKET REFORMS

As the chairperson of the Financial Stability Oversight Council, do you have confidence that you will be able to encourage the harmonization of derivative market reforms at a time at which it appears that you are unable to encourage or facilitate consensus between the Securities and Exchange Commission (SEC) and the Commodity Futures Trading Commission (CFTC)?

Secretary GEITHNER. Well, you were right to point out that we have a very complicated system in the United States, and by preserving a lot of different people with authority over the pieces of the system, it makes it a little harder to coordinate, and frankly, makes the process more complex. The additional challenge is these are global markets.

And so, it is very important to us that we get the world to move with us. What we do not want to do is raise the standards of the United States, have the world decide not to raise its standards and have markets just ship outside of the United States.

So, we have got two dimensions of complexity. One is we want to get the U.S. agencies in the same place on the sensible terms, and we want to get the world in the same place.

Now, the Congress in its wisdom did not give the Secretary of the Treasury the authority to write these rules, and I do not have the authority to force convergence on these agencies. But we are working very closely with them to try to make the case that we are not going to be able to get the world in a sensible place unless U.S. entities are aligned. And where the SEC and the CFTC, under their independent jurisdiction, have the discretion to be fully aligned, we think that makes a lot of sense.

I am actually pretty confident that the broad framework of oversight and derivatives is going to get landed in a sensible place, both here and globally. I am much more confident than I was 1 year or 18 months ago. There are still a lot of concerns out there about some of the details, and you know in our system we go out for public comment on each of these rules, and everyone has a chance to assess the implications in their context. That gives the regulators a chance to adapt.

So, we are on it. We are focused on it. We care a lot about making sure these rules land in a sensible place. And, you know, we have got some ways to go, but we are going to keep working on it.

Senator MORAN. Generically, Mr. Secretary, not necessarily your comments, but when a person says the Congress in its wisdom failed to do something, is that said just factually or with disrespect?

Secretary GEITHNER. No, that was extraordinary deference and respect.

Senator MORAN. All right, thank you.

Secretary GEITHNER. And to be fair, we did not seek authority to write the rules and derivatives. We thought they should be left with the SEC and the CFTC. And the SEC and the CFTC, not surprisingly, agreed.

Senator DURBIN. Let the record show that the witness is not under oath. Proceed.

Senator MORAN. He is not what?

Senator DURBIN. Under oath.

ENTREPRENEURSHIP OPPORTUNITIES

Senator MORAN. Under oath. Mr. Secretary, at the end of January, President Obama sent to the Congress his Startup American legislative agenda, and three items that are currently on the way to his desk, the so-called Jobs Act. And I am supportive of that development. In my view, there remains to be a lot of work done in regard to innovation and startups, creating an entrepreneurship environment. I got interested in this topic because, in my view, the Congress and the administration has failed to do much of anything about the deficits. And while I am not walking away from the spending and revenue sides of the deficit issue, another way—an additional way to deal with our growing deficit is to grow the economy.

And so, I started looking at entrepreneurship opportunities, trying to create that circumstance in the United States in which somebody who has an idea and goes to work in their backyard, their garage, their basement, has a greater opportunity of succeeding than they otherwise would have.

Senator Warner and I introduced legislation called the Startup Act that would make permanent zero capital gains for investments in small businesses. The President signed a temporary version of that provision that expires at the end of 2010—it went into effect in 2010 and has since expired. And I am interested in knowing your view, your opinion, as to the impact of this exemption in 2011, what additional investment we might expect if it was reinstated as either suggested by the President or in our legislation.

Secretary GEITHNER. Well, we are with you on this completely, and we think it should be extended and made permanent. And we think it would have a powerful incentive in encouraging investment in startups, and that is a good thing.

I do not have with me today an estimate of the magnitude of the impact, but I would be happy to see if there is anything with enough integrity we could share with you. We would be happy to do that.

Senator MORAN. I would welcome your input. Thank you very much.

Thank you, Mr. Chairman.

[The information follows:]

The administration supports a 100-percent exclusion from income for long-term capital gains on qualified small business stock from capital gains tax, and we proposed in our fiscal year 2013 budget to make this favorable tax treatment permanent. While we are not aware of any studies on the economic impact of this particular provision, largely due to the required 5-year holding period, it is no doubt an important incentive to encourage and reward investment in new and growing businesses, such as many startup companies.

Secretary GEITHNER. Just because you raised it, I think that there are other things in the tax law, too, that would be helpful in this context. And just for you to consider as you think about this legislation going forward, we think there is a very strong case to reinstate expensing, full expensing, for a temporary period of time, too. That creates an incentive for people to invest, good for the economy, good to grow the economy now. We have also suggested various ways to encourage through the tax code small businesses to add to payroll, hire more people, add hours, when we are trying to get more people back to work. I think those things will work by incorporating a grain of permanent capital gains inclusion for investment in small businesses. There is a lot of merit to those things.

ACCELERATED DEPRECIATION

Senator MORAN. Mr. Secretary, I am glad you added those points, and I share that view. I would add that it would be helpful in regard to one of those particular accelerated depreciation issues is general aviation. And the President has a habit of talking about general aviation aircraft and corporate jets. And the provision that we are always talking about that is being criticized is accelerated depreciation. And it is certainly an important one to the manufacturing base in Kansas and across the country.

But I know just as a rural member of, well, of the Congress, somebody who represents a very rural State, if we are going to have small businesses, manufacturers located in small towns, we ought to have a viable general aviation industry that encourages those businesses to be able to fly to places to connect with the rest of the world so that we are not all centered around airports. And I just would ask you to encourage the President to reduce the rhetoric about accelerated depreciation when it comes to general aviation aircraft.

