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FINANCIAL SERVICES COMMITTEE BUDGET VIEWS AND ESTIMATES, FY 2011

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Views and Estimates of the Committee on Financial Services on Matters to be Set Forth in the Concurrent Resolution on the Budget for Fiscal Year 2011

Pursuant to clause 4(f) of rule X of the Rules of the House of Representatives, section 301(d) of the Congressional Budget Act of 1974, and section 425 of Senate Concurrent Resolution 13, 111th Congress, the Committee on Financial Services is transmitting herewith (1) its views and estimates on all matters within its jurisdiction or functions to be set forth in the concurrent resolution on the budget for fiscal year 2011; (2) an estimate of the budgetary impact of all legislation which the Committee expects to consider during the coming session; and (3) recommendations for improved governmental performance.

ECONOMIC GROWTH AND JOB CREATION

The Committee is deeply concerned about the overall level of deficit spending in the President's FY 2011 budget and its impact on financial markets, the economy and jobs. More than 8.2 million Americans have lost their jobs since January 2007 and, since the $863 billion dollar stimulus bill was signed into law last year, more than three million Americans have lost their jobs, unemployment is near 10 percent, and the deficit is set to hit a record $1.6 trillion.

At a time when many families across America have been forced to do more with less, Washington continues to engage in unsustainable and reckless government spending. Americans are less financially secure today because of the staggering budget deficits expected over the next ten years. The President's FY 2011 budget will add $14 trillion to the national debt, thereby more than doubling the debt in 5 years. But the FY 2011 budget also fails to account for $370 billion that the Congressional Budget Office (CBO) estimates that the operations of Fannie Mae and Freddie Mac will cost taxpayers over the next 10 years, or the $1.6 trillion in outstanding debt issued by these firms, which are now owned and operated by the Federal government.

These unsustainable deficits are creating enormous fear among consumers and business owners, who are reluctant to spend, invest, and hire new workers because of uncertainty over new taxes, higher interest rates and the expanding role of government in the economy. As Donald Kohn, Vice Chairman of the Federal Reserve, observed: "The deficit is on track to remain quite large even as the economy recovers, pushing up the ratio of federal debt to gross domestic product substantially… Unless the trajectory is changed, the competition for savings between the government, on the one hand, and households and businesses, on the other, could be significant as households and businesses begin to borrow and spend in the recovery, putting upward pressure on interest rates."

In recent testimony before the Financial Services Committee, Federal Reserve Chairman Ben Bernanke warned that the United States could soon face a debt crisis like the one in Greece and other nations with large structural deficits, if action isn't taken to address unsustainable government spending. In particular, the United States could have trouble selling its debt to investors, which would force taxpayers to pay higher interest rates on our debt. "It's not something that is 10 years away," Chairman Bernanke said. "It affects the markets currently. It is possible that bond markets will become worried about the sustainability [of yearly deficits over $1 trillion], and we may find ourselves facing higher interest rates even today."

GOVERNMENT SPONSORED ENTERPRISES

Amid mounting mortgage losses, deteriorating credit quality, and eroding capital positions, the Government Sponsored Enterprises (GSEs) – Fannie Mae and Freddie Mac – were placed into conservatorship in September 2008. The rescue of Fannie Mae and Freddie Mac represented an extraordinary Federal intervention in private enterprise and could become the most expensive in history.

According to the CBO, the operations of Fannie Mae and Freddie Mac added $291 billion to the Federal deficit in 2009 but the Administration's budget request does not place the housing GSEs on-budget. The Administration's request does, however, include statements of financial condition for the GSEs and reflects the multi-billion dollar, taxpayer-funded Preferred Stock Purchase Agreement (PSPA) capital infusions. The Housing and Economic Recovery Act of 2008 (HERA) gave the Treasury standby authority to buy $200 billion in preferred stock or debt in Fannie Mae and Freddie Mac until December 31, 2009. The Obama Administration subsequently raised the commitment to $400 billion, and then announced on Christmas Eve 2009 that it was removing *any* limits on the use of Federal funds to cover losses at the GSEs. The Administration also extended its purchase authority until December 2012. Because of their continuing losses, Fannie Mae and Freddie Mac have so far received $127 billion from the Treasury Department under the PSPA.

