MEMORANDUM

TO: Citizens of the 16th Congressional District of Pennsylvania
FROM: Congressman Joe Pitts
DATE: Friday, October 3, 2008
RE: H.R. 1424, The Emergency Economic Stabilization Act of 2008

Today I voted against The Emergency Economic Stabilization Act because I felt it attempted to do the right thing the wrong way. America is facing a credit crisis. It needed to be addressed quickly and well. Congress has acted quickly, but it has not acted well.

This crisis began in 1995 when the government began pressuring lenders to give mortgages to high-risk borrowers in order to increase homeownership in America. This created a new market for lenders who soon rushed to make as much money as possible by inducing people who could only afford small houses to buy large ones instead. In other words, this crisis began with the government botching an attempt to do something good. It should not have ended that way as well.

This week, Congress had an opportunity to try again to do this correctly. Instead, the Senate sent the House a bill full of tax breaks for special interests, unrelated provisions, and only minor improvements. Instead of earning more votes by improving the bill, the Senate bill bought votes by adding "sweeteners."

The crisis we are facing is real. However, in this country I believe market problems should be addressed with market-based solutions. This bill is a big-government approach that increases the federal debt limit to $11.3 trillion, in order to create a quick fix. It gives unprecedented power to the federal bureaucracy. There are no reforms in this bill to correct the mistakes that caused this crisis. It does not address the basic problem. It does not adequately protect the taxpayer.

I and a great number of my colleagues advocated for a plan focused on market-based asset insurance, changes to the tax code, regulatory reform, and protections for homeowners and taxpayers. Unfortunately, our advice was not taken.

The bill does increase FDIC insurance limits, which should help. The Securities and Exchange Commission is reportedly also planning to alter the much-discussed "mark-to-market" accounting rules. That will also help. The bill passed today will probably have the desired effect of encouraging markets and removing "toxic" assets that are "clogging" credit markets.

American workers and American businesses are the best in the world. We will make it through this crisis, and we will return to prosperity.

I do want you to know, however, what I and so many colleagues in Congress would have done if we had had the chance to offer an alternative for a vote in Congress. Following is a summary of provisions our alternative would have contained. I will continue to advocate for these actions and reforms.

Representing you in Congress is a tremendous honor. It is also many times a tremendous challenge. The economic problems we face today are complex and difficult. Two thousand of you reached out to me over the last week to let me know what you thought. While calls came in on both sides of the issue, the overwhelming majority of you opposed this legislation. Regardless of your position, I was gratified to hear from so many of you. The principled arguments you made encouraged me and reminded me of the fundamental wisdom of our system of government. Democracy works.

What the Government Should Do

1. Create an Insurance Program

Instead of buying assets, the Treasury should insure the bad assets of banks and investors by:

1. **Stabilizing Financial Markets:** Require the Department of Treasury to create an insurance program to guarantee losses up to 100 percent, resulting from the failure of timely payment and interest from mortgage-backed securities (MBS) originated *prior* to the date of enactment. Such insurance would provide immediate value to the securities and a foundation for which they could then be sold.
2. **Creating Risk-Based Premiums**: Direct the Treasury Department to assess a premium on outstanding MBS to finance this insurance program. Participation in the program would be mandatory for *all* holders of such MBS in order to guard against adverse selection where only the holders of troubled assets participate. A risk-based premium would be assessed on those with troubled MBS to ensure those who have acted irresponsibly have to pay more than those who have acted responsibly. The premium would expire when the Treasury Secretary determines the fund has sufficient resources to meet any projected losses.
3. *Currently the federal government insures approximately half of all mortgage backed securities (MBS). We can insure the rest of current outstanding MBS; however, rather than taxpayers funding insurance, the holders of these assets should pay for it. The Treasury Department can design a system to charge premiums to the holders of MBS to fully finance this insurance.*

2. Create a Loan Program

Congress should work with the President, the Federal Reserve Bank, and the Federal Deposit Insurance Corporation to set up an additional loan program for failing financial institutions that would:

1. **Grant the Fed the authority to lend to financial institutions:** The Fed currently has $400 billion in cash that they could inject into the market place. This money could be infused into the market immediately and would allow banks to free up existing capital.
2. **Reform FDIC Regulations:** Congress should authorize the FDIC to backstop the Fed's loans by ensuring more capital. Additional FDIC insurance would shore up confidence in banks and keep people from losing their savings.
3. **Keep the Federal Government out of the market:** Fed loans to failing financial institutions should be backed by sell-only stock warrants. Backing government loans with sell-only stock warrants will allow the government to recoup its investment and prevent it from controlling a private institution.
4. *When the government stepped in to rescue AIG, the government made a loan at an interest rate similar to what most people pay on their credit cards. The government also received sell-only stock warrants as collateral for their loan. In this arrangement, AIG is able to continue meeting the needs of the market place while the government is in a strong position to recoup its investment. Additionally, bureaucrats in Washington will not be able to control AIG because of their sell-only stock warrant arrangement.*

3. Restructure the Tax Code

Congress should act immediately to increase private capital in the marketplace by reducing taxes to critical sectors of the economy:

1. **Two-Year Suspension of the Capital Gains Tax:** Immediately suspend the capital gains rate from 15 percent for individuals and 35 percent for corporations. By encouraging corporations to sell unwanted assets, this provision would unleash funds and materials with which to create jobs and grow the economy. After the two-year suspension, capital gains rates would return to present levels but assets would be indexed permanently for any inflationary gains.
2. **Net Operating Losses:** Allow companies to carry-back losses arising in tax years ending in 2007, 2008, or 2009 back 5 years, generating a tax refund and immediate capital. Despite the presence of willing buyers, many firms with MBS are not willing to sell at such a huge loss. This carry-back would provide cushion for any such loss, making firms more willing sellers.
3. **Repatriation Infusion:** Allow a repatriation window for profits earned by U.S. firms overseas. Such repatriation amounts would be taxed at 0 percent if invested in distressed debt (as defined by Treasury) for at least one year.
4. **Bank Losses on GSE Stock:** Allow banks to treat losses on shares of preferred stock in Fannie Mae and Freddie Mac as ordinary losses, not as capital losses.
5. *Instead of injecting taxpayer capital into the market to produce liquidity, private capital can be drawn into the market by removing regulatory and tax barriers that are currently blocking private capital formation. Too much private capital is sitting on the sidelines during this crisis.*

4. Reform Market Regulations

The SEC and Congress should immediately act to increase Transparency, Oversight, and Market Reform by:

1. **Limiting Executive Compensation:** Require the Treasury to write rules prohibiting excessive compensation or golden parachutes to executives of failed companies at the expense of taxpayers.
2. **Reforming the Credit Rating Agencies:** Call on the SEC to review the performance of the Credit Rating Agencies and their ability to accurately reflect the risks of these failed investment securities.
3. **Modifying Fair Value Accounting (Eliminate Mark-to-Market Rule):** Fair Value Accounting dictates that financial institutions holding financial instruments available for sale (such as mortgage-backed securities) must mark those assets to market. Currently, there is no meaningful market for mortgage backed securities. Asset value should not be assessed at unrealistic fire-sale prices. Regulators must evaluate the assets on the basis of their true economic value. The SEC should exercise its immediate ability to suspend fair value accounting standards as applied to mortgage backed securities. The mark-to-market rule can be suspended for six months and then replaced with a more accurate three year rolling average mark-to-market.
4. **Repealing Sarbanes-Oxley:** Sarbanes-Oxley failed with Freddy Mac. It failed with Fannie Mae. It failed with Bear Stearns. It failed with Lehman Brothers. It failed with AIG. It is crippling our entrepreneurial economy. Many more firms would be able to go public if the law was repealed. It is Sarbanes-Oxley's $3 million per startup annual accounting fee that is keeping these companies private.
5. **Ending "Naked" Short Selling:** In recent years the SEC has lifted restraints on short sellers of stock to allow "naked selling" (when a broker does not in fact borrow shares to deliver to the buyer) and to eliminate the requirement that short sellers could sell only on an uptick in the market. The SEC has temporarily restricted short sells on financial stocks. To prevent artificial price volatility, there should be no naked short sales and short sales should only take place when there are upticks in the market.
6. **Creating a Blue Ribbon Panel:** A blue ribbon panel with representatives of Treasury, SEC, and the Fed should make recommendations to Congress for reforms of the financial sector by January 1, 2009. *(This has in large part, already been accomplished by Treasury, which produced the "Department of Treasury Blueprint for a Modernized Financial Regulatory Structure" in the spring of 2008. We should take its suggestions seriously)*
7. **Reforming GSEs:** Since Congress chartered Freddie Mae in 1938 and Freddie Mac in 1970, these two Government-Sponsored Enterprises have consumed a lion's share of the market, undermining the housing market and jeopardizing the economy. Congress must learn from its mistakes by reforming these GSEs and limiting Federal exposure to high risk loans. Freddie and Fannie should never again be allowed to securitize the unsound mortgages created by the greed on Wall Street and poor policies in Washington.
8. **Reforming CRA:** In 1993 President Clinton advocated for changes to the Community Reinvestment Act (CRA). These proposals were adopted by 1997, and had the disastrous effect of encouraging lending agencies to offer irresponsible mortgages that people could

not afford. Congress should reform CRA and stop encouraging irresponsible lending practices.

5. Helping Homeowners

Congress should implement measures to encourage responsible homeownership and decreased mortgage foreclosures:

1. **Tax Credits:** Congress should provide additional tax credits for purchasing homes.
2. **Assistance to Homeowners:** Provide assistance to homeowners who have been caught up in the current mortgage crisis and are trying to save their homes by extending the *Cancellation of Mortgage Indebtedness Forgiveness*. In a foreclosure proceeding or write-down of principal on a mortgage, the forgiven debt is considered taxable income. The "Mortgage Forgiveness Debt Relief Act of 2007," P.L. 110-142, excludes debt forgiven before the end of 2009 from taxable income. The proposal extends this treatment for 3 years, through 2012. It does not extend the relief to home equity loans.