Secretary GEITHNER. I think our proposal, Senator, is to put them on the same footing, to level the playing field, with other people who make aircraft. But I get your point, and I understand your concern.

Senator MORAN. Thank you very much.

STUDENT LOAN CRISIS

Senator DURBIN. Mr. Secretary, I mentioned student loans earlier, and I want to draw some parallels. There are interesting parallels between mortgages and American student loan debt.

There is $1.4 trillion in mortgage debt in this country held by about 52.5 million mortgage holders, and 11 million, or about 20 percent of them, are under water. We are talking about what we do for principal reduction, to deal with the reality of foreclosure, and the impact it has on their lives, and our communities, and the future of the housing market.

Now, look at the parallel universe. Student loan debt totals $1 trillion—not $1.4 trillion, but $1 trillion. The number of students is 37 million; and 15 million, or 39 percent of them, are actually paying on their debt. That is 39 percent. The remainder, 61 percent, or 22 million, are not paying on their debt. Some are in school, but many of them are in a position where for a variety of reasons, they cannot pay on their debt.

One of your charges is to look ahead at the impact of certain financial decisions that are being made on the future of our economy. And when I look at what the foreclosure side on the mortgage market is doing to our economy overall, I then try to jump ahead a few years and anticipate the impact of this student loan debt on our economy.

Now, there is a significant difference. The most significant difference is that the mortgage debt is dischargeable in bankruptcy; the student loan debt is not. I ask people at the Federal agency, well, what do you think of this, that we have so much student debt out there owned by our Government, and so much it is not being paid, and defaults, and the like.

And their answer was a little smug. They said, we will get our money. Someday we will get our money. It may be a Social Security check, but we will get it. That is a grim prospect for someone 22 years old, and their mom, and signing up for a student loan to think that is the outcome of this decision.

Tell me what you think in terms of whether or not this should be a matter of concern. Are we dealing with a potential bubble as some analysts have said? And what do you think we should do about it?

Secretary GEITHNER. A very important question, and my compliments to you for drawing attention to it.

Let me just say a few general things, and we do share your concern, particularly about the unique challenges in the private student loan market.

In the Government student loan market, as you know, there are a lot of various forms of flexibility to make sure you can adjust payment to income over time, many other ones, too, and that is very important. In the private market, those protections do not exist, and we would like to work with you on how best to think about solving that problem. I know Secretary Duncan is thinking a lot about this.

As you know, the Consumer Financial Protection Bureau (CFPB), has responsibility and some authority to look at practices in these areas, and they are responsible now for taking a look at whether you are seeing behavior by lenders that would magnify the risks in this context. We think it is very important that—and the President has been very focused on this, to try to make sure we are holding all providers of postsecondary education—community, private, public—to higher standards for the quality of the education they provide to the country because, as you pointed out, many people are going to very expensive schools where they have not been able to earn a return that justifies the expense. And we are working very hard to make it more affordable for people to go to college with the Congress' support, a range of tax incentives, and other options.

But even with what CFPB is doing, even with these efforts to deal with some of the special challenges posed by these private universities and for-profit universities across the country, and even with steps the Congress has supported to make it affordable to go to college, we have a problem we do not how to deal with yet in the private student loan business. So, we would like to work with you on your specific proposal. There is definitely some merit in it. We want to do it carefully, but for all the reasons you said.

It is important to recognize that the average earnings for somebody who goes to college are much higher than somebody who just graduates with a high school diploma. There is a very good case for society as a whole and for the individuals to be able to borrow money, and afford, a community college or a 4-year college program. But you want to make sure you are doing that in the most financially sensible way for you, and with the protections you deserve in that basic context.

A lot of those protections exist in the Federal student loan market, and we have got some work to do to bring those to the private market.

Senator DURBIN. Let me add one other element I should have added, and the difference if we contrast mortgage loans and student loans. The bubble in the mortgage market was brought on by overpricing real estate. And as a result of people losing their homes, being unable to pay, real estate prices came down dramatically. The President raised this point in his State of the Union Address about the cost of higher education. It seems like there is no ceiling. It is just on its way up forever. And I am not sure if the bubble bursts and more and more students cannot make their payments, whether the message will be driven home to a lot of these institutions.

Some of the tuition charges at schools, including some I attended, I think have reached an outrageous level, and I do not think that they are sensible anymore in terms of the debt that a student has to incur. But they need to be. We have to create incentives for them to price a product that is worthy of the investment that many young students and their families are making.

It turns out that when it comes to the private loan side of it, more and more of these schools, even with the fact that you cannot discharge the loan in bankruptcy, are insisting that the parents sign on, too. And many parents who thought they were headed for retirement with a college-educated child end up continuing to work because of student debt that cannot be paid at the end of the day.

Secretary GEITHNER. It is also true that many people used to have the ability to borrow against their house to cover the cost of college for their kids, which was a very financially attractive way to pay for higher education. But, of course, that opportunity no longer exists for many people because of how much home prices have fallen.

Senator DURBIN. I am much larger than the average canary, but I hope that this testimony today will start some people thinking about what this student loan debt is going to mean to us in the longer term. And I am not sure which way to turn at this point.

Senator MORAN. Mr. Lautenberg is fine.

Senator DURBIN. Senator Lautenberg.

Senator LAUTENBERG. Thanks very much. Unscrupulous mortgage brokers' practices have led Americans to buy homes that they clearly could not afford, and today we see some for-profit colleges are pushing students to run up debt they can never repay. What, if anything, can the administration do to make sure that for-profit colleges do not put our economy at risk like the mortgage brokers did?