After the two GSEs were placed in conservatorship, the CBO concluded that Fannie Mae and Freddie Mac should henceforth be included in the federal budget. In its 2010 fiscal outlook, the CBO estimated that the 10 year cost of operating the companies will be $370 billion. However, the Office of Management and Budget (OMB) continues to treat Fannie Mae and Freddie Mac as "off budget," and does not include their activities on the government's balance sheet. Ultimately, it is OMB's decision as to whether the GSEs are included in the federal budget. Therefore, the Committee strongly recommends that OMB be statutorily required to move Fannie Mae and Freddie Mac "on budget," and to account for the losses they have sustained since they were placed in conservatorship in the same way as CBO calculates their losses. The Committee also recommends subjecting the two GSEs' debt – used to finance their mortgage purchases – to the statutory debt limit. To allow time for the implementation of this new law, an effective date of 90 days after enactment should be set.

The Committee is disappointed that the Obama Administration failed to live up to its previous commitment to provide recommendations on the future of Fannie Mae and Freddie Mac as part of the President's FY 2011 budget. In recent congressional testimony, Treasury Secretary Geithner acknowledged that it will be next year at the earliest before the Administration will be prepared to provide any such recommendations. This failure to map an exit strategy from an open-ended commitment that has already cost American taxpayers $127 billion is unacceptable.

FEDERAL HOUSING ADMINISTRATION

As private sector lenders have scaled back their activities, the Federal Housing Administration (FHA) has significantly increased its share of the single-family mortgage market from less than 5 percent to more than 30 percent. Increased delinquencies and foreclosures across the nation have had a detrimental effect on the financial health of the FHA program. Late last year, an independent actuarial review showed that FHA's capital reserve ratio had dropped below the Congressionally-mandated threshold of two percent to a less than expected 0.53 percent. The report also indicated that the economic value of the Mutual Mortgage Insurance Fund (MMIF) declined over 75 percent from last year, to $2.73 billion. If home prices do not recover, the economic value of the fund could fall below zero, prompting HUD to request an appropriation from Congress. This potential shortfall is deeply troubling, and the Committee urges the Administration to be vigilant in its efforts to weed out mortgage originators who seek to use the FHA program as a dumping-ground for poorly or fraudulently underwritten loans.

The Committee notes that the Department has announced its implementation of "several reforms to strengthen its credit policies, which will ultimately help shore up the reserves and reduce risk," including hiring a Chief Risk Officer. These are encouraging and necessary steps, but not sufficient to address the problem of the MMIF being significantly undercapitalized. In fact, FHA's recent actuarial report notes that there is likely to be a continued decline in its portfolio through 2011. According to testimony before the Committee, a bailout of the FHA could cost $54 billion or more. To avoid putting the taxpayer at unnecessary and avoidable risk, the Committee recommends increasing the FHA down payment requirement to a ratio that is more aligned with the risk its borrowers pose to the taxpayer.

In addition, the Committee is concerned that the FHA continues to lack the technological and management capacity to perform proper oversight of its single-family loan insurance portfolio. With the increase in loan limits and the recent changes in the FHA reverse mortgage program, sufficient efforts must be made to ensure proper monitoring of FHA-approved lenders/licensees, and to ensure that the program is not being abused by those seeking to take advantage of the American taxpayer.

TROUBLED ASSET RELIEF PROGRAM

The Committee is concerned that President Obama's decision to extend the Troubled Asset Relief Program (TARP) to October 3, 2010, has opened the door to efforts to spend unallocated and repaid TARP funds for programs unrelated to the global financial crisis. In fact, H.R. 4173, the financial regulation bill that passed the House on December 11, 2009, diverts $4 billion from TARP to a number of so-called "foreclosure mitigation and neighborhood stabilization programs." It diverts another $20.8 billion to pay for the massive expansion of government bureaucracy that will result from enactment of that legislation. In addition, the so-called jobs bill that passed the House of Representatives on December 16, 2009, diverts $138 billion from TARP to pay for more deficit spending.

TARP was originally enacted as a temporary plan to address an extraordinary crisis in our financial markets as a result of the collapse of financial firms that the government deemed "too big to fail." Those who voted for the Emergency Economic Stabilization Act, which created TARP, did so with the assurance that the money would be returned to the taxpayers.

Americans are struggling under the weight of high unemployment, sluggish economic growth, and uncontrollable federal deficits. The best way to bring about economic growth and job creation is to avoid the massive deficits and to stop the massive increase in the national debt. The Committee recommends beginning the process of putting our fiscal house in order by shutting down TARP, and immediately returning any unused funds to the American taxpayer.

DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

The Obama Administration's budget for the Department of Housing and Urban Development ((HUD) totals $48.5 billion for FY 2011. This represents a $1 billion increase over the FY 2010 request and a $2 billion increase over enacted levels. HUD is notorious for slow spend out rates in many of its programs, yet nothing in this budget addresses the large unexpended program balances sitting in HUD accounts. Furthermore, this budget does not include the types of reforms necessary to ensure programs are administered in a cost-effective and efficient manner. The Administration believes that its $48.5 billion request for FY 2011 will be offset by $6.9 billion in FHA receipts. The Committee is concerned that this number reflects overly optimistic assumptions and believes that HUD should not rely on income from the troubled FHA program that may never materialize to offset spending increases. Included in the Administration's FY 2011 budget are several new housing programs to be administered by HUD. For example, the Administration's budget request includes $250 million for the Choice Neighborhood program, $258.8 million for the so-called Transformation Initiative, and $150 million for developing and supporting the Sustainable Communities initiative in partnership with the Department of Transportation and the Environmental Protection Agency (EPA). While these programs may have laudable goals, the Committee believes that in light of the record deficits outlined above, now is not the time to be creating new, costly and unproven government programs.

The Committee is also concerned with the ever-increasing discretionary spending in the HUD budget and its impact on budget deficits now and in the future. For example, the HUD budget includes $19.6 billion (a $1.4 billion increase from FY 2010) for the Section 8 voucher program, which represents 47 percent of HUD's budget request. Clearly this level of funding for the Section 8 program is unsustainable. Over the years, Congress has grappled with issues regarding the overall cost of the program and consequently took steps to slow the growth of the program relative to its proportion of the overall HUD budget. However, the Administration's FY 2011 HUD budget and recent congressional actions would have the effect of reversing those cost savings. For this reason the Committee is concerned that without meaningful reform, funding levels necessary to sustain the section 8 program will negatively impact other HUD programs, such as housing for critical populations of the elderly, disabled and veterans.

NATIONAL HOUSING TRUST FUND

Created by the Housing and Economic Recovery Act of 2008, the National Housing Trust Fund was originally to be funded by Fannie Mae and Freddie Mac. Given the GSEs' current status in conservatorship, they are no longer available as a funding source; consequently, the President has requested $1 billion in separate funding. The Committee is concerned that the Trust Fund duplicates other Federal housing programs, such as the HOME Investment Partnership program, which provides grants to state and local governments to implement strategies designed to increase homeownership and affordable housing opportunities for low- and very low-income Americans. Of equal concern is the availability of Trust Fund monies to non-profit groups such as the Association of Community Organizations for Reform Now (ACORN), which has been implicated in voter fraud.

FORECLOSURE MITIGATION

In 2008, Congress established the Hope for Homeowners program, which was designed to provide FHA loans for at-risk borrowers, combined with a requirement for existing lenders to write down existing loans to below the home's current market value. Since its inception, Members have raised concerns about the effectiveness of the Hope for Homeowners program, and as predicted – at least by House Republicans – this program has been a failure by virtually every metric. Estimates that the program would help hundreds of thousands of struggling borrowers with negative equity obtain more sustainable mortgages have fallen far short. The CBO now believes the program will assist only 25,000 at a cost of $675 million, or just over $25,000 per assisted family. Congress should eliminate this program because it is ineffective, costly and does not maximize the taxpayer's investment in providing foreclosure mitigation to distressed homeowners.

In addition, the Obama Administration continues to implement its three-part Homeowner Affordability and Stability Plan intended to help up to 9 million at-risk borrowers. The plan includes (1) a refinancing plan for mortgages owned by Fannie Mae or Freddie Mac; (2) a $75 billion loan modification program; and (3) a commitment of $200 billion to purchase Fannie and Freddie preferred shares. Like Hope for Homeowners, this foreclosure mitigation initiative has failed to meet its objectives. As of January 31, 2010, nearly 1.3 million homeowners have received offers for "trial" modifications, but only 116,000 permanent modifications have actually been completed. For many Americans, the Administration's foreclosure mitigation programs raise questions of fundamental fairness, specifically whether it is equitable to provide taxpayer funds to over-extended homeowners who have fallen behind on their mortgages while homeowners who have been struggling to stay current and pay property taxes receive no help? While the Committee understands the need to address preventable foreclosures, the Committee is concerned that any government plan must ensure that speculators and the unscrupulous are not bailed out by working families that have budgeted responsibly and made sacrifices to live within their means.

U.S. SECURITIES AND EXCHANGE COMMISSION

The Committee is concerned about the Administration's FY 2011 budget request for the Securities and Exchange Commission (SEC) of $1.258 billion, which is a 12 percent increase over last year's $1.119 billion budget. To pay for the increase in spending, the budget proposes increases in SEC fees on securities transactions and registrants that would fully offset the increase. While the SEC should have adequate resources to restore investor confidence in financial institutions and markets following the financial crisis and to revitalize the Commission and refocus it on its core mission, these efforts should be closely monitored and the SEC should be held accountable for its progress and use of resources. Simply increasing spending and adding employees will not ensure effective regulation by the SEC.