Secretary GEITHNER. Well, excellent question. The President and Secretary Arne Duncan have in place a range of policies designed to address just this question. So, in addition to what the CFPB, we hope, will do in improving the quality of disclosure and providing information about borrowing choices for its students, in addition to what we can do through the tax system and elsewhere to help make college more affordable, the President and the Secretary of Education are working hard to try to reduce the rate of growth and costs.

You are both right to highlight this. You want individuals to know when they are thinking about how they pay for college or community college, about the difference between the protections you get with a Federal student loan and a private loan. So, you want them to go in eyes open. You do not want them to have unrealistic expectations about what they are going to be able to earn after college, not justified by the quality of the education they get. Those things are very important. And, again, you are right to bring attention to it.

I spent some time talking to the President and Secretary Duncan before our hearings; I knew you were going to raise it. I know that they are very focused on your specific suggestions and would like to work with you on it.

Senator LAUTENBERG. Well, is it possible that private student loans could have some of the same borrowing protections as Federal loans?

Secretary GEITHNER. Well, that would really be a matter for consideration by the Congress and the CFPB. That is something we have to look at. I know the chairman has proposed or is considering some specific legislation that would allow private student loans to be discharged in bankruptcy with a full set of protections. That would be one approach, and we will look at all sensible ideas in this area.

Senator LAUTENBERG. Right now, budget cuts would slash Pell Grants, 10 million students, by at least $1,000. What might be the impact of cutting Pell grants for student loans?

Secretary GEITHNER. Well, again, if the U.S. Government were at this time, with all the concerns we have about the basic competitive position of the American economy, and the need to equip Americans with the skills they need to get jobs to significantly reduce the assistance it provides students going to college, that would be a bad thing for the country. And it is one reason why it is important for us to recognize that even though we recognize our deficits are unsustainable, and even though we recognize we are going to have to bring them down over time, to understand where we cut and how we do it is as important as doing it itself.

And so, here we put in place tax reform and fiscal reforms to help reduce those deficits in the future, we have to be preserving room—and we can afford to do this as a country—preserving room to make it easier, not harder, for kids to go to college.

Senator LAUTENBERG. Going back some years, I was a beneficiary of the GI bill, and was able to get a pretty good education at Columbia Business School. And I helped co-found a company that now employs more than 40,000 people and presents the employee statistics every month, ADP. And we built the greatest generation, so called. I was one of the builders, but I do not know whether I carried my share of the 8 million people who got a GI bill education.

And not to avail ourselves out of what can come out of a broad-scaled educational program that encourages people, does not discourage them, does not put them under unrealistic burdens, and put our society further in debt, understand that watering those flowers produce—it is not only a beautiful scent, but a beautiful view.

Thanks very much.

Secretary GEITHNER. I agree. Could I just say, Mr. Chairman, that I, too, borrowed to finance my college and graduate school education, and I was able to repay those loans on a civil service salary, which was a very fortunate thing for me. I think as a country, if anything, we are under investing in an investment that would have very high returns for the country as a whole, and the GI bill is the best example.

Again, it's a good thing to remember as we think about how we find a bipartisan agreement on ways to reduce those long-term deficits, because we need to be doing that in a way that preserves room for these kinds of investments.

VOLCKER RULE

Senator MORAN. Mr. Secretary, I am going to ask you to advise one of my bankers in their efforts to comply with the record keeping requirements of the Volcker Rule.

The way I understand the situation is a bank without any proprietary trading ambitions, either before or after the financial crisis, would now have an affirmative obligation to prove the negative. In other words, although they never had a proprietary trading operation, the Dodd-Frank Act now forces them to develop an expensive compliance system to prove that fact to the Government.

Has the Treasury Department made any efforts to quantify the costs of that compliance, and how would you suggest a banker do that?

Secretary GEITHNER. I have heard that concern, and that is one of the many comments and concerns expressed by the private market in response to the rule proposed by the regulators. Again, this is a rule proposed by a group of independent regulators. I know they are taking a look at that concern among many.

I think the question they face is, can they find a way—and I am very confident they can—can they find a way to achieve the objectives of the law, which is to limit proprietary trading by the largest banks in the country, but still preserve exceptions the Congress designed for market making and hedging, and make sure that complying with that does not put an undue burden on the rest of the system. I am very confident they can do that, but they have got some work to do. And it is important to me, not just to your banker, that they get this right.

Senator MORAN. Thank you. I appreciate that confidence that it can be accomplished. And it is that reminder that this premise about too big to fail, one of the things we have to be very cautious of is that because of regulatory burdens, we do not force financial institutions to become bigger and bigger to cover the costs of the regulatory burden created by the Dodd-Frank Act and other legislative rulemaking.

SMALL BUSINESS LENDING FUND

Let me ask another one dealing with a similar topic, your written testimony references support for community banks from the Small Business Lending Fund (SBLF). But I am concerned about a lack of an exit plan for those several hundred banks that received TARP money from the Capital Purchase Program, that were not eligible or were otherwise prevented from participating in the SBLF. Do you have a strategy to recover those taxpayer dollars and to allow community banks to exit the program?

Secretary GEITHNER. Excellent question, and we are very focused on this. I should point out that we have already recovered more than $10 billion of the total amount invested by the Government in the banking system in the crisis. The expected return on those investments for banks is going to be north of $20 billion.

But you are right, we still have a series of quite small investments left in a number of community banks across the country. And we are working with those institutions and their regulators to encourage them to repay and make it possible for them to repay. Not everybody is going to be able to do it. There will be some banks that cannot do it. But we are trying to figure out a way to encourage those firms to replace those investments by the taxpayer with private investments as quickly as possible. And they generally want to do it, too. They are very eager to return those investments.

Senator MORAN. Mr. Secretary, thank you. Mr. Chairman, thank you.

FINANCIAL CRIMES ENFORCEMENT NETWORK INFORMATION TECHNOLOGY MODERNIZATION

Senator DURBIN. Mr. Secretary, in your Financial Crimes Enforcement Network (FinCEN), there has been a lot of work for a long time to upgrade the technology. Tell us where you are.

Secretary GEITHNER. Well, we have got some work ahead of us. And, as you have said, this has been a challenge for many arms of government. We have a stronger management team in place in working how to design and execute this modernization. We have drawn on resources outside FinCEN to help reinforce it. I would be happy to give the subcommittee more details on how things are going. But I think they are doing okay.

OFFICE OF FOREIGN ASSETS CONTROL SANCTIONS AGAINST IRAN, SUDAN, BELARUS, AND SYRIA

Senator DURBIN. There is another aspect of your agency. Most people might think about it instantly, the Office of Foreign Assets Control (OFAC), and it oversees economic sanctions against targeted foreign countries and regimes, terrorists, and other threats to America.

So, I would like to ask you, is work being done relative to the situation in Sudan by your Department?

Secretary GEITHNER. Absolutely, and I thank you for drawing attention to this part of the Treasury.

This part of the Treasury is responsible for designing and executing these financial sanctions we have in place with many countries around the world. And in Sudan, we have in place the most powerful sanctions available to us. They are very comprehensive, and I think they have been a pretty powerful incentive to reinforce the broader objectives of the State Department and the President in Sudan.

OFAC's work goes well beyond Sudan, and, of course, a big part of their work today surrounds Iran where we are making tremendous progress in bringing more pressure on Iran from countries around the world.

Could I just take this moment to convey my best wishes to Senator Kirk, who I know has been such a champion of a tougher approach in Iran. I want him to know as he recovers that we are making extraordinary progress using the authority he has helped give us at the Treasury working with countries around the world to bring more pressure to bear on Iran. We are having, we think, a big impact economically on them.

Senator DURBIN. I will make sure he gets that message.

One of the witnesses before the Foreign Relations Committee last, when we asked about Sudan and what we could do, said that there are at least three Sudanese leaders who have been found guilty of war crimes before the International Criminal Court: President Bashir, Defense Minister Hussein, and Government Minister Harun. And they asked whether we could and whether we are tracking their financial assets.

Secretary GEITHNER. Well, I would be happy to take a look at that more specifically and talk to my colleagues about it. The sanctions we have in place cover the government as a whole, but, of course I welcome that suggestion and I'm happy to consult with my colleagues. We will get back to your staff on whether we think that makes sense.

Senator DURBIN. I would like to ask you at the same time to consider the situation in Belarus with Viktor Lukashenko, the last dictator in Europe, as well as the Syrian dictator, Bashar al-Assad. If you would like to say another word or two about the situation in Iran. The President has told us and others, Secretary Clinton and others, that the sanctions regime is making an impact. Can you give us any testimony today about what you think the impact has been on the Iranian economy?

Secretary GEITHNER. Yes. All evidence suggests, and you can see it in what has happened to their exchange rate, the rate of inflation, and the difficulty they are having, frankly, trading with the rest of the world and selling their oil, that it is having very substantial economic effects.

You have seen 10 countries in Europe and Japan announce that they are going to substantially reduce imports of oil from Iran. The Europeans are going to cut them off completely. Countries around the world are in the process of taking additional steps to reduce their imports of oil. But beyond that, these financial sanctions are making it very difficult for countries to do business with Iran, very difficult for Iran to get paid for the oil they do ship, and to get paid for other things. And that is absolutely having an effect on the economy as a whole.

Now, we do not know, of course, what effect that is going to have on their nuclear ambitions. Of course, our ultimate objective is to convince Iran that they should join the consensus of the international community to renounce those ambitions. We think these sanctions are necessary, and we hope will be an effective path to achieve that.

I want to say in the Belarus context—happy to report in more detail—but we have put sanctions in place in Belarus on a number of senior government officials, including Lukashenko and others.

Senator DURBIN. Thank you.

Senator Moran.

Senator MORAN. Mr. Chairman, you started me down another line of questioning, and one of the areas—I think both of the areas we agree upon. I just would encourage the Treasury Department to fully implement, to enforce the sanctions as authorized by the Congress in regard to Iran, and I would encourage you to do that.

SALE OF AGRICULTURAL GOODS TO CUBA

On the topic of Cuba, one that the chairman and I have dealt with in the past, the administration has made—the Obama administration has made changes in our relationship, bilateral relationship with Cuba in regard to travel and regard to money being sent to Cuba. But you have not done anything in regard to the sale of agriculture commodities, food, and medicine.

And going back to the year 2001, the Congress passed legislation that authorized the sale for cash up front of those items. We had regulations developed by the Treasury Department that were in place for a number of years. The Bush administration Treasury Department changed those regulations, made it more difficult for those cash sales to occur in really two ways: third-party financing and the definition of when the shipment arrived or left the United States, the determining factor of when the cash had to be paid. Prior to those regulatory changes, it had to be paid when the ship landed in Havana. The Treasury Department changed the rules and said it had to be paid before the ship left the United States, making the United States' sales significantly less competitive.