At a minimum, the Committee recommends that the SEC be made to correct the deficiencies identified in the November 2009 Government Accountability Office (GAO) financial audit of the Commission. GAO found that the SEC's "internal control deficiencies" represented a "material weakness" that gave rise to "significant management challenges" that increased the security risk to data processed by the SEC and impaired the Commission's ability to adequately prepare financial statements, among other issues. The GAO also concluded that the SEC's continued reliance on poorly designed systems deprived the Commission's management of "accurate, complete, and timely transaction-level financial information that management needs to make well-informed decisions." It is only reasonable to expect the SEC to hold itself to the same rigorous financial and internal control standards as it would hold any of its registered and regulated entities.

In addition, the SEC must improve its record of examinations of registered investment advisers, one of the leading factors in the Commission's failure to detect the Bernard Madoff fraud. The Commission's Justification for the FY 2011 budget request contemplates a 9 percent yearly examination rate of registered investment advisers – roughly the same rate of examination as in prior years. In order to adequately protect investors and prevent future Madoff-like frauds, the Commission must increase the percentage of investment advisers examined by the SEC on a yearly basis. Any budget increases should ensure that resources are adequately directed toward this objective.

SECURITIES INVESTOR PROTECTION CORPORATION

The Administration's FY 2011 budget correctly describes the mission of the Securities Investor Protection Corporation (SIPC) as providing protections to customers against losses resulting from broker-dealer failure, thereby promoting investor confidence in the nation's securities markets. However, the Administration budget's flat assertion that SIPC will not require the use of its $1 billion line of credit from the U.S. Treasury Department over the next ten years is overly optimistic.

In 2008, SIPC was confronted with two unprecedented events: the liquidation of Lehman Brothers Holdings in September 2008 and the liquidation of Bernard L. Madoff Investment Securities in December 2008. While SIPC so far has had sufficient assets to handle these "hundred-year" events and successfully managed the Lehman liquidation, the Madoff proceeding continues to present SIPC with challenges regarding the most appropriate method to compensate Madoff's investors, which could place pressures on the sufficiency of the SIPC fund.

On February 17, 2009, the SEC charged Robert Allen Stanford and three of his companies with orchestrating a fraudulent, multi-billion dollar investment scheme centering on an $8 billion certificate of deposit (CD) program. While Stanford customers have not received coverage from SIPC, they believe they are entitled to such coverage for their losses and have appealed this decision to the SEC. If the SEC overrules SIPC's decision and expands SIPC coverage to banking products (such as CDs), expands coverage to products issued by a foreign entity (which may be owned by a U.S. company), or expands coverage to products which investors have custody of but which are now worth less than when they were purchased, claims could overwhelm the SIPC fund.

The Committee believes that budget projections for SIPC should be realistic and account for the possibility that broker-dealers can and do fail, and that Ponzi schemes and fraud can and do occur. In addition, the Committee does not look favorably on legislative reforms that would require SIPC to borrow against its credit line, thus placing additional significant burdens on American taxpayers.

NATIONAL FLOOD INSURANCE PROGRAM

The National Flood Insurance Program (NFIP) is facing serious challenges and needs comprehensive reform to stabilize its long-term finances, according to the Government Accountability Office (GAO). In addition to carrying a $19 billion debt to the U.S. Treasury for borrowing to pay flood claims relating to the devastating 2005 hurricanes, the NFIP is not collecting enough flood insurance premiums to cover the costs associated with the estimated risk of losses. The GAO has determined that the flood program's structure as designed is not actuarially sound. Rates for approximately 25 percent of policies are subsidized, and these are primarily for high-risk structures constructed before the NFIP's flood plain regulations and flood risk mapping went into effect. Some policyholders are paying rates that may be only 35 to 40 percent of actuarially-sound rates based on the estimated risk of flooding.

The Committee is concerned about efforts to expand the NFIP to include coverage for windstorms, which would further exacerbate the financial weakness of the program and displace a portion of the private insurance market for windstorm coverage. Both the House and the Senate versions of long-term reauthorization and reform measures that passed in the last Congress contained reforms with broad support to move the NFIP closer to risk-based pricing. It is important that the Congress move forward with comprehensive reforms to overhaul the NFIP, protect federal taxpayers from excessive and unwarranted financial exposures, and increase the role of the private insurance sector in flood risk management without further delay.