And other countries' exports to Cuba have increased, for example, to Brazil. Ours following those Treasury regulation changes were reduced, diminished. And as—this goes back to my days in the House of Representatives, Representative Peterson and I wrote the administration asking, if you are going to do those other two things, why do you refuse to take the steps necessary to deal with the agricultural sales—it is not even trade—agricultural sales for cash up front, and return us at least to the days that pre-existed the change by the previous Treasury administration.

I would be happy to know your response, but mostly I want to ask you to encourage the administration to do that, and to work with us as we try to craft legislation if you will not.

Secretary GEITHNER. I will be happy to work with you on it. And, as you know, there are Members of the Congress who have a somewhat different view than you on this, and they have occasionally tightened——

Senator MORAN. I have met them.

Secretary GEITHNER [continuing]. The things you are trying to loosen. And we have to be guided by what they put into law.

Senator MORAN. But the same thing could be true—be said for the other two aspects of trade in regard to the money being sent and the opportunity to travel to Cuba. And it just seems odd this is the one that there seems to be—there is an unwillingness for the administration to make the changes.

Secretary GEITHNER. Again, happy to listen to your concerns on this and to work with you on it. We try to hew closely to the line that Constitution draws, and when you change the law, then we move. But we are happy to talk to you.

Senator MORAN. I think we have had this conversation before. Your happiness to talk to me has been demonstrated previously, but the rules remain the same.

TAXPAYER SUPPORT OF FREDDIE MAC AND FANNIE MAE

The only—I think, Mr. Chairman, the only other question I would ask is, this is a question that Senator Kirk asked me to ask in regard to taxpayers being made whole in their investments and the rescue of Freddie Mac and Fannie Mae. And I think the point he wanted me to raise with you is that in the Senate Banking Committee, February of this year, Secretary Donovan estimated that the taxpayer exposure to the bad loans of Fannie Mae and Freddie Mac could exceed $1 trillion. Do you agree with that assessment?

Secretary GEITHNER. No, and I do not think it is likely he said it that way. Let me tell you how we look at this.

FHFA does a regular periodic assessment of what future losses might be even in the event we face another recession or another crisis, those are put in the public domain, and they periodically revisit those.

But I will tell you what they show. What they show is that all the losses they face going forward now are really the legacy problem of the choices they made during the financial boom. And today, because of the changes put in place since the crisis under the legislation the Congress passed, they have much more conservative underwriting standards and much more conservative lending practices.

Most independent economists assessing their book of business would say that the new business they are doing today, which is still very important—the housing market—is done on much more conservative financial terms and looks relatively profitable. And over time, those profits are helping reduce the losses we inherited.

But what FHFA does, and which is appropriate, is to periodically publish estimates of what those losses might be in the future to the taxpayer under even a significantly worse economic scenario. But the estimates out there, including the ones made by CBO, are nothing close to $1 trillion.

We will lose some money, but I think the current estimates are more in the range of $100 billion. And even those losses look like they are going to be largely offset by the Government's return on the range of other things that we did as part of the financial rescue done by the Federal Reserve and the Federal Deposit Insurance Corporation (FDIC) and the Treasury.

ADDITIONAL COMMITTEE QUESTIONS

But, you know, we got some ways to go, and really at the very early stage of putting in place reforms that will make the housing finance system work better in the future. We are pretty far advanced on the broader financial reforms, but not very far along on the reforms to the housing finance system.

Senator MORAN. Mr. Secretary, thank you.

Senator DURBIN. Mr. Secretary, thank you for your time and your valuable testimony.

Secretary GEITHNER. Thank you.

[The following questions were not asked at the hearing, but were submitted to the Department for response subsequent to the hearing:]

QUESTIONS SUBMITTED BY SENATOR RICHARD J. DURBIN

Question. What is the Department of the Treasury doing in its role as manager of the Senior Preferred Stock Purchase Agreements—through which the Government-sponsored enterprises (GSEs) have received about $170 billion in taxpayer assistance—to ensure the GSEs are engaging in behavior such as principal reduction that, as Secretary Geithner has stated, when appropriately used would "limit the futures losses of the GSEs"?

Answer. The Federal Housing Finance Agency (FHFA), as Conservator of Fannie Mae and Freddie Mac, is responsible for the oversight and management of the activities at Fannie Mae and Freddie Mac.

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Question. Who at Treasury is in charge of managing and overseeing the Senior Preferred Stock Purchase Agreements?

Answer. The Under Secretary of the Treasury for Domestic Finance is responsible for the management and oversight of the preferred stock investments under Senior Preferred Stock Purchase Agreements.

Question. How many Treasury employees work on a daily basis to oversee the financial assistance provided to FHFA?

Answer. Treasury takes very seriously its responsibility to oversee the financial support it provides under the Senior Preferred Stock Purchase Agreements. Employees of a number of Treasury offices, including the Office of Financial Markets, the Office of Financial Institutions, the Office of the Fiscal Assistant Secretary, and the Office of the General Counsel, provide support to the Under Secretary for Domestic Finance for the management and oversight of the financial support provided under the Senior Preferred Stock Purchase Agreements.

Question. What information, if any, is Treasury receiving from the GSEs to ensure that the billions in financial assistance they have received under the Purchase Agreements isn't being misused?

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Question. What is Treasury doing to ensure FHFA completes its principal reduction analysis in a timely manner and that FHFA does not indefinitely delay its results?

Answer. In 2012, Treasury assisted the FHFA in its analysis of the effects of targeted principal reduction on underwater mortgages owned or guaranteed by Fannie Mae and Freddie Mac in connection with payment-reducing loan modifications under HAMP. Treasury believes that principal reduction should be assessed as part of a payment-reducing modification, and the overall economic result compared to a modification without principal reduction. This approach ensures that principal reduction is implemented where it produces the best result from an economic standpoint. FHFA, as Conservator of Fannie Mae and Freddie Mac, is responsible for the oversight and management of the activities at Fannie Mae and Freddie Mac. In July 2012, FHFA announced it had concluded its analysis and it would not allow Fannie Mae and Freddie Mac to provide borrowers with principal reduction in connection with a modification. Treasury is ready to consult with the FHFA if they wish to continue a further analysis of principal reduction.

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Answer. FHFA is an independent Federal regulator and as such, it would not be appropriate for Treasury to comment on FHFA's mandate.

Question. Has FHFA shared their resource concerns with Treasury about implementing principal reduction as indicated in FHFA's January 20 letter to Representative Cummings? Has Treasury offered to help address resource issues?

Answer. In January 2012, Treasury announced that it was willing to pay principal reduction investor incentives to servicers participating in HAMP who were modifying underwater GSE loans, if the FHFA permitted the GSEs to participate in the HAMP Principal Reduction Alternative program (HAMP–PRA). After that announcement, Treasury engaged with FHFA regarding their concerns with resources needed to implement principal reduction and offered to pay additional administrative costs required to implement HAMP–PRA. As noted, FHFA decided in July 2012 not to allow GSEs to provide borrowers with principal reduction in connection with a modification. Treasury is ready to consult with the FHFA if they wish to continue a further analysis of principal reduction.

Question. What is Treasury doing to ensure that the tax consequences of principal reduction do not outweigh the benefits of principal reductions?

Answer. Treasury worked closely with Congress to ensure that the Mortgage Debt Relief Act of 2007 was extended through December 31, 2013. The Mortgage Debt Relief Act of 2007 generally allows taxpayers to exclude income from the discharge of qualified mortgage debt on their principal residence. Principal residence mortgage debt reduced through mortgage restructuring, as well as mortgage debt forgiven in connection with a foreclosure, can qualify for the relief.

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DOMESTIC FINANCE—FINANCIAL INSTITUTIONS/FEDERAL INSURANCE OFFICE

Question. Treasury's Federal Insurance Office (FIO) has a significant workload, particularly in international forums like the International Association of Insurance Supervisors (IAIS). FIO's work at the international level, in conjunction with state insurance supervisors, is important to the competitive standing of U.S. insurers and will help ensure that the United States gets the best outcome in reviews of international insurance standards. Please provide a progress report on the work that FIO is undertaking, including what the Department is doing to stand up and provide resources to this office and how many staff are expected to be in place by the end of each of fiscal year 2012 and fiscal year 2013.

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TERRORISM AND FINANCIAL INTELLIGENCE—FINANCIAL CRIMES ENFORCEMENT NETWORK

Question. The Financial Crimes Enforcement Network (FinCEN) collects Suspicious Activity Reports from financial institutions. Patterns in the data allow FinCEN to identify criminal "hot spots" that can be addressed through enforcement and coordination among law enforcement entities. In fiscal year 2010, FinCEN began a second attempt to upgrade the IT system that hosts this data.

When will the final product be available, and how will it improve financial intelligence efforts?

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QUESTIONS SUBMITTED BY SENATOR FRANK R. LAUTENBERG

DOMESTIC FINANCE—HOUSING

Question. Opponents of principal forgiveness for struggling homeowners have argued that lowering the amount owed on underwater mortgages would cost taxpayers too much.

However, analysis by the Federal Housing Finance Agency suggests that forgiveness would save taxpayers money.[1] What has your analysis of Treasury's principal forgiveness program revealed about the benefits of principal forgiveness for taxpayers and homeowners?

[1] See February 8, 2012 Letter from House Oversight Committee to FHFA Director DeMarco, which reads, in part, "according to the latest report you provided from December 2011 . . . implementing principal reduction programs for borrowers who are Net Present Value (NPV) positive would reduce overall losses by $28.3 billion, while principal forbearance programs for these borrowers would reduce overall losses by $27.9 billion compared to the cost of taking no action."

Answer. Treasury supports using principal reduction on a targeted basis where it makes economic sense to do so. When used in combination with a payment-reducing loan modification such as a Home Affordable Modification Program (HAMP) modification, principal reduction can be an effective way to help underwater borrowers avoid foreclosure and help housing markets to recover. The application of principal reduction to an underwater loan can, in many cases, help reduce a struggling borrower's monthly payment to a level where the borrower can sustain this lower, modified monthly payment and is less likely to default going forward. Currently, of all of the eligible underwater non-Government-sponsored enterprises (GSEs) loans receiving a HAMP modification in 2012, nearly three-quarters included some principal reduction.

DOMESTIC FINANCE—HOUSING

Question. Some have suggested that principal forgiveness on Fannie Mae and Freddie Mac mortgages would enrich banks that hold second liens.[2]

But principal forgiveness is essential for struggling homeowners and for restoring the health of our housing market. How can the Congress help homeowners while preventing a windfall for banks?

The concern that principal reduction could offer a benefit to large financial institutions that hold subordinate second liens is addressed HAMP through the associated Second Lien Modification Program (2MP). Servicers participating in 2MP are contractually obligated to proportionately modify each eligible second lien that is matched to a first lien HAMP modification. In the case of any first lien that has principal reduced in connection with a HAMP modification, the participating servicer is required, at a minimum, to reduce a proportional amount of principal on the associated second lien. Most major servicers are participants in 2MP (including the five largest mortgage servicers), so instead of providing a windfall to the banks, if Fannie Mae and Freddie Mac's (the GSEs) allowed principal reduction in connection with HAMP modifications on GSEs loans, it would compel the largest banks to help homeowners even further by writing down more second liens through 2MP.

Prior to the launch of 2MP, it was often difficult to even determine the owner of a second lien on a property subject to a first lien modification. Treasury facilitated the creation of a nationwide system to match first and second liens, thereby facilitating and ensuring that second liens are modified when there is a first lien modification, whether or not the modification involves principal reduction.

ECONOMIC POLICY

Question. In 2006, Christopher Bryski, a constituent of mine, passed away after not regaining consciousness from an injury he suffered 2 years prior. His Federal student loans were discharged by law when he passed, but his private loans were not, so his father is still paying them off. Do you believe that private student loans should have the same borrower protections as Federal loans?

Answer. Treasury defers to the Consumer Financial Protection Bureau (CFPB) on the issue of private student loans. CFPB issued a report in July 2012 that discussed borrower protections for private student loans.

QUESTIONS SUBMITTED BY SENATOR MARK KIRK

DOMESTIC FINANCE—HOUSING

Question. In your response to a question during the March 28 hearing, you indicated that you were not familiar with the statements made by Department of Housing and Urban Development Secretary Shaun Donovan during a hearing before the Senate Banking Committee on February 28. Secretary Donovan replied to questions from Senator Johanns as follows:

"Senator JOHANNS. Let me ask you about that, because I think you're making my point. How much today would the taxpayers be on the hook for when it comes to Fannie and Freddie? Everything, right?

"Secretary DONOVAN. There—there is no question that taxpayers are at risk for those loans being made. What I would also say, though, is all the evidence that we have is that the new loans being made are safe, good loans; that the exposure that taxpayers have is to the legacy loans that were made before they went into conservatorship.

"Senator JOHANNS. How much——

[2] See, for example, "A Bailout by Another Name", New York Times, March 24, 2012.

“Secretary DONOVAN. This is where the confidence issue is important. The single-most important thing we can do to protect taxpayers is ensure that those old loans, which we can’t make go away, perform in a way that improves their value, rather than continue as their value decline. In that sense, improving the housing market more broadly, keeping confidence in the securities that are issued by Fannie and Freddie, is critical going forward.

“Senator JOHANNS. How much are those legacy loans? If you’re the average taxpayer out there, and you’re tuned into this hearing, and you want to know how much you’re on the hook for, how much is that?

“Secretary DONOVAN. I’m sorry, Senator. I don’t have a number in front of me. Perhaps—I know that FHFA will be testifying on the next panel. I’m sure that they would have more specific details. But it’s obviously substantial, in the over-trillion-dollar range.”

Your specific response during the March 28 hearing was:

“The FHFA does a regular periodic assessment of what future losses might be, even in the event if we face another recession or another crisis. And those are put in the public domain and they periodically revisit those. But I’ll tell you what they show. What they show is that all the losses they face going forward now are really the legacy problem of the choices they made during the financial boom. And today, because of the changes put in place since the crisis under the legislation Congress passed, they have much more conservative underwriting standards and much more conservative lending practices. And most independent economists assessing their book of business would say that the new businesses they’re doing today, which is still important to the housing market, is done on much more conservative financial terms and looks relatively profitable. And over time, those profits are helping reduce the losses we inherited. But what FHFA does—and this is appropriate—is to periodically publish estimates of what those losses might be in the future to the taxpayer under even much—even, you know, a significantly worse economic scenario. And—but the estimates out there, including ones made by CBO are nothing close to $1 trillion.”

To clarify the precise level of exposure, please provide Treasury’s estimate of the value of outstanding mortgage loans that carry a direct or indirect Federal guarantee, broken down by “legacy loans” and “loans since 2010”, accompanied with an estimate of taxpayer exposure to loss. Also respond as to whether you view debt forgiveness as part of a plan to minimize the taxpayers’ long-term loss exposure.

Answer. The majority of losses at the GSEs stem from loans guaranteed prior to 2009. FHFA has conducted stress tests in order to project potential GSE losses and draws from Treasury over a 3-year forward-looking window. However, it is important to note that these are modeled projections and can change over time as inputs and assumptions change.

In the “Projections of the Enterprises Financial Performance”, FHFA reported on October 26, 2012, FHFA projected results for the period of 2013–2015. These results estimated that the cumulative amount of draws from Treasury less the dividends paid to Treasury for FHFA baseline scenario since conservatorship and through 2015 was $53 billion for Fannie Mae and $23 billion for Freddie Mac. Under a stress scenario, FHFA projected these amounts to be $94 billion for Fannie Mae and $38 billion for Freddie Mac.

The administration uses these projections as the starting point for its budget estimate of the cost of Treasury support for Fannie Mae and Freddie Mac and will provide updated estimates in the fiscal year 2014 budget. In the administration’s fiscal year 2013 mid session review, net payments of senior preferred liquidity payments minus dividends were projected to be $12 billion through the budget window of 2009–2022. The lower figure reflects FHFA’s projected stronger results and dividend payments to Treasury in the 2015–2022 period.

Treasury supports using principal reduction on a targeted basis where it makes economic sense to do so. When principal reduction is used in combination with a payment-reducing loan modification such as a HAMP modification, it can be an effective way to help underwater borrowers avoid foreclosure and help housing markets to recover.

Question. The debt limit increase approved as part of the Budget Control Act of 2011 is expected to accommodate the Treasury’s borrowing needs until the end of this year. Following the Student Aid and Fiscal Responsibility Act of 2009, student debt issuances by the Federal Government have widely expanded to displace loans no longer made through the subsidized student loan market, adding new demands for Treasury funding.

What is the numerical change in dollars to debt subject to the limit caused by this expansion in Government-issued student debt? How many days did student loan debt accelerate the need for a debt limit increase in 2011?

Currently, the Government is recovering 85 percent of every student loan dollar that goes into default status.

Are default rates greater than expected, and how is that affecting Treasury's ability to project its cash flow needs?

Answer. Student loans are a critical part of the administration's goal to increase access to higher education. Treasury plays an important role in financing direct loans and supporting delinquent debt collection across the Government. Borrowing related to student loans and grants increased our overall borrowing needs in fiscal year 2011 by approximately $155 billion, which was one of the factors that contributed to the need for a debt limit increase in 2011. Treasury has been working with the Office of Management and Budget and the Department of Education to analyze the data relating to student lending in order to accurately ascertain the lending program's impact on cash flows. This is an important issue that Treasury will continue to analyze and monitor closely.

INTERNATIONAL AFFAIRS

Question. A recent Federal Reserve paper concludes that Chinese foreign official flows into the United States and acquisition of United States Treasuries has had significant effects on Treasury yield, reducing interest rates.

Should we be encouraging foreign holdings of Federal debt, rather than criticizing them?

What are the risks related to foreign holdings of Federal debt that might offset our interest savings?

Answer. The market for Treasury securities is the deepest and most liquid fixed income market in the world. As a result, Treasury securities have a diverse investor based—domestic and international, small and large. We view this as a source of confidence in our market and an indication of the status Treasury instruments occupy in global fixed income markets. More broadly, the United States has a longstanding open investment policy, which has been beneficial to our growth and employment.

TERRORISM AND FINANCIAL INTELLIGENCE—TERRORIST FINANCING AND FINANCIAL CRIMES/OFFICE OF FOREIGN ASSETS CONTROL SANCTIONS

Question. On February 27, 2012, the Treasury Department issued a fact sheet entitled "Treasury Amends Iranian Financial Sanctions Regulations to Implement the National Defense Authorization Act" in which you wrote, "Beginning on February 29, 2012, privately-owned foreign financial institutions that knowingly conduct or facilitate any significant financial transaction with the CBI other than for the purchase of petroleum or petroleum products from Iran face U.S. sanctions, consistent with subsection 1245(d) of the NDAA." Nearly 1 month later, no sanctions have been imposed pursuant to subsection 1245(d) of the fiscal year 2012 National Defense Authorization Act (NDAA) (commonly known as the "Menendez-Kirk" amendment). As you know, unlike other sanctions law, the imposition of sanctions under "Menendez-Kirk" is not contingent on a Presidential determination. Simply put, under U.S. law, sanctions must be imposed when sanctionable activity is found.

Why is the administration not complying with the "Menendez-Kirk" amendment when it comes to the imposition of sanctions with regard to nonoil transactions conducted with the Central Bank of Iran?

Answer. The Treasury Department is aggressively implementing the "Menendez-Kirk" amendment, along with the full range of sanctions that we administer against Iran, to disrupt the Government of Iran's incoming revenue streams and its access to its existing revenues. As a key part of these efforts, we will continue to target both oil and nonoil dealings with the Central Bank of Iran under all appropriate authorities.

Question. Are you willing to report to us in writing that since February 29, 2012, the Treasury Department has found no evidence of activity sanctionable under subsection 1245(d) of the fiscal year 2012 NDAA?

Answer. The Treasury Department is aggressively implementing the "Menendez-Kirk" amendment, along with the full range of sanctions that we administer against Iran, to disrupt the Government of Iran's incoming revenue streams and its access to its existing revenues. As a key part of these efforts, we will continue to target both oil and nonoil dealings with the Central Bank of Iran under all appropriate authorities. Treasury will continue to work closely with the Congress as we implement the range of United States sanctions against Iran.

Question. Are you willing to report to us in writing that since February 29, 2012, the Treasury Department has seen no intelligence indicating foreign financial institutions have conducted nonoil transactions with the Central Bank of Iran?

Answer. Treasury is fully committed to targeting any foreign financial institutions engaged in sanctionable dealings with the Central Bank of Iran. However, it is longstanding Treasury policy not to comment on possible investigations.

Question. My staff has repeatedly asked the Treasury Department to brief in classified session on current intelligence relating to these issues. Why is the Department unwilling to meet with members of the Senate or their staff to discuss the administration's failure to comply with subsection 1245(d) of the fiscal year 2012 NDAA?

Answer. The Treasury Department is unaware of any outstanding briefing requests, but has been and remains willing to provide classified briefings as appropriate to the Congress.

Question. Has the Treasury Department observed any financial transactions with Central Bank of Iran since February 29, 2012, or designated Iranian banks since July 1, 2010, that were deemed nonsignificant and for which sanctions under Comprehensive Iran Sanctions, Accountability, and Divestment Act of 2010 or the "Menendez-Kirk" amendment were not imposed? If so, on what basis were the determinations made that the transactions were not significant? What foreign financial institutions were responsible for processing these transactions?

Answer. Treasury is fully committed to a robust implementation of the range of Iran sanctions that we administer to maximize their impact on the Government of Iran. However, it is longstanding Treasury policy not to comment on possible investigations.

SUBCOMMITTEE RECESS

Senator DURBIN. The subcommittee will stand recessed.

[Whereupon, at 3:23 p.m., March 28, the hearing was concluded, and the subcommittee recessed, to reconvene subject to the call of the Chair.]